



May 23, 2011

Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW.  
Washington, D.C. 20551

**Re: Notice of Intent To Apply Certain Supervisory Guidance to Savings and Loan Holding Companies**

**File Number: FR Doc. 2011-9588**

Dear Ms. Johnson:

The Financial Services Roundtable (the “Roundtable”<sup>1</sup>) appreciates the opportunity to provide the Board of Governors of the Federal Reserve System (the “Board”) with comments on the Board’s notice of intent (the “Notice”) to apply certain elements of its consolidated supervisory program currently applicable to bank holding companies (“BHCs”) to savings and loan holding companies (“SLHCs”) as published in the Federal Register on April 22, 2011.<sup>2</sup>

## **Background**

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), supervisory authority over SLHCs will transfer from the Office of Thrift Supervision (the “OTS”) to the Board on July 21, 2011 (the “Transfer Date”). In order to provide SLHCs with advance notice of how it intends to exercise its supervisory authority over SLHCs after the Transfer Date, the Board has recently issued two separate notices of intent. On February 8, the Board published a notice in the Federal Register indicating its intent to require SLHCs to file various BHC reporting forms after the Transfer Date (the “SLHC Reporting Notice”).<sup>3</sup> In the Notice published in the Federal Register on April 22, the Board is providing SLHCs with notice of its intent “to the fullest extent possible taking into account the unique characteristics of SLHCs” to apply its established approach to BHC supervision to SLHCs.<sup>4</sup> In the

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<sup>1</sup> The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America’s economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

<sup>2</sup> Notice of Intent To Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, 76 Fed. Reg. 22,662 (Apr. 22, 2011) (to be codified at 12 C.F.R. Chapter II).

<sup>3</sup> Notice of Intent to Require Reporting Forms for Savings and Loan Holding Companies, 76 Fed. Reg. 7,091 (Feb. 8, 2011). The Roundtable provided comments on that notice of intent in its letter of April 11, 2011. *See* note 15 *infra*.

<sup>4</sup> 76 Fed. Reg. at 22663.

Notice, the Board identifies three elements of its current supervisory program that will be particularly important to the evaluation of the consolidated condition of holding companies:

- the consolidated supervision program for large and regional holding companies;
- the supervisory program for small, noncomplex holding companies; and
- the holding company rating system.

The Board also indicates that in addition to applying the BHC supervisory program to SLHCs, it is considering applying to SLHCs the same consolidated risk-based and leverage capital requirements that currently apply to BHCs and is reviewing consolidated capital requirements for all depository institutions and their holding companies as part of its implementation of the Basel III framework.<sup>5</sup>

### **Relevant Factors**

We wish to point out certain relevant factors that should inform the Board’s thinking as it develops an approach to supervision of SLHCs. A number of these factors – which provide the basis for the current approach to BHC supervision – distinguish SLHCs from traditional BHCs. First, SLHCs as a group are highly diverse in their structures and mixes of activities. Although many smaller SLHCs are “shell” companies in which the savings association subsidiary of the SLHC holds most of the assets of the consolidated entity, many of the largest SLHCs are not shells. These SLHCs engage in a wide variety of commercial and non-bank financial activities, including securities brokerage and dealing, insurance underwriting, manufacturing and retailer activities. We believe that it is important for the Board to recognize that these SLHCs operate under a wide variety of business models and that an appropriately designed supervisory program must take this variety into account. Second, the financial profile of non-shell SLHCs differs from BHCs in that the SLHC’s savings association subsidiary typically constitutes a very small part of the SLHC’s consolidated assets and revenues and overall activity. These SLHCs bear little resemblance to traditional BHCs, in which the subsidiary insured depository institution (“IDI”) is the predominant entity in the BHC structure. Third, SLHCs predominantly engaged in financial activities are already subject to significant regulation with respect to their other financial activities by functional regulators. Under the purview of these existing functional regulatory regimes, individual SLHCs have developed robust compliance, control and risk management systems that are tailored to their specific mix of activities. Because a non-shell SLHC will have developed compliance, control and risk management systems that are tailored to its particular and predominant business model, non-shell SLHCs present significantly different regulatory and supervisory profiles than traditional BHCs. For an SLHC that is predominantly engaged in a non-bank financial activity, such as insurance, it would invert sound risk management practice on its head to require such an entity to base its enterprise-wide risk management on a BHC approach. Basing an enterprise-wide risk management approach on the BHC model because an SLHC happens to own a small savings association is inconsistent with a risk-focused approach to risk management when the predominant assets, liabilities, risks and business activities are insurance-based.

### **Statutory Framework**

The Board’s approach to SLHC supervision should also be informed by the fact that, subject to certain specific changes, the Dodd-Frank Act leaves the underlying statutory framework governing

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<sup>5</sup> *Id.* at 22665.

SLHCs under the Home Owners Loan Act (“HOLA”) largely intact.<sup>6</sup> In particular, the Dodd-Frank Act does not alter HOLA with respect to the range of activities in which SLHCs may engage. The principal exception is Section 626 of the Dodd-Frank Act, which expands upon the HOLA framework by authorizing the Board to require a grandfathered unitary SLHC to form an intermediate holding company (“IHC”) to conduct certain of the SLHC’s financial activities when doing so would ensure that supervision of an SLHC does not extend to the non-financial activities of the company. Upon the establishment of the IHC, Section 604 of the Dodd-Frank Act provides that the IHC’s parent entities cease to be SLHCs. *The IHC is fundamentally important to the Dodd-Frank Act’s approach to SLHC supervision, because it is designed to ensure that the Board will not exercise supervisory oversight over the non-financial activities of an SLHC.* We assume that when implementing its supervisory program, the Board will utilize the IHC as a mechanism to help in the creation of a supervisory program that is appropriately limited to the financial activities of SLHCs. Because the Board is likely to require at least certain grandfathered unitary SLHCs that are engaged in non-financial activities to create IHCs, it does not make sense to impose BHC supervisory requirements on entities that will cease to be SLHCs upon the creation of their IHCs. The diverse nature of grandfathered unitary SLHCs requires that significant latitude and flexibility be used in implementing the IHC structure and in addressing the various issues relating to the IHC structure, such as whether only a portion of the financial activities of an SLHC should be within the IHC, how non-U.S. financial activities will be treated, and the applicability of reporting, capital and source of strength requirements to the IHC structure. Given that the IHC structure will be new to both the Board and SLHCs, we request that Board refrain from imposing new supervisory requirements on grandfathered unitary SLHCs until rules are established implementing the IHC structure.

### **Developing a Focused and Tailored Supervisory Approach**

In order to properly account for the differences between BHCs and SLHCs, we respectfully request that instead of imposing its existing framework for BHC supervision on SLHCs, the Board instead utilize its supervisory authority to tailor a supervisory program for SLHCs that is based on the business models, asset-liability structures and risk profiles of the SLHCs themselves. We believe that a tailored supervisory program should reflect two key principles. First, rather than being based on a traditional BHC model that does not reflect the diverse characteristics of SLHCs, the SLHC supervisory program should focus on the actual types and extent of the risks presented by the SLHCs themselves. Second, the supervisory program should allow the Board to tailor the supervision of an individual SLHC to the size of its savings association subsidiary rather than to the size of the holding company. We believe that a tailored, focused approach recognizes both the diverse activities of SLHCs and that for many SLHCs, the savings association is a relatively small part of the SLHC as a whole. A tailored approach also allows appropriate weight to be accorded to the functional regulatory regimes that already apply with respect to the other SLHC financial activities that significantly outweigh the IDI activities. In sum, an approach tailored to the specific business models, asset-liability structure and risk profiles of SLHCs themselves will serve to greatly enhance the effectiveness of the SLHC supervisory program.

In order to assist the Board in the development of an effective approach to supervision of SLHCs, we offer further comments on the application of the Board’s BHC supervisory program to SLHCs, in particular the development of capital requirements for SLHCs.

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<sup>6</sup> The Dodd-Frank Act alters HOLA in certain respects. For example, the Dodd-Frank Act requires that a depository holding company act as a source of strength for its IDI (§ 616) and that certain SLHCs must be well-capitalized and well managed (§ 606). In addition, the Dodd-Frank Act also adds provisions relating to the functionally regulated subsidiaries of an SLHC (§ 604(g) & (h)).

## Application of the BHC Supervisory Program to SLHCs

The Board has indicated that it intends to apply its established BHC supervisory program to SLHCs.<sup>7</sup> The Board has also indicated that it does not believe that application of the BHC consolidated supervision program to SLHCs would require “any specific action on the part of SLHCs prior to the transfer date or cause undue burden on an ongoing basis.”<sup>8</sup> We respectfully suggest that imposition of the BHC supervisory program will require significant action by SLHCs well in advance of the effective date of any program and will impose significant costs and burdens. For example, various SLHCs may have to develop the infrastructure necessary to collect, aggregate and monitor data on an enterprise-wide level in a manner contemplated by the Board’s guidance. The risk management functions of many SLHCs may vary across individual entities within the SLHC structure, and may be configured with respect to the individual entities in the SLHC structure rather than with respect to the consolidated SLHC as a whole. Developing a fully consolidated approach and supporting infrastructure will likely require SLHCs to undertake significant lead-time investments to revise management information systems and other reporting systems.

Given the likelihood of significant burdens for SLHCs, we request that the Board provide for an appropriate transition period with respect to the application of any new supervisory program to SLHCs. In addition to the particular need for an appropriate transition period with respect to the application of new capital requirements to SLHCs (discussed *infra*), the Board should provide for an appropriate transition period with respect to the possible application of any specific BHC supervisory guidance, such as the elements of the BHC supervisory program referenced in the Board’s Supervisory Letter SR 08-9. We request that the Board explicitly allow for an appropriate transition period by providing for a transition period by rule after the Transfer Date, and also implicitly allow for the same through its interactions with, and informal supervisory oversight of, SLHCs after the Transfer Date.

As part of its implementation of the SLHC supervisory program, the Board is also considering transitioning SLHCs from the OTS rating system (“CORE”) to the BHC Holding Company Rating System, commonly referred to as “RFI.” In the Notice, the Board indicates that it intends to do so in part because of the belief that there is “substantial overlap between the two rating systems.”<sup>9</sup> Despite this belief, the Board notes that a “material” difference between the OTS and Board supervisory programs for holding companies exists with respect to the assessment of capital adequacy.<sup>10</sup> In order to address the capital issue, the Board is considering “applying the same consolidated risk-based and leverage capital requirements as BHCs to the extent reasonable and feasible taking into consideration the unique characteristics of SLHCs and the requirements of HOLA.”<sup>11</sup> As part of this effort, the Board also expects to issue a notice of proposed rulemaking addressing any proposed application of the Basel III-based capital requirements to SLHCs.<sup>12</sup>

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<sup>7</sup> 76 Fed. Reg. at 22663. The Board notes, however, that it is currently reviewing its guidance document on consolidated supervision pursuant to changes in the Dodd-Frank Act, including those that apply to the supervision of SLHCs. *Id.* n. 1.

<sup>8</sup> *Id.*

<sup>9</sup> 76 Fed. Reg. at 22664. At the same time, the Board states that changes to the RFI rating system may be necessary to accommodate SLHCs and their statutory and regulatory framework. *Id.* at 22665.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> Section 171 of the Dodd-Frank Act (the “Collins Amendment”) requires that BHCs and SLHCs maintain minimum leverage and risk-based capital not less than generally applicable leverage and risk-based capital requirements as applicable to IDIs on July 21, 2010. However, the capital “floor” of the Collins Amendment does not generally become applicable to SLHCs until July 21, 2015.

## Application of Basel Capital Requirements to SLHCs

We wish to express our strong reservations about the application of Basel III capital requirements to SLHCs. We believe that the application of consolidated bank-centric capital requirements to SLHCs without regard to the mix of their financial activities is unwarranted as a matter of sound prudential regulation. The staff of the Board has previously recognized the difficulties associated with attempting to “fit” non-bank-centric entities into a bank-centric model of capital regulation. For example, in a joint report with the National Association of Insurance Commissioners (“NAIC”), the staff of the Board recognized that bank capital requirements and insurance capital requirements differ in the types of risks they are intended to guard against.<sup>13</sup> Similarly, the Board in the Notice itself recognizes that SLHCs have historically engaged in a broad range of non-banking activities which were not contemplated when the BHC capital requirements were developed.<sup>14</sup>

For example, with respect to the incongruity of applying bank-centric capital requirements to insurance-centric SLHCs, we note that insurance companies hold assets on their balance sheet that simply have no analogue in the banking context. One example of such assets include separate account assets which are assets that support the insurer’s obligation under variable life insurance policies and variable annuity contracts. Although separate account assets are recorded on the insurance company’s balance sheet, the contractual arrangements under the associated variable life insurance policies or variable annuity contracts require the policyholder, not the insurance company, to bear any investment risk associated with the investment of the assets in the separate account. Requiring an SLHC to include separate account assets in a consolidated Tier 1 leverage ratio would skew the leverage ratio calculation even though the SLHC bears no investment risk for the separate account assets. Because the insurance company bears no investment risk with respect to separate account assets, application of a consolidated risk-based bank capital charge to separate account assets would likewise be incongruous, unless separate account assets were risk-weighted at 0%. Moreover, the Board bases its capital requirements, and BHC reporting in general, on financial statements prepared in accordance with generally accepted accounting principles (“GAAP”). As we noted in our previous letter responding to the SLHC Notice,<sup>15</sup> mutual insurance companies and fraternal benefit societies that are SLHCs are not required to prepare consolidated financial statements in accordance with GAAP, and instead prepare their financial statements in accordance with statutory accounting principles (“SAP”) as required by state insurance law and regulation. In this context, application of bank capital requirements to insurance-centric SLHCs could require the creation of a new financial reporting infrastructure for these companies.

We believe that it is essential for the Board to take differences in BHC and SLHC capital into account when determining appropriate capital requirements for SLHCs. Wholesale application of BHC capital requirements to SLHCs would force many SLHCs to comport their balance sheets with BHC capital requirements, even when doing so would make little supervisory sense and would yield little insight as to the risk profiles of those institutions. Conceptually, the Basel III framework is almost entirely bank-centric, and it could be at cross-purposes with the objectives underlying sound prudential regulatory policy to apply a bank-centric capital regime to SLHCs that are not bank-centric.

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<sup>13</sup> Report of the NAIC and the Federal Reserve System Joint Subgroup on Risk-Based Capital and Regulatory Arbitrage (May 24, 2002).

<sup>14</sup> 76 Fed. Reg. at 22665.

<sup>15</sup> Letter from Richard M. Whiting, Executive Director and General Counsel, The Financial Services Roundtable, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, April 11, 2011, *available at* [http://www.fsround.org/fsr/policy\\_issues/regulatory/pdfs/pdfs11/FINAL-CommentLetteronSLHCtoBHCReporting4.11.11.pdf](http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs11/FINAL-CommentLetteronSLHCtoBHCReporting4.11.11.pdf).

We urge the Board to exercise caution with respect to any decision to require diversified SLHCs to comply with the Basel III framework, and request that any capital requirements be designed to make due allowance for the differences between BHCs and SLHCs.

We believe that the Board should take the time necessary to develop a capital framework for SLHCs that gives appropriate weight to the differences between BHCs and SLHCs. We therefore support the Board's intention to continue to assess SLHC capital using supervisory methods similar to those currently employed by the OTS until consolidated capital standards are finalized.<sup>16</sup> We further request that the Board provide SLHCs with an appropriate transition period to bring themselves into compliance with any new capital framework that is ultimately developed. With respect to the reporting systems that would support any capital regime, we request that SLHCs that currently prepare financial statements based on SAP be permitted to continue to do so for purposes of complying with any new capital requirements applicable to SLHCs. This approach is consistent with the Board's existing supervisory approach, as the Board has allowed foreign banking organizations to prepare financial statements in accordance with local accounting practices.<sup>17</sup> Allowing these SLHCs to continue to prepare SAP-based financial statements would also be consistent with the Board's desire to have accurate information about the risk profiles presented by SLHCs. Because SAP-based accounting functions in the context of a well-established and robust regulatory regime,<sup>18</sup> we believe that allowing these SLHCs to continue to prepare SAP-based financial statements for purposes of compliance with any capital requirements is well-warranted.

### **Tailoring the Supervisory Program to the Size of the Savings Association**

Finally, we request that the Board consider tailoring its supervisory program to the size of the SLHC's subsidiary savings association rather than to the size of the SLHC itself. Our suggested approach is based on the different structures and the diversity of activities and business models that exist among non-shell SLHCs. It is also based on the fact that many SLHCs have relatively small savings association subsidiaries as compared to the size of the overall SLHC structure. By tailoring its SLHC supervisory program to the size of the SLHC's savings association subsidiary, the Board can implement a supervisory program that focuses on the risk that the SLHC poses to the banking system.

### **Conclusion**

We conclude by reiterating our request that the Board provide for an appropriate transition period with respect to the imposition of the SLHC supervisory program. This transition period should apply with respect to the application of any new elements of the BHC supervisory program to SLHCs, the application of the Basel III framework to SLHCs, and the development of compliance and reporting systems sufficient to meet the Board's requirement for consolidated risk management on the part of the SLHC. We further request that for SLHCs that currently prepare their financial statements in accordance with SAP, these SLHCs be allowed to continue to do so for purposes of compliance with the SLHC supervisory program, and that the Board consider tailoring supervision of SLHCs to the size

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<sup>16</sup> Press Release, Board of Governors of the Federal Reserve System, April 11, 2011, *available at* <http://www.federalreserve.gov/newsevents/press/bcreg.20110415a.htm>.

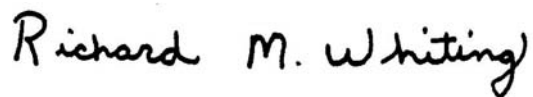
<sup>17</sup> See FR Y-7, General Instructions for Preparation of the Annual Report for Foreign Banking Organizations, Report Item 1a: Financial Statements (authorizing foreign banking organizations to prepare financial statements "in accordance with local accounting practices.").

<sup>18</sup> State insurance law and regulation usually requires that insurers submit quarterly and annual unaudited financial statements and annual audited financial statements in accordance with Accounting Practices and Procedures Manual adopted by the NAIC. This manual is subject to periodic review and revision and interpretation by the NAIC.

of an SLHC's subsidiary savings association. We request that as the Board develops its approach to the supervision of SLHCs, particularly those that engage in non-bank financial activities, it provide a further opportunity to comment after the Transfer Date on any proposed guidance or proposed rulemaking. Finally, we also request that the Board refrain from imposing new supervisory requirements on grandfathered unitary SLHCs until the rules implementing the IHC structure have been implemented.

We thank the Board for the opportunity to comment. We look forward to collaborating with the Board, both before and after the Transfer Date, to develop a supervisory framework for SLHCs that is efficient and effective. If you have any questions, please feel free to contact me or Brian Tate at (202) 289-4322.

Sincerely,

A handwritten signature in black ink that reads "Richard M. Whiting". The signature is written in a cursive, slightly slanted style.

Richard Whiting  
Executive Director and General Counsel