Mark R. Thresher
Executive Vice President
Chief Financial Officer
Nationwide Mutual Insurance Company

VIA ELECTRONIC TRANSMISSION
regs.comments@federalreserve.gov

September 16, 2016

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue NW
Washington, DC 20551

Re: Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities (FRB Docket No. R—1539 and RIN No. 7100 AE 53)

Dear Secretary Frierson:

On behalf of Nationwide Mutual Insurance Company ("Nationwide Mutual") and its affiliated companies, we appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System ("Board") on its advanced notice of proposed rulemaking regarding approaches to regulatory capital requirements for Board-supervised institutions significantly engaged in insurance activities (the "ANPR").[1]

Nationwide Mutual is a mutual insurance company organized under the laws of the State of Ohio since 1925. Nationwide Mutual is the lead entity and ultimate controlling parent of all entities in the Nationwide group of companies (collectively, "Nationwide"). Nationwide is a diversified financial services organization offering a wide range of insurance, annuity, investment and banking products and services.

Nationwide Mutual and its property and casualty insurance subsidiaries primarily underwrite personal automobile, homeowners and commercial insurance products. Nationwide Financial Services, Inc. ("Nationwide Financial"), an indirect subsidiary of Nationwide Mutual, develops and sells a diverse range of products, including individual annuities, private and public sector retirement plans and other investment products sold to institutions, life insurance and advisory services. In addition, Nationwide Financial provides mutual funds through Nationwide Funds Group and banking products and services through Nationwide Bank, a federal savings bank and member FDIC.

By virtue of their ownership of Nationwide Bank, Nationwide Mutual and Nationwide Financial are registered as savings and loan holding companies ("SLHCs") pursuant to Section 10 of the Home Owners' Loan Act of 1933 ("HOLA"). As of June 30, 2016, the Nationwide enterprise had approximately $204 billion in total consolidated assets, of which Nationwide Bank constitutes around $6.4 billion in assets (around 3%).

[1] Federal Reserve, Capital Requirements for Supervised Institutions Engaged in Insurance Activities, 81 Fed. Reg. 38631 (June 14, 2016).

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Nationwide
is on your side

Nationwide Support for the Building Block Approach

Nationwide Mutual commends the Board's decision to pursue the Building Block Approach ("BBA") for insurance savings and loan holding companies ("Insurance SLHCs"). The BBA seeks to aggregate capital resources and requirements across the various legal entities in an insurance group to arrive at a comparison of aggregate qualifying capital to aggregate regulatory capital. We believe the BBA is directionally aligned with industry identified key principles of an appropriate group capital framework for Board-supervised insurers.

We further commend the Board for appropriately recognizing that Insurance SLHCs are less complex, domestically focused and far less influential on the broader economic system as compared to insurance companies designated as systemically important financial institutions ("Insurance SIFIs") by the Financial Stability Oversight Council ("FSOC").[2] In addition, as the Board notes, many Insurance SLHCs, including Nationwide, are not required to produce financial statements in accordance with generally accepted accounting principles ("GAAP"). Therefore, a consolidated capital approach for such institutions is unnecessary in light of the associated regulatory burden.

We agree the BBA is an appropriate methodology for creating a group capital regime for Insurance SLHCs. The BBA offers a foundation for objective and subjective capital evaluation for these companies and provides numerous important advantages, including but not limited to the following:

- The BBA would be tailored to the insurance business model because it leverages existing risk-sensitive capital frameworks designed specifically for insurance companies. These frameworks are well-understood, have proven to be robust over time and continue to evolve to address emerging risks and changing business practices.

- Because the BBA would leverage existing capital frameworks and capital processes that are robust and mature, it could be implemented reasonably quickly and with less resource intensity than a newly created capital standard. For the BBA, new capital determination processes presumably will be limited to the identification and quantification of certain adjustments and the development of calibration and scaling mechanisms.

- Because the BBA would be consistent with existing regulatory solvency rules, it would continue to promote prudent risk management within the various legal entities comprising the organization.

- Through calibration of existing regulatory capital requirements and capital resources, the BBA would allow for comparison of institutions across jurisdictions (e.g., U.S., Europe and Japan) and across different institution-types (e.g., insurers, banks and asset managers). Moreover, this approach would maintain comparability across

[2] *Id.* at 38634.

companies within a common jurisdiction and would eliminate the potential for market distortions that could result from subjecting companies within a common jurisdiction to different standards. Additionally, it would allow for a comparison of companies within an industry that have varying geographic, product, consumer or other characteristics; such an approach enhances the ability to oversee and promote general financial stability.

- The BBA would be able to effectively capture all material risks associated with non-insurance and unregulated companies within an organization by assigning them to an appropriate capital regime.

- The BBA would appropriately reflect differences between insurers, banks and unregulated activities. Likewise, it would also reflect differences that exist between companies within the same industry (e.g., life and non-life insurers). This is because the BBA would rely on existing regulatory capital regimes that already provide differentiated treatment of the risks inherent in the businesses they are designed to evaluate.

- Because the BBA does not require the use of a consolidated balance sheet, it can utilize multiple accounting regimes (e.g., U.S. GAAP, SAP). For entities with no formal regulatory capital regime, an appropriate regime can be assigned under the BBA. Furthermore, the BBA would largely be anchored to existing audited accounting and capital frameworks.

The Board identifies a few potential weaknesses of the BBA in the ANPR. We believe all of these potential weaknesses can be adequately addressed through reasonable, repeatable and auditable adjustments and the use of scalars. Furthermore, some of these perceived weaknesses can, and should, be viewed as advantages.

- The Board notes that, at the top-tier, the BBA would be an aggregated (as opposed to consolidated) framework. While the Board indicates that this is a potential weakness, we believe that an aggregated approach is arguably superior to a consolidated approach because it will not allow weakly capitalized entities to be masked through the consolidation process. Rather, the BBA will use a bottom-up methodology to ensure that all material entities are included in the group solvency calculation based on their bespoke local regulatory capital regimes.

- The Board cites regulatory arbitrage through techniques such as double leverage as another potential weakness of the BBA. We believe regulatory arbitrage concerns are alleviated through appropriate adjustments that are relatively simple (e.g., the elimination of intercompany transactions). Likewise, the use of scalars to calibrate capital requirements among varying regimes will also serve to address regulatory arbitrage concerns.

- The Board notes the BBA would need to account for intercompany transactions, which may result in extensive adjustments. Indeed, the BBA will require certain

adjustments to be made; however, we believe that inventorying intercompany transactions and making relatively simple adjustments is much less burdensome than developing the necessary processes and controls around an entirely new consolidated capital framework.

Specific Considerations in Developing the BBA

Nationwide endorses the detailed comments offered by the American Council of Life Insurers ("ACLI") on the merits of the BBA and its recommendations on how it can be effectively implemented by the Board. We comment separately to emphasize critical considerations, steps and elements of an aggregated capital framework that must be considered by the Board when constructing the BBA.

Scope and Applicability of the BBA

The Board seeks comment on the criteria used to determine whether a supervised institution should be subject to regulatory capital requirements tailored to the business of insurance. The Board indicates that it is considering using the threshold in the Board's Regulation Q, under which a SLHC is determined to be an insurance SLHC if it holds 25% or more of its total consolidated assets in insurance underwriting subsidiaries (other than assets associated with insurance underwriting for credit risk).

Nationwide supports the Board's use of the above threshold; however, we note that Regulation Q also includes "a top-tier SLHC that is an insurance underwriting company" in its explanation of institutions that are excluded from application of Regulation Q because they are insurance SLHCs. We note that certain insurance SLHCs have their largest insurance underwriting company as the top-tier entity in organization. Therefore, we would recommend that the Board clarify that the BBA would apply to Insurance SLHCs where (1) the top-tier holding company is an insurance underwriting company, or (2) the top-tier holding company holds 25% or more of its total consolidated assets in subsidiaries that are insurance underwriting companies (other than assets associated with insurance for credit risk). In the alternative, the 25% threshold should not be limited to assets held in "subsidiaries." Rather, it should indicate the following: the top-tier holding company holds 25% or more of its total consolidated assets in insurance underwriting companies.

The ANPR also indicates that the Board is considering whether the BBA is appropriate for larger or more complex depository institution holding companies or only a subset of these firms. We believe that through a well-defined aggregation process with appropriate adjustments and scalars, the BBA framework can be appropriately applied to any institution regardless of size, ownership type (e.g., mutual or stock), corporate structure, breadth of business, countries of operation or any other distinguishing attributes.

In the event the Board decides to utilize multiple regulatory capital frameworks (e.g., a consolidated approach in addition to the BBA), we believe that the consolidated approach should be reserved for those institutions that (1) have been designated by the FSOC as

Insurance SIFIs thereby subjecting them to Board supervision **and** (2) are required by applicable law to prepare consolidated financial statements in accordance with GAAP. Even if these two tests are satisfied, the Board should have discretion to determine that the institution could proceed to calculate its group capital requirements under the BBA.

Compliance/Effective Date of the BBA

Because the BBA leverages existing capital standards and processes, it can be implemented relatively quickly as compared to other alternatives. To the greatest extent possible, we believe the BBA should seek to utilize existing regulatory reports, records, data and systems. However, it will still take time to develop the various processes and controls related to identification of all entities within a group, the identification of the appropriate capital regime for non-regulated entities, the determination and calculation of appropriate adjustments and the application of scalars. For this reason, we recommend that Insurance SLHCs subject to the BBA would be given, at a minimum, twelve (12) months before coming into compliance with any rules implementing the BBA.

In terms of reporting the aggregated group solvency ratio to the Board, we recommend that the BBA be calculated and reported on an annual basis using calendar year-end financial information. This calculation could be performed subsequent to the timeframe for preparing the NAIC Risk Based Capital ("RBC") Report, which is due each year on March 1.

Critical Steps in the Calculation of the BBA

The Board when constructing the BBA must consider the following critical steps and elements of an aggregated capital framework:

1. The BBA should require Insurance SLHCs to identify all legal entities in their organizational structure. For purposes of this exercise, Insurance SLHCs can leverage existing regulatory organizational reports (e.g., the NAIC Schedule Y, which identifies all legal entities in an insurance holding company group and the ultimate controlling person).

2. The BBA should require Insurance SLHCs to assign a classification to each identified legal entity based on the entity's operational purpose and any applicable regulatory capital regime. For example, NAIC RBC for regulated U.S. insurance companies[3] and insurance-related entities[4] and Basel III, as adopted by the applicable federal banking agency, for insured depository institutions.

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[3] A "regulated insurance company" can be defined a licensed insurance company or "insurer" as such term is defined under relevant state law or the laws of a foreign jurisdiction.

[4] An "insurance-related entity" can be defined as (i) a direct or indirect subsidiary of a regulated insurance company or (ii) an affiliate of a regulated insurance company that engages in activity for the benefit of, or in support of, the general account or separate account of a regulated insurance company affiliate, or that are otherwise necessary or properly incidental to the business of the affiliated insurance company. However, the Board may wish to enumerate certain exceptions based on the nature of the activities of the entity.

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3. Insurance SLHCs should be permitted to employ exclusion and materiality tests to determine if and how legal entities are incorporated in the BBA calculation. If an entity meets the test for exclusion, it can be removed from the scope of the BBA altogether.[5] If an entity is immaterial, it should be included in the scope of the BBA, and a simplified, conservative treatment should be provided to reduce the operational burden of determining capital requirements for the entity.[6] In principle, we recommend excluding or deeming entities immaterial when they do not have the ability to pose significant risk to the organization.

4. The BBA should require Insurance SLHCs to construct an inventory of all entities and their assigned regulatory capital regimes, any intercompany transactions and any permitted and prescribed accounting practices. This inventory will provide transparency around entities that have been excluded or deemed immaterial. In addition, the inventory will assist in the identification of instances when intercompany transactions (including interaffiliate reinsurance transactions and intragroup holdings) and permitted or prescribed accounting practices could lead to non-comparable bases for calculating available or required capital.

5. Insurance SLHCs should be required to make adjustments to available and regulatory capital when necessary to ensure comprehensive coverage of risks, while avoiding double counting, and to achieve consistency and comparability of capital across and within capital regimes to mitigate arbitrage. Nationwide supports the specific adjustments, including captive treatment, proposed by the ACLI in its comment letter.

6. Insurances SLHCs should employ scalars to required capital in order to equate varying capital regimes in a stable, repeatable manner. In addition, available capital should be scaled to the extent the underlying accounting constructs deviate from regime to regime. Scaling both available and required capital is a "total balance sheet" approach that recognizes the interdependence between assets, liabilities, regulatory capital requirements and available capital resources. We recommend calibrating the scalars according to two observable points of each regime: (i) the regulatory triggers (e.g., CAL RBC); and (ii) the average operating ratio, for insurance groups of similar size and financial health. This approach provides the Board with a simple framework that holistically captures "total balance sheet" differences between regimes and calibrates scalars objectively using robust, observable data. It is important that both calibration points (as opposed to the regulatory trigger or operating level alone) be used to determine the scalar adjustment, because there are differing levels of conservatism in

[5] Entities can be excluded from the scope of the BBA if (i) it is not a regulated insurance company or insured depository institution; (ii) it contains less than $100 million in total aggregated assets; (iii) it has less than $50 million in revenue; and (iv) the entity presents no demonstrable recourse to the group.

[6] Entities should be deemed "immaterial" if (i) it is not a regulated insurance company or insured depository institution; (ii) it contains less than 0.5% of the group's total aggregated assets; (iii) it comprises less than 0.5% of the group's total revenue; and (iv) the entity presents no demonstrable recourse to the group.

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reserves (based in accounting) and other differences across regimes that cannot be fully captured in a single calibration point.

7. Insurance SLHCs should calculate the group's available capital by summing available capital for each legal entity, after the appropriate adjustments and scalars have been applied. The ANPR discusses utilizing a uniform definition of available capital on a fully consolidated basis. However, we believe this approach is problematic because it will not adequately address the differences in asset valuation or liability conservatism in the varying underlying accounting regimes. We believe that summing available capital for each legal entity is the most appropriate approach to ensure alignment with the required capital component of the BBA and a coherent group solvency ratio.

8. Insurance SLHCs should calculate the group's required capital by summing required capital for each legal entity, after the appropriate adjustments and scalars have been applied. The baseline capital requirement for each legal entity should be set to the regulatory intervention level for the relevant regulatory regime (e.g., Basel III or U.S. RBC). For U.S. insurance companies under RBC, the baseline capital requirement is the level at which U.S. insurance companies must file a corrective action plan (i.e., the Company Action Level).

9. The BBA should provide Insurance SLHCs with a diversification benefit to account for intra-group sources of diversification. While diversification across major insurance risk charges (e.g., asset risk, insurance risk, interest rate risk, business risk) is captured through the utilization of existing capital regimes, we note that inter-risk diversification (e.g., geographical and line of business diversification) is not. Therefore, we believe that the BBA must contain a mechanism to account for intra-group sources of diversification.

Conclusion

For the above reasons, we strongly support the BBA as an appropriate capital framework for Insurance SLHCs. In further defining and implementing the BBA, we urge the Board to consider the critical steps and considerations defined above, and the detailed recommendations set forth in the ACLI's comment letter.

As always, we appreciate the dialogue and look forward to further opportunities to comment.

Very truly yours,
NATIONWIDE MUTUAL

Mark R. Thresher
Executive Vice President and Chief Financial Officer