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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551

Subject: Docket OP-1416 – Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies

Dear Secretary Johnson:

On behalf of Nationwide Mutual Insurance Company and its affiliated companies (Nationwide), we appreciate the opportunity to comment on the above-referenced proposal. Nationwide operates through an insurance holding company system registered with the Ohio Department of Insurance. By virtue of its ownership of Nationwide Bank, Nationwide is registered with the Office of Thrift Supervision as a savings and loan holding company (SLHC) pursuant to Section 10 of the Home Owners' Loan Act of 1933 (HOLA) and, therefore, impacted by the proposal.

In connection with our more detailed comments below, we respectfully request that the Board of Governors (the "Board") consider the following:

- The proposal should minimize disruption to business operations, consistent with the statutory mandate to preserve stability of the financial system.
- The Board should recognize the uniqueness of the highly regulated insurance business model, and avoid a "one-size-fits-all" supervisory approach.
- Insurance-owned thrifts should be recognized as a discrete class for supervisory purposes. Such an approach would enable the Board to recognize the inherent differences of the insurance business model from banking and avoid the potential for inaccurate tracking and data comparisons under inappropriate bank-centric metrics. Treating insurance-owned thrifts as a distinct class would also avoid the imposition of costly, burdensome or redundant supervision on insurers, yet enable



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the Board to develop a robust and effective framework for the supervision of insurers that own small banks.

In its notice of intent (NOI), the Board identifies three elements of its current supervisory program critical to effective supervision of the consolidated condition of holding companies. Two of those elements would apply to Nationwide: 1) the Board's consolidated supervision program for large and regional holding companies; and 2) the Board's holding company rating system. Accordingly, our specific comments that follow are focused on these two areas.

Consolidated Supervision Program for Large and Regional Holding Companies

In the NOI the Board sets forth its intention, to the greatest extent possible taking into account the unique characteristics of SLHCs and the requirements of the HOLA, to assess the condition, performance and activities of SLHCs on a consolidated risk-based approach in a manner consistent with the Board's established approach regarding bank holding company (BHC) supervision. The Board notes that its objective will be to ensure that the SLHC and its non-depository subsidiaries are effectively supervised and can serve as a source of financial strength for, and do not threaten the soundness of, the subsidiary depository institution.

The Board states that applying the BHC consolidated supervision program to SLHCs is essential to executing its supervisory responsibilities under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Act") and is consistent with HOLA. The BHC program is risk-focused and entails supervisory activities, continuous monitoring, discovery reviews and testing, all of which vary based on size, complexity and risk of the holding company on a consolidated basis. The Board relies upon assessments by bank and functional regulators of BHC subsidiaries.

In the NOI, the Board recognizes that the BHC program has similarities to the current Office of Thrift Supervision (OTS) program for SLHC supervision; however, the Board states its expectation that for some SLHCs the BHC program may entail more intensive supervisory activity than the OTS program. Notably, the Board also expresses the expectation that BHC supervision would not require any specific action by SLHCs prior to the July 21, 2011 transfer date or cause undue burden on an ongoing basis.

Holding Company Rating System

In addition to its proposal regarding the BHC supervisory program, in the NOI, the Board details its intention to replace the OTS CORE rating system with the Board's RFI/C(D) rating system (commonly known as RFI).



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While there is significant overlap between the CORE and RFI rating systems, the Board has identified two differences. First, CORE does not explicitly take asset quality into account. Second, unlike BHCs, SLHCs currently are not subject to regulatory capital requirements.

Nationwide Comments

As noted above, the Board is seeking public input in connection with the proposal to apply the BHC consolidated supervisory program and the RFI rating system to SLHCs. Specifically, the Board is seeking comment with regard to:

1. The burden of these potential modifications to supervisory activities on SLHCs.

Nationwide appreciates the Board's view that applying the BHC program to SLHCs is essential to executing its supervisory responsibilities under the Act. For example, under the Act, a SLHC must act as a source of financial strength to its subsidiary savings bank. Moreover, Section 171 of the Act imposes for the first time upon SLHCs minimum risk-based and leveraged capital requirements on a consolidated basis.

Understanding the statutory requirements that the Board is implementing, Nationwide welcomes helpful reviews of internal control functions, liquidity, discovery reviews and reviews of the activities of nonbank subsidiaries. However, Nationwide respectfully suggests that the Board ensure that the reviews are not redundant to Nationwide's already highly regulated activities and do not add cost to, or burden, Nationwide's business activities. We also request that the Board recognize the unique nature of the insurance business model and its differences from the bank-centric Bank Holding Company Act.

Nationwide appreciates the Board's stated expectation that imposition of the BHC supervisory program will not require SLHCs to take any special action prior to July 21, 2011 or cause undue burden to SLHCs on an ongoing basis. Given the Board's lack of daily supervisory familiarity with the property and casualty insurance and life and annuity business models and the governance structure of top tier mutual insurance companies, we urge the Board to rely on the National Association of Insurance Commissioners (NAIC) and state insurance regulators for information regarding insurance products, distribution and company operations, and on the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority for information regarding registered variable life and annuity products and broker-dealer and investment advisory activities. Finally, the Board should rely on the Department of Labor for information regarding retirement products and distribution. We believe that reliance on reports from these agencies, as well as public filings and other public sources, will minimize any supervisory gaps because the bulk of Nationwide's activities



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are already highly regulated by duly constituted state and federal insurance and financial authorities.

In sum, we hope that the Board institutes a process that achieves its supervisory goals without inadvertently adding to the cost and burden of institutions whose safety and soundness the Board seeks to preserve. The Board will have a learning curve with respect to entities predominately engaged in the business of insurance and therefore we recommend that the Board rely as much as possible upon the existing prudential authorities. It would not be appropriate or helpful to impose a bank-centric view of risk (with its attendant stringent regulatory consequences) upon a long-proven and established insurance business such as Nationwide, which has been thriving for 85 years. This is especially true, as in Nationwide's case, when the depository institution is a relatively small part of the overall organization.

2. Whether there are any unique characteristics, risks or specific activities of SLHCs that should be taken into account when evaluating which supervisory program should be applied to SLHCs and what changes would be required to accommodate these unique characteristics.

Insurance Company SLHCs that Own Thrifts. SLHCs have unique characteristics since, unlike BHCs, they can engage in both financial and nonfinancial activities. Nationwide is a SLHC predominately engaged in insurance activities. We believe that for supervisory and reporting purposes, the Board should treat insurance companies that own thrifts as a discrete class. The thrift charter with the Qualified Thrift Lender Test framework rooted in consumer lending is aligned with Nationwide's multiline consumer insurance operations.

Grandfathered SLHCs. Moreover, Nationwide is a grandfathered SLHC under Title IV of the Gramm-Leach-Bliley Act of 1999 and is therefore entitled to engage in new and existing commercial activities under HOLA. Current Board supervisory activities focus on BHCs, which are prohibited from engaging in activities not closely related to banking or nonfinancial in nature. Any Board supervision of grandfathered SLHCs such as Nationwide should acknowledge the difference between typical BHCs (prohibited from engaging in nonfinancial activities) and grandfathered SLHCs like Nationwide, which are permitted to engage in new and existing commercial activities. And notably, Nationwide's nonfinancial activities are relatively immaterial to the overall organization and should in no event warrant preoccupation from, or a large investment by, Federal Reserve examiners.

Insurance Company Risk Profile. Indeed, given the highly regulated nature of the business of insurance by the states in which Nationwide conducts business and various federal agencies and self-regulatory organizations, together with extensive statutory reporting systems managed by the NAIC, we believe that the overall risk profile of an



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insurer would be lower in frequency and severity than a typical BHC, especially those insurers that own small depository institutions. We provided an extensive discussion on the risks relating to the insurance business model in our letter to the Financial Stability Oversight Council dated November 5, 2010.

BHC Reporting. With respect to BHC reporting, one of its purposes is to provide apples-to-apples comparisons to other BHCs for systemic monitoring. Imposing a BHC reporting regime upon insurance companies that are SLHCs would not yield an apples-to-apples comparison. We think it might be more fruitful for the Board to work with the industry to develop reports that are suitable for insurance-owned banks as a discrete class of entities, rather than attempt to compare them to BHCs. A strict insurance-to-bank comparison would likely convey an inaccurate picture of insurance business risks relative to banking business risks. The weighting of risk will be critical to assignment of appropriate capital and liquidity levels for an insurance company that owns a small depository institution. We recommend a delay of BHC reporting by one year to develop a useful reporting scheme for insurance companies that own thrifts. For more detailed information on our views regarding BHC reporting, please see Nationwide's comment letter to the Board dated April 11, 2011.

Insurance Expertise in the Federal Reserve. We also believe that in addition to the above suggestions, the Board should establish an office with special insurance expertise within the Federal Reserve. The office could act as a liaison with state regulators and other insurance company regulators as well as with the NAIC and the new Federal Insurance Office. The insurance office within the Federal Reserve could also act as a resource for the Reserve Banks, which manage the examinations and to the Board on insurance issues. In addition, the office could design a set of metrics appropriate for insurance company reporting on a consolidated basis. By way of analogy, the SEC has established an Office of Insurance Products because insurance products and their funding vehicles do not neatly fall within the parameters of the Investment Company Act of 1940 or the Securities Act of 1933.

We appreciate the Board's proactive solicitation of comment and willingness to take a careful, deliberative approach to its new responsibilities. Given the importance to the nation and the financial system of these new responsibilities, we respectfully request that the Board takes sufficient time to implement its supervisory program and avoid a "one-size-fits-all" fits all approach. An overbroad and reflexive application of the current BHC supervisory program would not capture a true picture of insurance company risk and financial condition and could result in the unnecessary and unwarranted derogation of our proven business model.



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Capital Adequacy

In addition to the items addressed above, the NOI seeks public input on capital requirements as part of the ratings system. As noted above, Section 171 of the Act imposes upon SLHCs for the first time minimum risk-based and leveraged capital requirements on a consolidated basis. The Act establishes a floor referencing the standards applicable to insured depository institutions under prompt corrective action regulations under Section 38 of the Federal Deposit Insurance Act. The Board plans to implement Section 171 and the Basel Committee on Banking Supervision's *Basel III: A global regulatory framework for more resilient banks and banking systems* (Basel III). The Board is considering applying to SLHCs 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. The Board plans to propose standards in 2011, finalize them in 2012, and begin implementation in 2013.

Despite the foregoing, the Board recognizes that the broad range of nonbanking activities in which SLHCs have traditionally engaged were not contemplated when the consolidated risk-based and leverage capital requirements were developed. The Board is seeking public input concerning the applicability of the Section 171 and Basel III capital standards to SLHCs. Specifically, the Board is seeking comment with regard to:

1. What specific provisions, consistent with the Act, should be incorporated in the proposed rule in order to address such unique characteristics, risks and/or specific activities?

Compliance with the NAIC risk-based capital system. We suggest that the Board consider a SLHC that is an insurance company to be in compliance with Section 171 of the Act if it is in compliance with the risk based capital requirements under state insurance law. The NAIC risk-based capital (RBC) system was created to provide a capital adequacy standard that is related to risk, raises a safety net for insurers, is uniform among the states, and provides regulatory authority for timely action. A separate RBC formula exists for each of the primary insurance types: life and annuity, property/casualty, and health. The NAIC Risk-Based Capital system has two main components: 1) the risk-based capital formula, that establishes a hypothetical minimum capital level that is compared to a company's actual capital level, and 2) a risk-based capital model law that grants automatic authority to the state insurance regulator to take specific actions based on the level of impairment.

Once a formula is applied to an insurance company, the results are treated as confidential supervisory information. Overall results reflecting total adjusted capital (capital and surplus) and authorized control level RBC (1 of 4 levels of minimum capital) are available in five year historical compilations in a company's statutory annual



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statement. For the convenience of the Board, we are appending hereto an overview of state insurance RBC principles risks, formulas, action levels and trend testing.

We believe that the sophisticated actuarial-based capital framework for insurance companies is suited to each insurer's risk profile and reflective of each insurer's permissible general account investments. For example, bonds are a particularly suitable and typical general account investment for insurance companies because they match the relatively longer duration of the liability involved in an insurance policy or annuity contract. Investment risk is a key element in insurance company RBC measurements.

2. Which instruments currently included in SLHCs' regulatory capital would be either excluded from regulatory capital or more strictly limited under Basel III?

Surplus Notes. As a mutual insurance company organized under Ohio insurance law and registered with the OTS as an SLHC under Section 10 of HOLA, Nationwide is not subject to the bank regulatory capital framework. Thus, the Tier 1 RBC and leveraged capital regimes do not apply. Once they do apply as required by Section 171 of the Act, Nationwide as a mutual insurance company (and therefore precluded from raising capital through a common stock offering) would be limited in its ability to raise Tier 1 capital.

Under Ohio insurance law, Nationwide is permitted to issue hybrid instruments known as surplus notes. It is not clear how surplus notes would be treated under BHC capital definitions. Under the Act, while issuances of hybrid instruments are permanently grandfathered and not deductible from Tier 1 capital, new issuances would be subject to deduction from Tier 1 capital. Yet, it is not clear what treatment, if any, surplus notes would receive and whether they would be treated as Tier 2 capital. Insurance companies are not banks. Their capital instruments can be very different and, as is evident from a cursory review, insurance company capital instruments are not contemplated by banking regulations.

Risk Weighting of Insurance Company Asset Classes. We also note that under the current bank regulatory risk weighting system, insurance company asset classes that do not fit within the prescribed risk weightings would be weighted 100%. For example, separate account assets of an insurance company are identified with and fund variable life insurance policies and annuity contracts issued to customers. Under the policies and contracts, and consistent with state insurance law and federal securities laws, the investment risk of the separate account assets resides with the customer and not the general account of the company. Accordingly, separate account assets pose a nominal risk to the company. However, because they do not fit within the prescribed risk weighting categories, they are weighted 100%. By contrast, under Ohio insurance law, separate accounts are assigned a capital charge of five basis points (.05% of assets) which reflects the nominal risk to the insurer. However, under the bank Tier 1 RBC, the



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insurance company would be required to absorb an 800 basis point (8% of assets-- based upon prudential regulatory practice that increases for depository institutions the prompt corrective action minimum Tier 1 level from 6% to 8%) capital charge that would adversely impact sound and efficient capital management and the ability of the insurer to write business.

We believe that similar difficulties arise in connection with the treatment of reserves. For banks, the allowance for loan and lease losses is specifically defined as Tier 2 capital. By contrast, there is no guidance with respect to insurance loss reserves. Given the highly technical nature of bank capital regulations based upon the experience of prudent bank capital management over time, their unadjusted application to the insurance capital structure would inaccurately reflect the insurer's true risk profile.

Another example in which difficulties arise is in connection with the risk weighting of corporate bonds. Under the bank capital regulations, all corporate debt receives a 100% risk weighting. A lower weight can apply to asset- or mortgage- backed securities, and some other limited positions. Thus, a AAA or AA asset- or mortgage-backed security is assigned a 20% risk weight, while a AAA or AA corporate bond receives a 100% risk weight.

Risk weightings under the bank regulations do not account for the insurance business model which is not based on loan originations (like banks) but rather primarily upon liquid securities. Accordingly, the bank-centric RBC standards do not account for the liquidity benefits of insurance company assets in the form of a highly liquid securities portfolio.

For example, insurance company investment portfolios typically contain a large proportion of corporate bonds. If insurers were required to reduce their corporate bond holdings to offset the higher capital requirements because of the applications of bank risk weighting, the result would be the unintended reduction in insurance company demand for corporate bonds. Insurers would then substitute less liquid securities, including asset- or mortgage-backed securities. A reduction in insurer demand for bonds could have a significant and systemic impact on the ability of U.S. companies to access funding in the debt markets and would likely lead to higher funding costs. Thus, without major adjustments to the risk weighting criteria as applied to insurers, we believe the purpose of the Section 171 of the Act in facilitating financial stability would be compromised.

Capital Conservation Buffer Charges. Similar issues arise with respect to the Basel III proposal to impose a capital conservation buffer charges and countercyclical systemically important financial institution charges. We believe that such charges may be appropriate for bank holding companies or systemically significant firms, given the risk model. However, the charges may be less appropriate and unnecessarily



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constraining with respect to the insurance business model where (as in Nationwide's case) the insurer owns a small bank relative to its overall operations.

We believe that the best approach (*i.e.* the quickest, most administratively feasible, effective, and safest and soundest approach) would be for the Board to deem compliance with long-standing and tested state RBC requirements as equivalent to compliance with Section 171 of the Act. If the Board does not adopt such an approach, the Board should consider adjusting the risk weightings to more properly reflect the lower risk of the insurance business model. For example, separate accounts which more resemble collective trust funds of a bank should get similar treatment to bank collective trust funds.

Notably the principle of equivalence is used by the Board to determine if the capital of a foreign bank is equivalent to the capital that would be required of a U.S. bank holding company. The recent proposed rule under Section 171 of the Act notes that the Board has been making capital equivalency findings for foreign banks since 1992. The Board should consider a similar approach for domestic insurance companies. It would be manifestly unfair to treat foreign banks more favorably than U.S. insurance companies, which are subject to the laws of the several States of the United States of America.

- a. How prevalent is the issuance of such instruments? Please comment on the appropriateness of the Basel III transitional arrangements for non-qualifying regulatory capital instruments. Provide specific examples and support any proposed alternative treatment.

Given the inability of a mutual insurance company to raise capital through public stock offerings, Nationwide has relied upon its surplus note program for funding. Nationwide has issued and outstanding surplus notes totaling \$2.2 billion in five different tranches with maturities varying by tranche and ranging from the year 2024 to 2039. A deduction from bank Tier 1 capital could preclude the mutual from counting on an important source of funding as Tier 1 capital.

3. Are the proposed Basel III-based transition periods appropriate for SLHCs and, if not, what alternative transition periods would be appropriate and why?

Section 171 of the Act prescribes that the minimum leverage and RBC capital ratios are effective five years after enactment (*i.e.* by July 21, 2015), the third year into the Basel phase-ins. We are concerned that an abrupt ramp up of capital demands could have procyclical effects depending upon conditions at the time. This could unnecessarily curtail the ability of insurance carriers to write business and thereby impact capacity to the detriment of the consumers. We believe that an appropriate preventive measure is for the Board to deem compliance with the state insurance RBC framework as equivalent to the capital that would be required under Section 171. If not, the Board



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should act to calibrate the risk weightings to properly reflect the lower degree of risk reflected in the insurance business model relative to typical bank holding companies and ensure a more gradual and less abrupt phase-in period.

4. What methods should the Board consider implementing for assessing capital adequacy for SLHCs during the period between the transfer date and implementation of consolidated capital standards for SLHCs.

The Board should continue to use the approach currently used by the OTS (*i.e.*, quantitative-qualitative supervisory approach). During the five-year transition period, the Board should consider implementation of the state insurance RBC framework as an equivalent alternative to the BHC regulatory capital framework. Doing so would provide a more useful comparison based upon the reality of the insurance business model and would involve the least business disruption to the benefit of financial and market stability.

In summary, we appreciate the opportunity to comment and urge the Board to adopt a flexible, tailored approach to the supervision of insurance SLHCs like Nationwide. We appreciate the dialogue and look forward to further opportunities to comment.

Very truly yours,

NATIONWIDE

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