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Ms. Jennifer J. Johnson, Secretary
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Mr. Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
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Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (OCC: Docket No. OCC-2012-0008 and RIN 1557-AD46; FRB: Docket No. R-1442 and RIN 7100-AD-87; FDIC: RIN 3064-AD95) (NPR 1)

Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements (OCC: Docket No. OCC-2012-0009 and RIN 1557-AD46; FRB: Docket No. R-1442 and RIN 7100-AD-87; FDIC: RIN 3064-AD96) (NPR 2)

Ladies and Gentlemen:

United Services Automobile Association (USAA) is pleased to provide our comments with respect to the two above-described proposed rules regarding regulatory capital (the Proposed Rules) that the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (the Board) and the Federal Deposit Insurance Corporation (collectively, the Agencies) jointly proposed under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).¹

¹ Regulatory Capital Rules, 77 Fed. Reg. 52792 (proposed August 30, 2012); Regulatory Capital Rules, 77 Fed. Reg. 52889 (proposed August 30, 2012).

USAA is a membership-based association, which together with its family of companies, serves present and former commissioned and noncommissioned U.S. military officers, enlisted and retired military personnel, and their families. Since USAA's inception in 1922 by a group of U.S. Army officers, we have pursued a mission of facilitating the financial security of our members and their families by providing a full range of highly competitive financial products and services, including personal lines of insurance, retail banking and investment products. Our core values of service, honesty, loyalty and integrity have enabled us to perform consistently and be a source of stability for our members, even in the midst of the unprecedented financial crisis of recent years.

USAA is a holding company for a diversified financial services group of companies and is itself a personal lines property and casualty insurance carrier. USAA's affiliated companies enhance our product and geographic diversification, and our overall financial strength benefits from our diversification into life insurance, banking, investments and other products and services.

USAA Life Insurance Company (USAA Life), a subsidiary of USAA, offers life insurance, annuities and health insurance products and services to our members. USAA Federal Savings Bank (USAA Bank), an indirect wholly owned subsidiary of USAA, is a federally chartered savings association organized to offer personal retail banking services, including home mortgages and automobile loans to our members. Because USAA Bank was chartered in 1983, and is USAA's only savings association, USAA is a grandfathered unitary savings and loan holding company (SLHC) that was previously regulated by the Office of Thrift Supervision. As such, USAA has not previously been subject to the Bank Holding Company (BHC) risk-based capital adequacy guidelines found in Appendix A of Regulation Y.

A. Summary

The Proposed Rules largely ignore the insurance-specific risk-based capital regime and related accounting and reserving requirements developed to address the risks inherent in the insurance industry. Imposing a one-size-fits-all framework on insurers will have negative consequences for insurers and for the overall economy, and will not achieve the objectives the Agencies seek to attain by proposing these rules.

- Our letter urges the Agencies to avoid the so-called "double-counting" of insurance assets by adopting the "deduction and deconsolidation" approach as proposed by the Basel Committee on Banking Supervision but rejected by the Board's final rule entitled "Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II" published on December 7, 2007² (hereinafter "2007 Advanced Framework" or the "Framework").
- Alternatively, the Agencies could provide SLHCs that have insurance underwriting subsidiaries and SLHCs that are themselves operating insurance underwriters (collectively referred to in this letter as "Insurance SLHCs"), the option to deduct an amount of capital related to insurance underwriting activities that is higher than the

² Risk-Based Capital Standards, 72 Fed. Reg. 69288, 69324 (December 7, 2007).

minimum regulatory capital requirement of the insurance underwriting entities within the holding company, and to deconsolidate the assets of those insurance underwriting entities when determining the consolidated regulatory capital of the company pursuant to the Proposed Rules.

- The Agencies should postpone until at least January 1, 2015, the Basel III implementation deadline for SLHCs which do not currently use Basel I risk-based capital rules or BHC capital adequacy guidelines.
- Finally, we request the Agencies make certain changes relating to the risk-weighting for certain asset classes (*e.g.*, asset backed securities and equities).

B. Adopt the “deduction and deconsolidation approach” for SLHCs that have insurance underwriting subsidiaries or are themselves insurance underwriters.

The Proposed Rules require deduction of an amount of capital equal to 200% of the Authorized Control Level (ACL) of any insurance underwriting subsidiary of an SLHC from the numerator of its consolidated risk-based capital ratio without a corresponding deduction of the assets of those insurance subsidiaries from the denominator of the ratio. This approach places an unfair and inappropriate burden on Insurance SLHCs by effectively “double-counting” in the consolidated assets of the SLHC those assets relating to insurance underwriting used to calculate the minimum capital requirement of the insurance underwriting entities within the SLHC.

Instead, the deduction and deconsolidation approach endorsed by the Basel Committee should be adopted by the Agencies in order to appropriately recognize insurance underwriting risks. We propose that the Agencies require an Insurance SLHC to deduct 200% of the ACL of its insurance underwriting entities and deconsolidate the assets of those insurance underwriting entities subject to state insurance regulatory requirements.³

The Agencies state that the rejection of the deduction and deconsolidation approach in the Proposed Rules is consistent with the 2007 Advanced Framework. It is important to note, however, that the Framework applied only to “core banks,” which are essentially very large, internationally active banking organizations.⁴ In determining whether a banking organization meets the required thresholds to be defined as a core bank, the 2007 Advanced Framework allows an organization to exclude from its total consolidated assets the assets held by any insurance underwriting subsidiary. Therefore, it is unlikely that any Insurance SLHC was then, or is now, a core bank as defined by the 2007 Advanced Framework. For this reason, we do not believe the Agencies fully considered the impact that rejecting the deduction and deconsolidation approach would have on Insurance SLHCs. We urge the Agencies to reconsider the merits of that approach at least with respect to SLHCs.

Explaining its rejection of the full deduction and deconsolidation approach in the 2007 Advanced Framework, the Board stated that a consolidated BHC risk-based capital measure should (1)

³ If this proposal is accepted, the deduction could be applied to the parent insurance underwriter as well.

⁴ A core bank is defined as a banking organization that holds either: (i) consolidated total assets of \$250 billion or more, or (ii) consolidated total on-balance sheet foreign exposures of \$10 billion or more.

incorporate all credit, market, and operational risks to which the depository institution holding company is exposed, (2) minimize the potential for regulatory capital arbitrage, and (3) reflect the consolidated organization. The Board opposed the deduction and deconsolidation approach because, in the Board's view, the state insurance risk-based capital requirements do not consider credit risk and the deconsolidation approach creates opportunities for regulatory arbitrage with respect to insurance underwriter versus depository institution holding company regulatory capital requirements. We address each concern in turn below:

1. Insurance risk-based capital calculations do incorporate credit, market and operational risk.

State regulators impose upon Insurance SLHCs strict, comprehensive risk-based capital standards. These standards do, in fact, take into account credit, as well as market and operational risks to which Insurance SLHCs are exposed, including risks posed by insurance underwriting subsidiaries.

USAA's state regulator identifies various risk categories in its risk-based capital model: asset risk of affiliates; other asset risk, including credit risk, interest rate risk and market risk; underwriting risk or insurance risk; and business risk.⁵ Credit risk under the insurance risk-based capital model represents the potential for default of principal and interest or fluctuation in fair value of assets, including fixed income and equity. Fixed income assets include bonds, collateral loans and mortgage loans, short-term investments, cash, and other long-term investment assets. Equity assets include unaffiliated common and preferred stock, real estate, and long-term assets. Additionally, all insurance companies are subject to an asset concentration factor that reflects the additional risk of high concentrations in a single issuer.⁶ Fixed income and equity investments constitute a significant and essential part of any insurer's portfolio, and insurance regulations appropriately and effectively address the credit risk these assets present.

2. The deconsolidation approach does not result in regulatory arbitrage.

The Board previously stated that a fully consolidated approach minimizes the potential for regulatory capital arbitrage, because it avoids creating an incentive to book individual asset exposures at a subsidiary to obtain potentially more favorable capital treatment. With respect to Insurance SLHCs, the deconsolidation approach does not incent regulatory arbitrage but, instead, is an effective means of balancing the interests of the Agencies and insurance regulators. Deconsolidation allows an Insurance SLHC to manage, on a consolidated basis, the required amounts of capital to appropriately address risks presented by banking and insurance underwriting activities. It permits the Insurance SLHC to maintain sufficient capital to protect consumers, who in USAA's case are its members, through strong insurance claims payment

⁵ Risk categories are based on the National Association of Insurance Commissioners (NAIC) Risk-Based Capital for Insurers Model Act (Volume II-312). Most U.S. insurance jurisdictions have adopted statutes, regulations or bulletins that are substantially similar to the NAIC Model Act 312. See also the excellent discussion of how the state insurance regulatory risk-based capital framework specifically accounts for the same asset-specific risks identified in NPR 1 and NPR 2 in the comment letter submitted by the American Council of Life Insurers.

⁶ NAIC Risk-Based Capital General Overview, July 15, 2009, at http://www.naic.org/documents/committees_e_capad_RBCoverview.pdf.

capability and by serving as a significant source of strength to its insured depository institution subsidiaries.

Subjecting insurance-related assets to an insurance-centric capital rule and subjecting all other assets of the SLHC to a bank-centric capital rule is a simple and prudent approach to management and control of all risks inherent in an Insurance SLHC. Insurance underwriting necessitates significant investments in debt and equity securities and other assets that generally have longer average maturities or durations than investments in a depository institution liquidity portfolio. Using the deconsolidation approach, investments in these assets classes for insurance underwriting purposes would be subject to appropriate insurance capital standards and be excluded from the capital standards in the Proposed Rule that are not designed to measure or address insurance underwriting risks.

We believe Congress's adoption of the insurance company exception to the Volcker Rule's prohibition on proprietary trading effectively required separation of insurance and banking investments for purposes of applying the Volcker Rule and supports the argument that deconsolidation of insurance assets is appropriate. The exception recognizes that the ability to make certain investments (that are generally prohibited for banks) must be preserved for insurers because those investments are essential to the safe and effective operation of an insurance business.⁷ In the Volcker Rule context, we are not aware of concerns indicating that regulatory arbitrage may result from the insurance company exception. We submit that the same reasoning applies to the deconsolidation of insurance assets, and it will not result in regulatory arbitrage.

3. The insurance-based capital requirements reflect the consolidated enterprise.

The Board has stated that the capital requirements imposed by a functional regulator at the subsidiary level reflect the capital needs at the particular subsidiary and that the consolidated measure of minimum capital requirements should reflect the consolidated organization. This is not the case for a reciprocal (like USAA) or mutual insurance company that is an Insurance SLHC. In USAA's structure, the ultimate parent company within the Insurance SLHC is an insurance underwriter, and the capital requirements imposed by the functional regulator reflect the consolidated organization. Thus, at a minimum, the Board's rationale for rejecting deconsolidation does not apply when the Insurance SLHC is itself an operating insurance underwriter.

Moreover, deduction and deconsolidation is the right approach because it allows the Agencies to appropriately coordinate with state functional regulators.⁸ Dodd-Frank requires the use of

⁷ Acknowledging the nature of insurance underwriting, Congress excluded from the Volcker Rule's prohibition those investments that are "for the general account" of an insurer, provided those investments are permitted by applicable state insurance law.

⁸ See Section 604(g) of Dodd-Frank stating that the Agencies must use:

- “(i) reports and other supervisory information that the savings and loan holding company or any subsidiary thereof has been required to provide to other Federal or State regulatory agencies;
- “(ii) externally audited financial statements of the savings and loan holding company or subsidiary;
- “(iii) information that is otherwise available from Federal or State regulatory agencies; and
- “(iv) information that is otherwise required to be reported publicly.

supervisory information and coordination with state regulators, thereby recognizing and supporting state authority and rulemaking when applying consolidated capital requirements to an Insurance SLHC. The Agencies should deconsolidate insurance underwriting assets in an Insurance SLHC when determining consolidated banking capital requirements in recognition of the responsibility of state insurance regulators to impose meaningful capital requirements on the consolidated Insurance SLHC.

With respect to an Insurance SLHC, deduction of the minimum regulatory capital requirement of insurance underwriting entities ("200 percent of the subsidiary's Authorized Control Level as established by the appropriate state regulator of the insurance company") must be accompanied by a corresponding deduction of the assets of the insurance underwriting entities that are used to establish that minimum insurance regulatory capital requirement.

C. If the full deduction and deconsolidation approach is not adopted, give an Insurance SLHC the option to deconsolidate insurance underwriting assets provided it deducts an amount of capital equal to a greater percentage of Authorized Control Level.

If the full deduction and deconsolidation approach is not adopted, the Agencies should give an Insurance SLHC the option to deconsolidate its consolidated insurance assets when determining consolidated regulatory capital requirements under the Proposed Rules provided it deducts a greater amount of insurance underwriting subsidiary capital than is stated in the Proposed Rules (*e.g.*, 300% of ACL).

D. Avoid Double Implementation of Basel I and Basel III for SLHCs.

The Proposed Rules provide for a phase-in of Basel III for BHCs by allowing BHCs to calculate risk-weighted assets using methodologies in Basel I. However, USAA, as an insurer and SLHC, has never been required to comply with Basel I risk-based capital rules. As a result, application on January 1, 2013 of the new Basel III capital standards outlined in NPR 1 results in a costly, complex two-step implementation process that unfairly burdens SLHCs like USAA.

These requirements would force USAA to implement current Basel I capital rules, which will require USAA to design systems to accurately risk-weight total consolidated assets according to the "current" rules, and to simultaneously develop new technologies and new monitoring and reporting systems, processes, and strategies in order to be prepared to implement the new risk-weighting rules under NPR 2 by 2015.

This implementation schedule imposes unnecessary and burdensome costs on Insurance SLHCs. Moreover, these standards are not necessary since these companies already meet rigorous, risk-based capital requirements imposed by state insurance regulators.

See also Dodd-Frank Section 604(h)(2) (stating that the Board should coordinate with other regulators); and *see* Board of Governors of the Federal Reserve System, Division of Banking Supervision and regulation, Division of Consumer and Community Affairs, SR 08-9 / CA 08-12, dated October 16, 2008 (SR 08-9 "reiterates the importance of coordination with, and reliance on, the work of other relevant primary supervisors and functional regulators").

By, in effect, requiring SLHCs like USAA to manage to two sets of new rules by 2015, the Agencies are imposing unfair burden on those SLHCs and providing an advantage to BHCs that are already managing capital and risk in accordance with Basel I. Moreover, USAA and other Insurance SLHCs are currently burdened with a variety of other new regulatory requirements associated with Dodd-Frank, such as regulatory reporting to the Board, stress testing and capital plans, none of which are new for BHCs. This double implementation process is an additional, unnecessary burden to place on SLHCs.

We respectfully request that the Agencies clarify that if an SLHC is not currently using Basel I, it does not need to implement the risk-based capital requirements using Basel I by January 1, 2013. Instead, these SLHCs should comply with Basel III by the 2015 deadline only. This timeline is supported by Congress in the Collins Amendment, Section 171(b)(4)(D) of Dodd-Frank, which provides that SLHCs have until 2015 to implement Basel III.

E. Provide Risk-Weighting Relief for Asset-Backed Securities and Equities.

As discussed above, USAA is a diversified financial services institution. It is our mission to provide a *full range* of highly competitive financial products and services to members of the U.S. military community. Military families have unique financial services needs because they face deployment, overseas assignments and frequent duty station changes. As a result, servicemembers often use overseas banking, remote (online or mobile) banking, wire transfers and foreign automobile and renters insurance. Families frequently moving across state lines need auto title changes, new insurance policies, and easy access to banking services. Active duty servicemembers in combat situations or with war-related disabilities have specialized life insurance needs. USAA is one of the few providers of these specialized services. USAA strives to provide insurance, banking and other financial services in a seamless and dependable manner during all the events in our members' lives.

USAA has grown deliberately by developing products based on the needs of our members. Our diversification across banking, personal lines insurance, life insurance, brokerage, mutual funds and retirement services has allowed USAA to flourish throughout numerous financial and nonfinancial crises and to meet or exceed applicable regulatory requirements. Our experience is that strong insurance operations positively impact the financial strength of the SLHC and the depository institution it supports.

The Proposed Rules, however, could hinder USAA's efforts and ability to competitively provide a full range of products – to maintain this diversification and fulfill these unique needs of the military community. This is particularly true of USAA Life Company. As a result, and in addition to the changes to the Proposed Rule discussed previously in this letter, we urge the Agencies to make certain changes to specific asset risk-weightings in the Proposed Rules. We believe the following three adjustments to the risk-weightings of assets will help account for the investment needs of insurers and thereby better serve our military constituents:

- 1. The Supervisory Simplified Formula Approach (SSFA) and gross up risk-weight method (Gross Up Method) are overly complex and unnecessarily difficult to implement.*

The processes supporting the SSFA and Gross-Up Method are complicated, time-intensive and overly dependent upon vital information from third parties to determine accurate risk-weightings for securitization exposures. In order to make correct calculations under these approaches, banking organizations will need very specific and detailed information from issuers, servicer/trustee reports or other third party providers (e.g., Intex, Bloomberg), who generally do not provide the necessary information. This reliance is problematic in that collateral performance may not be available for all securitization exposures (e.g., foreign securitizations), and there are inconsistencies across the industry with respect to the standards and definitions used to make those calculations (e.g., there is no industry standard for reporting CUSIP level information and the term “default” is not clearly defined). These complicated approaches will place SLHCs and other banking organizations at risk for inaccuracies or inconsistencies, and will require additional, comprehensive steps to audit data providers to ensure that reporting is verified and reliable.

Other requirements under the SSFA and Gross-Up Method are also extremely onerous for Insurance SLHCs. For example, the requirement to model CUSIP level investments as well as mutual fund look-through risk weights adds a substantial burden to insurance companies that hold these investments and does not add value in quantifying risk exposure. Moreover, the Proposed Rules make forecasting future risk-weighting of assets very difficult, if not impossible, because such forecasting requires: (i) anticipating the composition of forecasted portfolios at the CUSIP level and (ii) predicting deal and collateral specific performance. The dependability of underlying forecasting assumptions can be suspect. For example, in 2006 it is improbable that any banking organization would have forecasted declining residential mortgage backed securities performance using the SSFA approach. Therefore, this particular risk-weighted asset approach would not have indicated a need to increase capital levels to address a looming credit crisis. The capital conservation buffer included in NPR 1 is a more appropriate and effective way to address the need to hold more capital to prepare for times of financial stress.

2. Risk-weights and risk exposure are inconsistent across asset classes.

Under the Proposed Rules, the risk-weightings for corporate bonds and equity exposure are 100% and 300%, respectively. For certain securitization exposures, depending on the methodology, the risk-weighting could exceed 1250%. These weightings are unrealistic and onerous, especially to insurance companies that invest heavily in these long-term assets. Moreover, this risk-weighting does not correspond to the actual risk the product presents to an investor (as opposed to an issuer). Asset-backed securities are collateralized, contain diverse and numerous underlying assets, and are structured to expose the investor to less risk.

Additionally, insurers often invest in student-loan backed ABS where up to 98% of collateral performance is guaranteed by the U.S. government. The SSFA and the Gross-Up Method do not give credit to this guarantee. The ABS is modeled through traditional risk weightings, which may result in a risk weight of 1250% under SSFA and over 1250% risk weight under the Gross-Up method. We suggest the Agencies forego the SSFA or Gross-Up Method when there is underlying collateral or a government guarantee and instead rely on the standard risk-weight for agency or GSE securitization exposures.

3. Risk weightings for certain asset classes increase insurance risk.

ABS and equities are important investments for insurance companies. ABS investments match appropriately with long-term insurance risks by providing long-term, stable income. Equities provide diversity and growth opportunities.

The higher risk weighting of these certain long-term investment assets (up to 1250% for ABS and 600% for equities) will make them less attractive for insurers to hold. In other words, subjecting insurers to bank-centric capital standards, which generally encourage relatively short-term investments for bank liquidity purposes, could prompt insurers to decrease their investments in longer term assets. Decreasing longer term investments will negatively impact users of insurance and retirement products. The Agencies should ensure that the Proposed Rules do not inadvertently encourage investment behaviors that may increase insurance product risks. An insurer must have the ability to manage an investment portfolio composed of short and long-term investments designed to provide resources for the payment of all types of claims (e.g., property damage resulting from a minor automobile accident; complete and catastrophic loss of a home and other property in a major weather event; a death that triggers payout on a life insurance policy). Placing massive risk weights on long-term investments would seriously hinder the management of insurance portfolios.

F. Conclusion

The Proposed Rules are overly burdensome because the Agencies appear to have taken a one-size-fits-all approach to measuring risk exposure and the correlating risk-based capital requirements. In their present form, the Proposed Rules are likely to incent investment management practices that would hinder the management of risk in insurance underwriting.

USAA is concerned that the proposed capital rules are not fully aligned with each other, and will create an inefficient capital burden on the banking and insurance industries. For example, the purpose of conservation capital in the Proposed Rules is to ensure that banking organizations build up capital buffers that can be drawn down as losses are incurred. Meanwhile, SSFA will result in higher risk-weightings of assets in times of stress, exacerbating banking organizations' capital sustainability and adequacy.

Insurance companies provide a significant source of long-term stable funding for the corporate, real estate, and governmental sectors. The overall impact of the potential capital inefficiencies created by the Proposed Rules will, inevitably, be passed through to various stakeholders including but not limited to, employees, the debt and equity markets, consumers, policyholders, depositors and ultimately the U.S. economy.

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We appreciate the important role the Agencies play in providing for the safe and sound operation of the banking system in the U.S. We are confident that this objective can be met by allowing historically safe and sound institutions like USAA to continue providing a diversified, full range of financial services and products to customers at competitive prices. We also appreciate the

October 22, 2012

Page 10

Agencies' consideration of our comments. Should you have any questions or wish further clarification or discussion of our points, please contact Kristine Thomas, Vice President, Corporate Regulatory Counsel, at 210-498-0686.

Sincerely,

A handwritten signature in blue ink, appearing to read "Steven Alan Bennett". The signature is stylized with a large, looped "S" and a long horizontal stroke at the end.

Steven Alan Bennett
Executive Vice President
General Counsel & Corporate Secretary