9800 Fredericksburg Road
San Antonio, Texas 78288

January 12, 2024

VIA ELECTRONIC SUBMISSION

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Chief Counsel's Office
Attention: Comment Processing
The Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

Reference: **Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity (Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008)**

Dear Ladies and Gentlemen,

United Services Automobile Association, on behalf of itself and its subsidiaries (collectively, "**USAA**"), welcomes the opportunity to comment on the notice issued by the Office of the Comptroller of the Currency (the "**OCC**"), Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), and the Federal Deposit Insurance Corporation (the "**FDIC**") (collectively, the "**Agencies**") entitled *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity,* published in the Federal Register on September 18, 2023 (the "**Capital Proposal**").[1]

USAA is a Texas reciprocal inter-insurance exchange and membership-based association established in 1922. We are driven by our mission to facilitate the financial security of our more than 13 million members of the U.S. military, veterans who have honorably served, and their families by providing a full range of competitive financial products and services, including insurance and retail banking.

[1] 88 Fed. Reg. 64028 (Sept. 18, 2023).

9800 Fredericksburg Road
San Antonio, Texas 78288

Among USAA's subsidiaries is USAA Federal Savings Bank ("**FSB**"), a federal savings association chartered in 1983 that is wholly owned by USAA Capital Corporation, which in turn is wholly owned by USAA. FSB has approximately $109 billion in total consolidated assets and a 94% insured deposit base.[2] FSB offers retail banking products and services – deposit products, credit cards, and secured and unsecured loans – to our retail consumer member base. Capitalized significantly above regulatory expectations, FSB has a leverage ratio of 8.8%, 17% tier-1 capital, and 18.7% total risk-based capital.[3]

Part I of this letter includes our general comments on the Capital Proposal. Part II provides feedback and recommendations with respect to tailoring of the requirements for Supervised Insurance Organizations ("**SIOs**") to address the Capital Proposal's interaction with the Federal Reserve's final insurance capital rules, termed the "Building Block Approach" ("**BBA**").[4] Part III recommends a clarification in the regulatory amendments to align with the language in the Capital Proposal's introductory text.[5]

I. General Comments

We generally support the Agencies' objectives to establish risk-based capital requirements that reflect the risks of a banking organization's exposures and reduce complexity in the regulatory framework.[6] We encourage the Agencies to maintain their practice of tailoring capital, liquidity, and other requirements based on the size, complexity, and overall risk presented by each banking organization. This risk-based approach supports the Agencies' safety and soundness goals by supporting the resilience of large, complex banking organizations that pose greater risk to the financial system, limiting the regulatory burden on lower-risk organizations, and promoting a diversity of sizes, structures, and activities among banking organizations.[7]

We recommend that the Agencies: (a) adopt a risk-based approach that calibrates capital requirements based on a variety of risk factors rather than asset size alone; (b) avoid unintended consequences for military borrowers by eliminating the proposed credit conversion factor for off-balance sheet exposures pending further analysis; (c) support diversity among financial organizations with tailored requirements that do not disproportionately affect savings associations;

[2] As of September 30, 2023 Call Report.
[3] *Id.*
[4] *See* Capital Proposal 64031, FN 12 ("The Board anticipates that any final rule based on the proposal in this Supplementary Information would include appropriate adjustments as necessary to take into account any final insurance capital rule")*; see also* Questions 1, 175.
[5] We agree generally with the comments provided by the American Bankers Association and Bank Policy Institute with respect to the need for a tailored approach to capital requirements, in particular for Category III and IV banking organizations, as well as with comments relating to the Capital Proposal's overstated risk weights for credit and operational risk and the potential negative impact on credit availability and pricing.
[6] *See* Capital Proposal at 64030.
[7] *See* Press Release, Vice Chair Barr, Why Bank Capital Matters (Dec. 1, 2022) ("Higher capital requirements help to ensure that larger, more complex banks internalize this greater risk and counterbalance the greater costs to society by making these firms more resilient. Further, matching higher capital standards with higher risk appropriately limits the regulatory burden on smaller, less complex banks whose activities pose less risk to the financial system. This helps to promote a diverse banking sector that provides consumers greater choice and access to banking services").

9800 Fredericksburg Road
San Antonio, Texas 78288

and (d) provide transition periods that enable firms to comply with newly applicable requirements without imposing undue burdens, in particular on Category IV firms.

a. Alignment of Capital Requirements and Risks

The Capital Proposal departs from the Agencies' existing risk-based approach by seeking to uniformly apply capital requirements to all banking organizations at or above a $100 billion asset threshold without consideration of their activities, structures, and risk characteristics. The use of asset size alone to determine an organization's risk profile – and accordingly, the stringency of capital requirements – does not account for characteristics that materially affect that risk profile. The domestic and foreign banking organizations in Category IV have diverse risk profiles and operations ranging from commercial banking, international trading, and brokerage activities to traditional consumer banking focused on military families. Even within Category IV, banks that engage primarily in consumer banking and have low uninsured deposits have significantly lower risk profiles than commercial financial institutions with significant levels of uninsured deposits.

We recommend the Agencies calibrate the Capital Proposal to apply requirements based on a banking organization's risk profile, including risk-based application of the Accumulated Other Comprehensive Income ("**AOCI**") opt-out option and the market risk requirements.

i. AOCI opt-out

The Capital Proposal would eliminate the AOCI opt-out option and require Category III and IV institutions to recognize unrealized gains and losses for securities classified as available for sale ("**AFS**"). Eliminating the AOCI opt-out for all institutions above the $100 billion threshold does not account for the diverse risk profiles of the organizations that would be subject to the proposed rules. We recommend the final capital rule adopt a tiered approach that would require a banking organization to recognize AOCI in its regulatory capital based on factors that reflect its actual risks, including an organization's activities and uninsured deposit levels – not just based on asset size. A tiered, risk-based approach is consistent with the Agencies' general approach to balancing regulatory burdens with regulatory requirements like those found in existing liquidity coverage ratio and net stable funding ratio rules.[8]

The Agencies state that recognizing AOCI in regulatory capital will provide a more accurate reflection of a banking organization's actual loss-absorbing capacity at a specific point in time, including its ability to maintain minimum capital ratios even if liquidity demands lead an organization to sell AFS securities and realize losses.[9] Many organizations, however, do not present this type of substantial liquidity risk, particularly those institutions with low levels of uninsured deposits. Requiring such organizations to recognize unrealized losses would not serve the prudential goals given that those organizations are less likely to sell AFS securities and realize

[8] *See* Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 86 Fed. Reg. 9120 (Feb. 11, 2021) ("**NSFR**"); Liquidity Coverage Ration: Liquidity Risk Measurement, 79 Fed. Reg. 61440, 61446 (Oct. 10, 2014) ("**LCR**") (the final LCR rule "seeks to calibrate the net cash outflow requirement for a covered company based on the composition of the organization's balance sheet, off-balance sheet commitments, business activities, and funding profile").
[9] *See* Capital Proposal at 64036.

9800 Fredericksburg Road
San Antonio, Texas 78288

those losses. Even if those organizations decided to sell AFS securities and realize the losses, resulting liquidity risk would still not arise.

In the absence of significant prudential benefit, the risk of including AOCI in regulatory capital across all Category IV institutions looms large. The AOCI opt-out is designed in part so that smaller or less complex institutions do not need to manage books– including volatility in regulatory capital ratios– in response to market fluctuations. Volatility causes complications and inconsistencies in capital planning, asset-liability management, and interest rate risk management.[10]

A requirement to include AOCI in regulatory capital calculations should account for material differences in banking activities, e.g., banking organizations whose activities are primarily consumer versus commercial or based on levels of uninsured deposits. An organization's funding sources – in particular, uninsured deposit levels – provide an appropriate measure for risk of liquidity stress that could cause an organization to sell AFS securities at a loss and place regulatory capital ratios at risk, because uninsured deposits are more susceptible to liquidity runs.[11] The Agencies have discussed the impact of these material differences with respect to funding stability and liquidity risk, noting that certain types of funding, such as retail deposits, are more stable "due in large part to the presence of full deposit insurance coverage and other stabilizing features, such as another established relationship with the depository institution."[12] Additionally, one lesson from the banking events in March 2023 is that some deposits, including from venture capital firms or high net-worth individuals may be likely to have a faster run rate.[13] Consumer banks generally do not present the same level of risk as deposits at predominantly commercial banks: traditional consumer deposits are more stable and have a longer duration compared to the large deposits of high-net-worth individuals and commercial deposits,[14] both of which are likely to move in a stressed scenario.[15]

To align the inclusion of AOCI in regulatory capital, we recommend that the Agencies adopt a tiered approach based on uninsured deposits, with an increase in the required amount of AOCI inclusion in regulatory capital in proportion to the level of an organization's risk of liquidity stress

[10] *See* Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62018, 62027 (Jan. 1, 2014) ("**2013 Capital Rule**") ("the agencies recognize that for many banking organizations, the volatility in regulatory capital that could result from the proposals [to include AOCI in regulatory capital] could lead to significant difficulties in capital planning and asset-liability management.").
[11] *See* Federal Reserve Financial Stability Report – May 2023: Funding Risks, p.49-52 *available at* https://www.federalreserve.gov/publications/files/financial-stability-report-20230508.pdf.
[12] *See* NSFR at 9142.
[13] *See* Remarks, Vice Chair Barr, *The Importance of Effective Liquidity Risk Management*, Dec. 1, 2023, *available at* https://www.federalreserve.gov/newsevents/speech/barr20231201a.htm ("The lessons from March [2023] also indicate that some forms of deposits, such as those from venture capital firms, high net-worth individuals, crypto firms, and others, may be more prone to faster runs than previously assumed").
[14] *See* NSFR at 9143 ("funding from financial sector entities exhibited less stability than funding provided by non-financial wholesale counterparties, which in turn exhibited less stability than insured retail deposits.").
[15] *See* LCR final rule at 61497 (noting that wholesale counterparties are generally more sophisticated than retail counterparties and present greater liquidity risk during a stress period).

9800 Fredericksburg Road
San Antonio, Texas 78288

based on their activities and uninsured deposit levels.[16] For example, banking organizations could include 10% of AOCI for 15% or less uninsured deposits, 25% for 15% to 25% uninsured deposits, 50% for 26% to 50% uninsured deposits, and 100% for 51% to 100% uninsured deposits. This approach would enable both (i) banking organizations to align their business and capital strategies and their risk appetites to make decisions based on the level of risk and resulting regulatory burden and (ii) the Agencies to achieve their goal of regulatory capital ratios that balance prudential benefits and regulatory burden while encouraging prudent risk-taking behavior.[17]

ii. Market Risk

Under the Capital Proposal, all large banking organizations would be subject to the market risk capital requirements regardless of their level of trading activity. Category IV organizations that engage in minimal or no trading activity do not present risks that justify the burdens associated with the market risk capital requirements. To support alignment of regulatory burdens with the risk presented by an organization's trading activity, we recommend that the final capital rule include a threshold to exempt Category IV organizations that do not engage in material trading activity from these requirements.[18] This risk-based approach would support the Agencies' objective of ensuring that regulatory capital requirements adequately address risks presented by banking organizations engaged in significant trading activity while appropriately balancing regulatory burdens for those banking organizations that do not engage in such activities.

The Agencies note in the Capital Proposal that "implementing the proposed market risk capital requirements would require significant operational preparation."[19] Operationally, the rule would require institutions to develop and maintain policies and procedures for appropriate management of market risk, regardless of whether any such risk exists. The Agencies estimate that the requirements for reporting, recordkeeping, and disclosures would result in substantial annual burden hours for institutions.[20] Organizations with minimal or no trading activity will carry these burdens without achieving or needing a material reduction in risk.

We propose that the final capital rule include a materiality threshold of $5 billion or greater in aggregate trading activity for the rule to apply to Category IV institutions.[21] This threshold reflects the Agencies' definition of "significant trading activity" in the Capital Proposal and accounts for potential risks presented by trading activity at an amount that the Agencies consider significant.

[16] *See, e.g.*, NSFR at 9136 (discussing risk-based application of NSFR requirements based on both an asset threshold and risk factors relating to funding stability and noting that Category IV organizations that rely heavily on short-term wholesale funding are "relatively more vulnerable to the funding stability risks addressed by the reduced NSFR requirement relative to similarly sized banking organizations that rely more heavily on stable funding such as retail deposits").
[17] *See, e.g.*, Ding, Dong and Sickles, Robin C., *Capital Regulation, Efficiency, and Risk Taking: A Spatial Panel Analysis of U.S. Banks* (2018) PANEL DATA ECONOMETRICS: EMPIRICAL APPLICATIONS ("We find a stricter capital requirement causes banks to reduce investments in risk-weighted assets, but at the same time, increase holdings of non-performing loans, suggesting the unintended effects of higher capital requirements on credit risks").
[18] Response to Question 2.
[19] *See* Capital Proposal at 64095.
[20] *See* Capital Proposal at 64174 - 64177 (estimating average burden hours for supervised institutions of 2,597 (OCC), 2,716 (Federal Reserve), and 2,486 (FDIC)).
[21] Response to Question 80.

9800 Fredericksburg Road
San Antonio, Texas 78288

Adopting a materiality threshold such as this would appropriately balance the prudential benefits with the potential costs.[22]

b. Potential Disproportionate Impact on Members of the Military

Under the Capital Proposal, off-balance sheet items such as unused credit card lines would receive a credit conversion factor applied to the notional amount reflecting the expected proportion of the item that could become an on-balance sheet credit exposure.[23] The proposed credit conversion factor could incentivize banking organizations to reduce or close unused and dormant credit lines to reduce the impact of off-balance sheet exposures on their capital calculations, which could result in an overall contraction of available credit for retail customers. We urge the Agencies to eliminate this provision until they have thoroughly studied and identified ways to avoid potential disproportionate impacts this may have on populations, including members of the military, that display credit usage patterns with surge periods and periods of inactivity or decreased usage.

Members of the military are routinely subject to deployments, sea duty, and permanent change of station, and they are more likely to exhibit more volatile credit card usage or to reactivate and use a credit card that has been dormant for at least a year.[24] Based on USAA's review of its over 9 million bank members, active duty and reserve military members are 30% more likely than non-military members over a two-year period to have instances of high card usage when starting with low usage.[25] Active duty and reserve military members are also 30% more likely than the general public, within a two-year period, to make a purchase using a credit card that has not had any activity in the last 12+ months. Due to their usage patterns, military members may be disproportionately impacted if banking organizations take actions such as credit-line reductions or account closures to manage the capital impacts of off-balance sheet exposures in response to the Capital Proposal. The Capital Proposal may unintentionally undermine protections for servicemembers' financial transactions afforded by the Servicemembers Civil Relief Act.[26]

For military customers at other banking organizations that do not have the same data as USAA, these unintended impacts may be difficult to identify or avoid, especially if the organizations adopt a policy to manage off-balance sheet exposures based on account usage patterns over a set period of time, such as 12 or 18 months.[27] Accordingly, we recommend that the credit conversion factor

[22] *See* Capital Proposal at 64094 (discussing the revised criteria for subjecting banking organizations with significant trading activity to the market risk requirements).
[23] *See* Capital Proposal at 64051.
[24] Account dormancy considerations with respect to the military community have been addressed by policymakers in other instances, such as with respect to abandoned property and escheat requirements. *See, e.g.*, Michigan Public Act 79 of 2020, revising the state unclaimed property law to exempt property owned by active-duty military members serving overseas or domestically.
[25] High card usage is characterized as greater than 80% credit line utilization. Low card usage is characterized as less than 20% credit line utilization.
[26] *See* 50 USC 3919(2).
[27] *See, e.g.*, Equifax, *Inactive Credit Card: Use it or Lose it?, available at* https://www.equifax.com/personal/education/credit-cards/articles/-/learn/inactive-credit-card-account-closed/ (last accessed Nov. 29, 2023) ("after a certain period of time, which varies depending on the lender or creditor's policies, they may consider your account 'inactive' and it may be closed"). *See also* Experian, *What to Do if Your Bank Closes Your Account*, (Nov. 17, 2023) *available at* https://www.experian.com/blogs/ask-experian/what-to-do-if-bank-closes-your-account/.

9800 Fredericksburg Road
San Antonio, Texas 78288

be removed from the proposal until the Agencies have fully studied the potential disproportionate effect for certain populations, including members of the military.

c. Disproportionate Impact on Savings Associations

A risk-based approach to regulatory capital rules supports "a vibrant, diverse banking system with banks of all sizes by applying capital requirements appropriate to the size and risks of institutions."[28] The Capital Proposal's one-size-fits-all approach to capital requirements does not recognize the diversity in this country's banking system. Certain aspects of the Capital Proposal create a disproportionate burden for savings associations due to the unique legal requirements for their assets under the qualified thrift lender ("**QTL**") test from the Home Owners' Loan Act ("**HOLA**"). To avoid disproportionate impact for savings associations and support diversity of charters in the banking system, we recommend that risk weights in the final version of the Capital Proposal be adjusted to limit risk weights on qualified thrift investments ("**QTI**").

Congress created the federal savings association charter to support consumer lending, in particular for residential mortgages.[29] Congress had multiple opportunities to reconsider HOLA since its passage in 1933 and each time Congress elected to retain the federal savings association charter as part of the U.S. financial system.[30]

Under HOLA, a federal savings association like FSB is required to meet the QTL test.[31] The QTL test requires at least 65% of the savings association's portfolio assets to be QTI, e.g., mortgages, home equity loans, loans made through credit cards, and mortgage-backed securities. These QTL asset requirements constrain savings associations' flexibility with respect to asset composition such that the Capital Proposal's overstated risk weights for QTI exposures will disproportionately burden savings associations. Over time, this could have the unintended and undesirable effect of homogenizing banking charters for organizations subject to this proposal.

To support diversity in the U.S. banking sector and avoid unintended impacts for savings associations, we recommend that the Agencies ensure that capital requirements for assets that are included as QTI are calibrated to the risks they present, with the Basel framework establishing the upper limit for such risk weights. For example, the proposed risk weights for residential real estate exposures are 20 percentage points higher than in the Basel framework, while the risk weights for retail exposures are 10 percentage points higher.[32] While all banking organizations, regardless of charter type, would be subject to the capital requirements associated with increased risk weights,

[28] *See* Press Release, Statement by Vice Chair for Supervision Michael S. Barr (July 27, 2023), *available at* https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20230727.htm.

[29] *See* Government Accountability Office, *Thrifts and Housing Finance: Implications of a Stricter Qualified Thrift Lender Test*, Report to Congressional Committees pg.2 (1991) *available at* https://www.gao.gov/assets/ggd-91-24.pdf.

[30] *See* Kwan, Simon, Federal Reserve Bank of San Francisco *Bank Charters vs. Thrift Charters*, FRBSF Economic Letter (Apr. 24, 1998) *available at* https://www.frbsf.org/economic-research/publications/economic-letter/1998/april/bank-charters-vs-thrift-charters/ ("One of the key issues in Congress's current debates about modernizing the financial services industry is whether to eliminate the charter for thrifts (savings and loans)").

[31] *See* 12 USC 1467a(m); *see also* OCC Comptroller's Handbook, "Qualified Thrift Lender" (Nov. 2013), *available at* https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/qualified-thrift-lender/pub-ch-qualified-thrift-lender.pdf.

[32] *See* Capital Proposal at 64052; Basel framework, 20.82.

9800 Fredericksburg Road
San Antonio, Texas 78288

savings associations are subject to requirements that limit the ability to adjust their investment strategy to minimize exposure to QTIs with overstated risk weights because of the 65% minimum QTI requirement. To offset this disproportionate impact on savings associations, the Agencies could apply a 20% risk weight to QTIs similar to its treatment of government-sponsored enterprises and Basel's treatment of residential real estate exposures.[33]

Additionally, the Capital Proposal's elimination of the AOCI opt-out will disproportionately increase burdens on savings associations that invest in mortgage-backed securities to satisfy the minimum 65% QTI requirement by increasing capital requirements and creating operational difficulty and inconsistency with respect to interest rate risk management. Mortgage-backed securities are inherently duration-bearing and would add volatility and risk to regulatory capital calculations as organizations recognize unrealized losses. Conversely, designating mortgage-backed securities as HTM to avoid AOCI recognition would decrease organizations' balance sheet flexibility and create difficulties in managing the durations of the AFS and HTM portfolios and associated interest rate risk strategies.

d. Provide Adequate Transition Times

The Capital Proposal does not provide adequate transition time to support Category IV banking organizations in adopting the substantial new requirements without incurring significant and unwarranted financial and operational risks and burdens. The Capital Proposal currently establishes a July 2025 transition, which would provide fewer than 18 months for Category IV banking organizations to develop and implement action plans to comply with the final capital rule. This proposed transition is less than half of what is provided under the current capital rule. The final capital rule should provide for a 36-month implementation timeline before the rules take effect. Additionally, the final capital rule should adopt a back-weighted five-year phase-in period that allows effective adoption of the new capital requirements based on anticipated cash flows on investment securities as they approach maturity.

Current capital regulations provide substantially more time for a banking organization to comply with expanded capital requirements upon meeting the applicability criteria for advanced approach expectations.[34] Today, banking organizations meeting advanced approaches criteria have six months to adopt a written implementation plan to meet the expanded capital requirements.[35] That implementation plan must include a start date no later than 36 months after the date that the organization became subject to the expanded requirements.[36] The current capital rules also provide that the institution's relevant regulator may extend the start date.[37] The final capital rule should be consistent and provide a delayed effective date of three years at a minimum.

The current capital rule's 36-month implementation timeline is reasonable and realistic and offers insight into the significant operational burdens and requirements (including identifying resources

[33] *See* Capital Proposal at 64040.
[34] *See* 12 CFR 217.121; 12 CFR 3.121; 12 CFR 324.121 (regulatory capital rules for the Federal Reserve, OCC, and FDIC, respectively, providing timing for transition upon meeting the criteria for advanced approaches requirements).
[35] *See* 12 CFR 217.121(a)(1); 12 CFR 3.121(a)(1); 12 CFR 324.121(a)(1).
[36] *See id.*
[37] *See id.*

9800 Fredericksburg Road
San Antonio, Texas 78288

that have been budgeted and are available to execute on the implementation plan) for an organization newly subject to expanded capital requirements.[38] If a three-year implementation timeline under the current capital rule is appropriate when banking organizations are aware that they are approaching one of the thresholds for application of the expanded advanced approaches and can be planning for such implementation in the years before the criteria triggered then we believe the same 36-month period – if not more – is appropriate for the implementation of new requirements to organizations that were not already planning such implementation.

A three-year implementation timeline, in addition to a phase-in of requirements, will also support Category IV firms in adopting the new expanded capital requirements and related operational processes in a manner that supports prudent capital risk management practices, especially with respect to AOCI. If the Agencies decide to eliminate the AOCI opt-out for Category IV organizations, a delayed implementation date should reduce volatility in regulatory capital calculations for Category IV firms by allowing for legacy securities acquired under the current capital regime to mature.

II. Considerations for SIOs

Because the Federal Reserve recognizes that SIOs present materially different risk and business profiles from organizations primarily engaged in banking activities, it has taken steps to tailor its regulatory and supervisory approach to SIOs.[39] We continue to support the Federal Reserve's thoughtful approach in adopting regulations and supervisory frameworks designed to maintain safety and soundness while addressing the unique characteristics of SIOs.[40] In that regard, we suggest that the final capital rule incorporate a risk-based approach to capital requirements for SIOs.[41] Our comments below include (a) discussion of interaction of the Capital Proposal with other existing and proposed regulatory requirements; (b) recommendations regarding applicability of requirements in the Capital Proposal to SIOs; and (c) recommendations for adjustments to address interactions between the Capital Proposal and the BBA to support consistency with the Federal Reserve's final insurance capital rules.[42]

a. Interaction of Regulatory Requirements

Layers of conservatism in existing and proposed regulatory capital requirements result in burdens for SIOs that are not commensurate with their risk profiles, especially where such requirements are magnified by a mechanism such as scaling. The Capital Proposal notes that some of the

---

[38] *See* 12 CFR 217.121(b); 12 CFR 3.121(b); 12 CFR 324.121(b).

[39] *See, e.g.*, Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 88 Fed. Reg. 82950 (Nov. 27, 2023) ("**BBA**"); 2013 Capital Rule at 62027 (discussing the Federal Reserve's decision to exclude SIOs from its 2013 capital rules to consider the development of appropriate capital requirements for SIOs); Supervision and Regulation Letter 22-8, *Framework for the Supervision of Insurance Organizations* (Sept. 2022) ("**SR 22-8**") pg.3 (discussing differences between SIOs and institutions primarily engaged in banking activities).

[40] *See, e.g.*, BBA; SR 22-8.

[41] *See* SR 22-8 pg.1.

[42] *See* Capital Proposal at 64031, FN12 ("The Board anticipates that any final rule based on the proposal in this Supplementary Information would include appropriate adjustments as necessary to take into account any final insurance capital rule").

9800 Fredericksburg Road
San Antonio, Texas 78288

proposed requirements are more stringent than those in the Basel III reforms.[43] The interaction of the Capital Proposal's increased risk weights with scalars under the BBA will result in a uniquely disproportionate impact for SIOs, because the scaling mechanism under the BBA uses multipliers based on risk-weighted assets ("**RWA**") to calculate the totals for both available capital (numerator) and the capital requirement (denominator). An increase to RWA under the Capital Proposal will result in both an *increase* to the denominator as well as a *decrease* to the numerator in an SIO's capital ratio calculation.[44] While all banking organizations, including SIOs, that become subject to the Capital Proposal would experience an increase in the denominator, only SIOs will be uniquely subject to the decrease in the numerator under the BBA, because the numerator is calculated by subtracting a percentage of RWA from the SIO's bank regulatory total capital.[45] As a result, an SIO would be subject to an additional decrease in its total capital ratio under the BBA calculation as compared to organizations subject only to bank regulatory requirements.[46]

In addition, the effects of other regulatory requirements that impact capital calculations, such as the recently implemented Current Expected Credit Loss Standard ("**CECL**"), are not yet fully understood and should be considered in connection with the recently adopted BBA, this Capital Proposal, and the Long-Term Debt proposed rule. For example, requirements under CECL relating to loan loss allowances impact the timing and level of capital: building allowances through provision expense results in a reduction of net income, which accordingly also reduces capital.[47] Because the CECL transition period is ongoing, the industry cannot fully understand how CECL will impact capital levels, or how the requirements in the Capital Proposal or BBA will interact with CECL. Additional proposed regulatory changes such as the proposed amendments to interchange fees under the Federal Reserve's Regulation II[48] also will have an impact on banking organizations' capital levels in ways that cannot be fully evaluated without time to obtain and analyze data.[49]

Accordingly, we recommend that the Agencies consider the impact of the Capital Proposal, and its interaction with other existing and proposed regulations, on banking organizations, including SIOs.

b. Material Differences Presented by SIOs

---

[43] *See* Capital Proposal at 64030.
[44] *See* BBA at 82975-76, codified at 12 CFR 217.606 (establishing scaling modifiers for BBA regulatory capital ratios).
[45] *See id.*
[46] Only SIOs subject to the BBA are required to calculate their regulatory capital ratios under this scaling mechanism. *See id.* at 82969, establishing purpose and applicability of the BBA.
[47] *See* Loudis, Bert, Sasha Pechenik, Ben Ranish, Cindy M. Vojtech, and Helen Xu (2021). "New Accounting Framework Faces Its First Test: CECL During the Pandemic," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, December 03, 2021, https://doi.org/10.17016/2380-7172.3025.
[48] *See* Debit Card Interchange Fees and Routing, 88 Fed. Reg. 78100 (Nov. 11, 2023).
[49] For example, the proposed changes to Regulation II will impact the revenues that banking organizations receive from interchange fees; in addition, the calculations in the Capital Proposal relating to fee income under the operational risk component will also be impacted by the changes to Regulation II. *See id.*; Capital Proposal at 64084 (discussing treatment of fee income, including from interchange fees, under the operational risk component).

9800 Fredericksburg Road
San Antonio, Texas 78288

We support the Federal Reserve's approach to risk-based capital regulation for SIOs, in particular the recognition, as reflected in the BBA final rule, that a capital framework "tailored to the supervised firm's business model, capital structure, and risk profile" would more appropriately capture and account for differences between the business of insurance and banking.[50] The BBA exempts SIOs from the leverage ratio and supplementary leverage ratio requirements in the Federal Reserve's Regulation Q.[51] Additionally, the BBA provides that an SIO is not required to comply with the bank-focused capital conservation buffer or with the countercyclical capital buffer.[52] We support excluding SIOs from these requirements. Due to the differences between SIOs and other banking organizations, these requirements would not have a meaningful impact on a SIO's resilience or overall risk, and we recommend that the Capital Proposal preserve the BBA's approach of exempting SIOs from these requirements.

Additionally, we recommend that the Federal Reserve ensure the requirements in the Capital Proposal are calibrated based on the different risks that SIOs present.[53] For example, in the Framework for Supervision of Insurance Organizations, the Federal Reserve notes that SIOs may face capital fungibility constraints different from banking organizations and "recognizes that supervised insurance organizations are typically less exposed to traditional liquidity risk than banking organizations" and that insurance products generally have product features that help mitigate liquidity risk.[54] As discussed in Section I.a.i., for organizations that present lower risk of liquidity stress and are less likely to sell AFS securities at a loss, the prudential benefits of AOCI inclusion in regulatory capital calculations do not outweigh the burdens. Given the Federal Reserve's acknowledgement that SIOs are less exposed to traditional liquidity risk than other banking organizations, we recommend that the Federal Reserve preserve the AOCI opt-out for SIOs by adding a new subsection (i) to section 22 of Part 217, as follows:

> 217.22(i) *Insurance depository institution holding companies.* Notwithstanding any other provision of this section:
>
> > (1) A Board-regulated institution that is an insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company is not required to make regulatory adjustments to its common equity tier 1 capital based on subsection (b)(1)(ii) of this section

Features unique to SIOs, including their overall lower liquidity risk, underscore the importance of a risk-based approach to elimination of the AOCI opt-out to prevent potential disproportionate burdens associated with management of balance sheet flexibility and asset portfolios.

c. Interaction with the BBA

To support consistency in capital standards and requirements for SIOs, we recommend that the Federal Reserve consider potential interactions between the BBA and this Capital Proposal that may create disproportionate burdens for SIOs. The BBA framework's use of a scaling mechanism to translate and aggregate capital positions under differing regulatory regimes (e.g., insurance and

[50] *See* BBA at 82967; *see also* 2013 Capital Rule at 62027.
[51] *See* BBA at 82969; 12 CFR 217.10.
[52] *See* BBA at 82969; 12 CFR 217.11.
[53] *See* SR 22-8, pg. 5-12.
[54] *See* SR 22-8, pg. 11.

9800 Fredericksburg Road
San Antonio, Texas 78288

banking) exacerbates the elements of additional conservatism inherent in the capital requirements or the multipliers used for scaling which leads to materially more stringent capital requirements for SIOs whose regulatory capital is calculated under the BBA. We recommend that the Federal Reserve evaluate and account for the interaction of multiple requirements relating to regulatory capital to ensure that they do not, either separately or in combination, result in layers of excess conservatism and regulatory burdens disproportionate to the risks presented by SIOs subject to such requirements.

We also recommend that the Federal Reserve undertake an assessment of the scaling formula in the BBA based on material changes as a result of any final capital rules based on this Capital Proposal.[55] The scalars in the BBA are based on historical probability of default in both the insurance and banking industries, with the scaling multiplier used to translate equivalent solvency ratios between the two capital regimes.[56] However, considering that the Capital Proposal seeks in part to increase resilience and loss-absorbing capacity for large banking organizations, any final capital rule will likely result in material change to the probability of default in the banking industry. Accordingly, we recommend that the Federal Reserve assess whether the scalars should be recalibrated to reflect this increased resilience and avoid overly conservative calculations under the BBA methodology that disproportionately impact SIOs.

III. Technical Correction for SIOs

We recommend that the final capital rule include language in the applicability section of Subpart E of Regulation Q[57] clarifying application of the bank capital rules to SIOs subject to the BBA.[58]

Specifically, we recommend that the Federal Reserve revise the applicability provision of Part 217, Subpart E to include a new subsection that addresses applicability to top-tier and mid-tier holding companies of insurance depository institution holding companies, as follows:

217.100(b)(1) This subpart applies to:

> (i) A top-tier bank holding company or [covered] savings and loan holding company domiciled in the United States that…
>
> …
>
> (C) In the case of a bank holding company, or a covered savings and loan holding company, that does not calculate minimum risk-based capital requirements under subpart B of this part by operation of § 217.10(f)(1), this part applies to a depository

[55] *See* BBA at 82963 (stating that the Federal Reserve will recalibrate scalars as necessary, including based on any changes to risk-based capital under the insurance regulatory regime).
[56] *See* Comparing Capital Requirements in Different Regulatory Frameworks, September 2019, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190906a1.pdf.
[57] 12 CFR 217.100.
[58] *See* Capital Proposal at 64031, FN 12 ("The Board anticipates that any final rule based on the proposal in this Supplementary Information would include appropriate adjustments as necessary to take into account any final insurance capital rule").
Response to Questions 1, 175.

9800 Fredericksburg Road
San Antonio, Texas 78288

institution holding company that is a subsidiary of such bank holding company or covered savings and loan holding company, provided that:

> (1) The subsidiary depository institution holding company is an insurance mid-tier holding company; and
>
> (2) The subsidiary depository institution holding company's assets and liabilities are not consolidated with those of a depository institution holding company that controls the subsidiary for purposes of determining the parent depository institution holding company's capital requirements and capital ratios under subparts B through F of this part.[59]

Adopting this language in Subpart E would support consistency with the BBA with respect to applicability of the bank regulatory capital rules to SIOs, consistent with the Federal Reserve's goal of designing an appropriate capital standard for insurance depository institution holding companies based on the flexibility provided by Congress in section 171 of the Dodd-Frank Act.[60]

*   *   *

USAA appreciates the Agencies' consideration of these comments. If you have any questions, please do not hesitate to contact Tate Wilson, Vice President, Corporate Regulatory Counsel at 210-722-2312 or Tate.Wilson@usaa.com, or me.

Sincerely,

Robert J. Johnson, Jr.
Executive Vice President
Chief Legal Officer & General Counsel

[59] *See* BBA at 82968 (adopting regulatory language to apply 12 CFR Part 217 to a mid-tier holding company subsidiary of a top-tier savings and loan holding company that is an insurance underwriting company).
[60] *See* BBA at 82951.