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VIA ELECTRONIC TRANSMISSION
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July 22, 2016

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

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F St., NE
Washington, DC 20549

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Incentive-Based Compensation Arrangements (FRB Docket No. 1536 and RIN No. 7100 AE-50; OCC Docket ID OCC-2011-0001; SEC File No. S7-07-16; and FDIC RIN 3064-AD86)

Dear Sirs or Madams:

On behalf of Nationwide Mutual Insurance Company ("Nationwide Mutual") and its affiliated companies, we appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System ("Board"), the Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation ("FDIC") and the Securities and Exchange Commission ("SEC") (collectively, the "Agencies") on their proposed rules on incentive-based compensation arrangements (the "Proposed Rules") implementing Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1]

[1] 81 Fed. Reg. 37670 (June 10, 2016).

For reasons discussed below, we believe insurance savings and loan holding companies ("ISLHCs") should be excluded from the scope and application of the Proposed Rules.[2] Alternatively, we believe that, at a minimum, any assets related to insurance company operations should be excluded from the calculation of "average total consolidated assets" for purposes of determining an institution's "level" under the Proposed Rules. We believe that the foregoing approaches will help to ensure both an appropriate cost-benefit result and competitive compensation practices within the insurance industry, the primary industry of ISLHCs. In addition, we believe that any application of the Proposed Rules to Nationwide Mutual's savings association or any other covered institution subsidiary must be based solely on the asset size of these subsidiaries and not on the total consolidated assets of the top-tier holding company.

Background of Nationwide

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

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

By virtue of their ownership of Nationwide Bank, Nationwide Mutual and Nationwide Financial are registered as savings and loan holding companies ("SLHCs") pursuant to Section 10 of the Home Owners' Loan Act of 1933 ("HOLA"). As of December 31, 2015, the Nationwide enterprise had approximately $197 billion in total consolidated assets, while Nationwide Bank had approximately $6.4 billion in assets.

We respectfully request that the Board consider our comments bearing in mind the following key facts: First, Nationwide Mutual, the top-tier SLHC of Nationwide Bank, is an operating mutual insurance company and lead entity of the Nationwide enterprise. Second, Nationwide Bank represents roughly 3% percent of the total assets of the Nationwide enterprise.

[2] The Board has previously defined ISLHC to mean (i) a top-tier savings and loan holding company that is an insurance underwriting company, and (ii) a top-tier savings and loan holding company that holds 25% or more of its total consolidated assets in subsidiaries that are insurance underwriting companies (other than assets associated for insurance for credit risk). *See* 12 CFR § 217.2.

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Executive Summary

Nationwide Mutual supports properly structured incentive-based compensation programs as an effective tool for attracting and retaining skilled staff, while at the same time promoting the financial health of the institution by aligning the incentives of staff and other stakeholders and discouraging inappropriate risk-taking. In furtherance of these goals, we are generally supportive of the Board's use of principles-based guidance in its supervision of incentive-based compensation programs. Principles-based supervisory guidance can be appropriately tailored to an individual institution based on its size, complexity, risk profile and scope of operations.

On the other hand, Nationwide Mutual believes that it would be inappropriate to apply the Proposed Rules and the prescriptive, enhanced standards designed for Level 1 and Level 2 institutions (the "Enhanced Standards") to ISLHCs, which the Board has properly recognized "generally are less complex, less international and not systemically important."[3] For this reason, we believe the Board should exclude ISLHCs from the scope and application of the Proposed Rules. In the alternative, we believe that, at a minimum, any assets related to insurance company operations should be excluded from the calculation of "average total consolidated assets" for purposes of determining an institution's "level" under the Proposed Rules. The following reasoning supports Nationwide Mutual's view:

- The Enhanced Standards in the Proposed Rules are clearly designed to serve as enhanced prudential standards that are intended to guard against risks to the financial stability of the U.S., similar to the Dodd-Frank Act's Section 165 standards. Therefore, such standards should be reserved for those banking institutions that present a risk to the stability of the U.S. financial system. They should not apply to ISLHCs, which the Board has recognized are not systemically important.

- The Proposed Rules appear to be developed based solely on the Board's experience supervising large, systemically risky banking institutions. The Proposed Rules do not include any discussion or consideration of the appropriateness or the impact of applying the rules to insurance companies.

- Because the Enhanced Standards would apply only to a small number of ISLHCs and not to all insurance companies, application of these requirements to ISLHCs would place them at a significant competitive disadvantage in attracting and retaining high performing executives and key employees. This could result in a weakening of the ISLHC's senior management and other staff, which could negatively impact overall risk management and safety and soundness.

- Any safety and soundness benefit in applying the Enhanced Standards to ISLHCs is significantly outweighed by the regulatory compliance costs that these institutions would incur as a result of having to reform their incentive-based compensation programs to come into compliance with the prescriptive Enhanced Standards. From a safety and

[3] Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 Fed. Reg. 38634 (June 14, 2016).

soundness perspective, it would be more appropriate for the Board to utilize principles-based supervisory guidance, which can be appropriately tailored for ISLHCs based on their size, complexity, risk profile, and scope of operations.

- Congress did not intend for the Board and other banking agencies to apply and enforce Section 956 and the Proposed Rules against functionally regulated insurance companies.

For the above reasons, Nationwide Mutual strongly believes that the Board's Proposed Rules, and the Enhanced Standards contained therein, should not be extended to ISLHCs. Alternatively, we believe that, at a minimum, any assets related to insurance company operations should be excluded from the calculation of "average total consolidated assets" for purposes of determining an institutions "level" under the Proposed Rules. The foregoing approaches would prevent an ISLHC from being subject to the prescriptive Enhanced Standards because of substantial insurance activities, which do not contribute to systemic risk. Furthermore, it would alleviate the potential anti-competitive impacts and disproportionate regulatory compliance burdens, as noted above, and be consistent with Congressional intent in enacting Section 956.

Our suggested approach would preserve the Board's and the other Agencies' ability to apply the general prohibitions and restrictions applicable to all institutions (the "Baseline Standards") to an ISLHC's savings association, investment advisors and broker-dealers with over $1 billion in total consolidated assets. However, we strongly believe that the application of the Proposed Rules to these institutions must be based solely on the asset size of these individual subsidiaries and not on the total consolidated assets of the top-tier holding company.

In addition, under our suggested approach the Board could utilize principles-based supervisory guidance to assess any safety and soundness concerns posed by ISLHCs incentive-based compensation practices. ISLHCs could utilize this guidance to appropriately tailor their incentive-based compensation programs in consideration of their size, complexity, risk profile and scope of operations.

Provided below is a detailed discussion of Nationwide Mutual's rationale for excluding ISLHCs from the application of the Proposed Rules and the prescriptive Enhanced Standards, and an explanation as to how the Board can still achieve its safety and soundness objectives without the need to subject ISLHCs to rules-based standards that were clearly intended for systemically risky firms.

Discussion

I. The Enhanced Standards in the Proposed Rules operate similarly to the Board's Section 165 enhanced prudential standards and, therefore, their application should be limited to systemically important banking institutions.

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The Enhanced Standards in the Proposed Rules are similar in spirit to the Dodd-Frank Act's Section 165 enhanced prudential standards ("EPS"), which are designed to prevent or mitigate risks to the financial stability of the U.S. that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions.[4] Similar to the EPS, the Enhanced Standards were designed for complex institutions that are interconnected with the greater financial system and whose excessive risk-taking could precipitate the failure of the institution, thereby posing financial stability risk to the U.S. Nationwide Mutual believes that the Enhanced Standards, and the significant compliance burden associated with these standards, should be reserved only for those banking institutions that present a risk to the stability of the U.S. financial system. As a result, it would not be appropriate to extend such standards to ISLHCs, which the Board has appropriately recognized do not present financial stability risk and are not systemically important.[5] As the safety and soundness regulator of ISLHCs, the Board would be better served by utilizing principles-based guidance in its supervision of these institutions. Principles-based supervisory guidance could effectively be tailored to the complexity, risk profile, size and scope of operations of these institutions.

As stated in the Preamble, "[l]arger financial institutions in particular are interconnected with one another and with many other companies and markets, which can mean that any negative impact from inappropriate risk-taking can have broader consequences. The risk of these negative externalities may not be fully taken into account in incentive-based compensation arrangements, even arrangements that otherwise align the interests of shareholders and other stakeholders with those of executives and employees."[6] The Preamble goes on to provide that "[w]ithout restrictions on incentive-based compensation arrangements, covered institutions may engage in more risk-taking that is optimal from a societal perspective, suggesting that regulatory measures may be required to cut back on the risk-taking incentivized by such arrangements."[7] The foregoing passages suggest that supervised institutions may have incentive-based compensation arrangements that properly align risk-taking incentives, but certain institutions, due to their complexity and interconnectedness with the greater financial system, warrant the application of enhanced, rules-based standards for societal reasons; namely, in order to guard against financial stability risk. Thus, it follows that those institutions that are not systemically risky and not highly interconnected with the global financial system should not be subject to rules-based enhanced standards. For these institutions, the Board should be able to rely on principles-based supervisory guidance that can be appropriately tailored to the institution being supervised.

Of note, the asset size thresholds for Level 1 and Level 2 institutions set forth in the Proposed Rules are the same thresholds that are utilized to determine whether a bank holding company is subject to the Section 165 EPS (i.e., $50 billion or more in total consolidated assets), and which bank holding companies should be subject to certain more stringent prudential banking standards (i.e., $250 billion or more in total consolidated assets for Level 1

[4] 12 U.S.C. § 5365.
[5] Speech from Governor Tarullo at the National Association of Insurance Commissioners International Insurance Forum, Washington, D.C. (May 20, 2016) http://www.federalreserve.gov/newsevents/speech/tarullo20160520a.htm
[6] 81 Fed. Reg. at 37674.
[7] Id. at 37675.

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institutions).[8] These asset size thresholds further suggest that the Board and other agencies view these standards similar to standards that are appropriate for systemically important banks that warrant heightened supervisory attention.

Importantly, Congress did not subject SLHCs with over $50 billion in assets to the Section 165 EPS in recognition of the fact that these institutions are very diverse in their operations (e.g., insurance-focused, commercial-focused, etc.) and they often have relatively small banking operations. By basing the application of the Enhanced Standards solely on "average total consolidated asset size", it will effectively result in an ISLHC with insurance assets that exceed $50 billion and with a relatively small depository institution being treated in the same manner as a systemically important bank holding company. This is the case even if the ISLHC's activities do not present any risk to the stability of the U.S. financial system. As has been recognized on numerous occasions by various scholars and studies, traditional insurance activities are not systemically risky. Therefore, it would not be appropriate for insurance activities to contribute to a decision to apply the prescriptive Enhanced Standards to ISLHCs when such standards are intended to guard against financial stability risks that are not presented by these institutions.

The Preamble also indicates that the requirements of the Proposed Rules are tailored to reflect the size and complexity of each of the three levels of covered institutions, with Level 1 being subject to the most rigorous requirements. However, there does not appear to be any meaningful difference in rigor between the requirements applied to Level 1 and Level 2 institutions. As compared to Level 2 institutions, Level 1 institutions are only required to defer an additional 10% of incentive-based compensation for their senior executive officers and significant risk takers, and for an additional one-year deferral period for both short-term and long-term incentive-based compensation plans. In addition, Level 1 institutions will need to include the top 5% of highest-compensated employees as "significant risk takers" under the Proposed Rules "relative compensation test", as compared to 2% for Level 2 institutions.

On the other hand, both Level 1 and Level 2 institutions will be subject to the same significant regulatory compliance costs of having to reform their incentive-based compensation programs; identify a relatively large population of "significant risk takers"; conduct regular downward adjustment and forfeiture reviews and document all associated decision-making; establish an independent risk management framework and compliance program; and complete annual written assessments on the effectiveness and compliance of the incentive-based compensation programs from management and either the independent risk management function or internal audit.

The relatively minor differences described above do not appear to reflect any meaningful tailoring of the requirements between Level 1 and Level 2 institutions, let alone between systemically important banks and ISLHCs that control relatively small depository institutions. In a recent speech at the National Association of Insurance Commissioner's International Forum, Governor Tarullo noted, "[i]t is important that financial regulation be tiered so as to regulate for the kinds of risks various groups of financial institutions actually pose, rather than to regulate in

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[8] *See e.g.,* Risk Weighted Assets – Internal Ratings-Based and Advanced Measurement Approaches, 12 CFR § 217.100 et seq.; Liquidity Risk Measurement Standards (Regulation WW), 12 CFR part 249.

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a monolithic fashion."[9] Here, if the Proposed Rules are adopted as currently proposed, then a $50 billion ISLHC with a relatively small bank would be faced with nearly the same incentive-based compensations restrictions and regulatory compliance expectations under the prescriptive Enhanced Standards as a $2.4 trillion global systemically important bank that is nearly 50 times its size.

Additionally, a number of ISLHCs are grandfathered unitary SLHCs under the HOLA and, as such, they are exempt from limitations on their ability to engage in non-financial activities.[10] For example, Nationwide Mutual is the ultimate controlling parent of Nationwide Realty Investors (NRI), a commercial real estate development firm with slightly over $1 billion in assets. Despite the fact that NRI is **not** engaged in activities that are financial in nature, it would be treated as a Level 2 institution and be subjected to the Board's prescriptive Enhanced Standards if the rules adopted as proposed. Clearly, the Board could not have intended that a commercial real estate development firm with slightly more than $1 billion in assets would be subject to the same prescriptive rules as a $249 billion dollar banking institution.

In their current form, the application of the Proposed Rules to ISLHCs and their subsidiaries is exactly the type of monolithic regulation Governor Tarullo told insurance regulators he was seeking to avoid, rather than financial regulation that is tiered and properly tailored to the risks actually posed by ISLHCs. For these reasons, Nationwide Mutual believes that it would be inappropriate to apply the prescriptive Enhanced Standards, which operate similar to the Section 165 EPS, to those ISLHCs that the Board has appropriately recognized do not pose a risk to the stability of the U.S. financial system.

II. The Proposed Rules appear to be developed based solely on the Board's experience supervising large, systemically risky banking institutions, and do not include any discussion or consideration of the appropriateness or the impact of applying the rules to insurance companies.

As is evident from the Preamble, the Proposed Rules and the Enhanced Standards contained therein appear to be based solely on the Board's and other banking agencies' understanding of existing practices at banking organizations and their collective experiences supervising these institutions. However, the Preamble does not cite any instances where the Board or other banking agencies considered existing practices of insurance companies, how the Proposed Rules would capture executives or "risk takers" within an insurance organization, how insurance risks manifest themselves over time, and how mandatory deferral amounts and periods would be effective in managing these risks.

As support for the design of the Proposed Rules and the Enhanced Standards, the Preamble cites the following examples, studies and standards:

[9] Governor Tarullo, *supra* note 6.
[10] 12 U.S.C. § 1467a(c)(3) and (c)(9)(C).

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- Loan officers and mortgage brokers at Washington Mutual who were compensated based on loan volume, not on the quality of their loans, and who were paid more for issuing higher risk loans.[11]

- A 2009 survey of banking organizations by the Institute of International Finance in which 98% of respondents recognized the contribution of incentive-based compensation practices to the financial crisis.[12]

- An ongoing multidisciplinary, horizontal review of incentive-based compensation practices at 25 large, complex banking organizations that began in 2009 and is focused on reviewing lines of business operations in the areas of trading, mortgage, credit card, and commercial lending operations.[13] The Preamble notes how the Federal banking agencies experience in this area is also relevant to incentive-based compensation practices at broker-dealers and investment advisers; however, it makes no mention of insurance companies.[14]

- The Board's supervisory oversight, which focuses most intensively on large banking organizations due to the risk that flawed approaches at these organizations is more likely to have adverse effects on the broader financial system.[15]

- The Board's engagement at the Financial Stability Board and Basel Committee on Banking Supervision developing principles on international compensation, governance and conduct that have produced a variety of publications aimed at further improving incentive-based compensation practices.[16]

- A 2011 Board White Paper providing examples of how compensation practices have evolved at institutions involved in the Board's horizontal review since the financial crisis.[17]

- Incentive compensation standards imposed under the Emergency Economic Stabilization Act of 2008 (as amended by section 7001 of the American Recovery and Reinvestment Act of 2009) for recipients of financial assistance under the Troubled Asset Relief Program ("TARP"), 99% of which were either banks, financial services companies, government-sponsored enterprises, investment funds, mortgage servicers,

[11] 81 Fed. Reg. at 37674.
[12] Id.
[13] Id. at 37675. These financial institutions include: Ally Financial Inc.; American Express Company; Bank of America Corporation; the Bank of New York Mellon Corporation; Capital One Financial Corporation; Citigroup Inc.; Discover Financial Services; The Goldman Sachs Group, Inc.; JP Morgan Chase & Co.; Morgan Stanley; Northern Trust Corporation; The PNC Financial Services Group, Inc.; State Street Corporation; SunTrust Banks, Inc.; U.S. Bancorp; and Wells Fargo & Company; and the U.S. operations of Barclays plc, BNP Paribas, Credit Suisse Group AG, Deutsche Bank AG, HSBC Holding plc, Royal Bank of Canada, The Royal Bank of Scotland Group plc, Societe Generale, and UBS AG.
[14] Id.
[15] Id.
[16] Id.
[17] Id.

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or state housing organizations. Neither Nationwide Mutual nor any of the other ISLHCs took TARP funds.[18]

- Examples of traders with large position limits, underwriters, and loan officers as non-executive personnel who have the ability to expose an institution to material amounts of risk.[19]

The above supporting examples demonstrate that the Board's Proposed Rules and Enhanced Standards were developed based on its experience supervising large banking organizations with little to no consideration of the appropriateness of applying such standards to insurance companies. In fact, the only mention of the term "insurance" can be found in the sections on "International Developments", where the Proposed Rules indicate that regulators in Canada, Australia, and Switzerland have taken a guidance-based approach to the supervision and regulation of incentive-based compensation, or an approach that combines guidance and regulation, and these countries have applied such guidance to banks and large insurance companies.[20]

Both Congress and the Board have recognized the need to make sensible adjustments to laws, regulations and supervisory guidance in order to appropriately reflect the distinguishing characteristics of ISLHCs. This was evident in Congress' unanimous vote to enact the Insurance Capital Standards Clarification of Act of 2014, which provided the Board with authority to establish consolidated capital requirements for insurance companies that are distinct from the requirements applied to banks.[21] The Board recently issued an Advanced Notice of Proposed Rulemaking on capital standards for insurers that intends to treat insurance company operations separately and distinctly from banking operations.[22] Moreover, the need to make sensible adjustments for insurers was evident in the decision of Congress and the Board to exclude insurance company assets from the restrictions of the Volcker Rule.[23] Furthermore, the Board has stated in supervisory guidance that it intends, to the greatest extent possible, to take into account the unique characteristics of SLHCs that are insurance companies when supervising these institutions.[24] However, the Proposed Rules do not provide any evidence that the Board has considered the unique characteristics of ISLHCs, and there is no evidence that it has made any adjustments for the insurance business model in this instance.

The failure to consider the insurance business model is further evident in certain definitions and the supporting rationale for those definitions in the Preamble. For example, the Proposed Rules define a "significant risk taker" utilizing two separate tests. Under the "relative compensation test", a person is a significant risk taker if they have received annual base salary and incentive-based compensation of which at least one-third is incentive-based and that compensation places the covered person in the top 5% for Level 1 institutions, and top 2% for

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[18] Id. at 37693; *See also* https://projects.propublica.org/bailout/list.
[19] Id. at 37674.
[20] Id. at 37678.
[21] Insurance Capital Standards Clarification Act of 2014, S. 2270, 113th Cong. (2014).
[22] *Supra* note 4.
[23] 12 U.S.C. § 1851; 12 CFR part 248.
[24] Supervision and Regulation Letter (SR) 11-11, Supervision of Savings and Loan Holding Companies, July 21, 2011. http://www.federalreserve.gov/bankinforeg/srletters/sr1111.pdf.

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Level 2 institutions, of the highest compensated covered persons in the entire consolidated organization, including affiliates.[25] The Preamble indicates that in selecting the 5% and 2% thresholds for Level 1 and Level 2 institutions, respectively, it reviewed a limited sample of banking organizations with total consolidated assets of $50 billion or more to determine what types of positions would be captured. Based on this review, "managing directors, directors, senior vice presidents, relationship and sales managers, managers, mortgage brokers, financial advisors, and product managers" were captured by the relative compensation test.[26] While some of these positions may exist at an insurance company, others do not, and without any study of the impact of the Proposed Rules on insurers, it is unclear how deep into an insurance organization this test would go and whether the positions captured would be appropriately viewed as "significant risk takers" for an insurance company.

The second test for determining whether a covered person is a "significant risk taker" looks to whether the covered person has the authority to commit or expose 0.5% or more of the capital of a covered institution (the "exposure test").[27] The exposure test relates specifically to the covered person's authority to cause the covered institution to be subject to credit risk or market risk, but does not include their ability to expose a covered institution to other types of risk that may be more difficult to measure, such as compliance risk.[28] As supporting examples, the Preamble cites individuals that serve in revenue-generating roles at banks that are not typically revenue-generating roles at insurance companies (e.g., covered persons engaged in lending or trading activities).[29] Moreover, the Preamble indicates that in developing the exposure test "the Agencies were cognizant of the significant losses caused by actions of individuals, or a trading group, at some of the largest financial institutions during and after the financial crisis."[30] This example further highlights the banking agencies use of prescriptive Enhanced Standards that are based on their experience supervising large, systemically risky banking organizations. Their decision to extend such standards to ISLHCs is further indicative of monolithic regulation as opposed to financial regulation that is tiered and properly tailored to the risks actually posed by insurers.

In the event ISLHCs are subjected to these prescriptive Enhanced Standards designed for banks, the rules are likely to be both over inclusive and under inclusive in identifying individuals that are "risk takers" within an insurance organization. Due to the uniqueness of the insurance business model, and based on the fact that ISLHCs do not pose a threat to the financial stability of the U.S., it would be more appropriate for the Board to allow ISLHCs to utilize principles-based supervisory guidance and internal risk assessments to identify those positions within their organizations that could potentially expose the institution to the risk of material financial loss. Once identified, the ISLHC's management, in coordination with the insurer's risk management function, could determine the appropriate risk-taking incentives and controls that are best suited for the insurance business model rather than relying on prescriptive Enhanced Standards that were designed for complex, systemically risky banking organizations.

[25] Proposed § 236.2(hh).
[26] 81 Fed. Reg. at 37695.
[27] Proposed § 236.2(hh).
[28] 81 Fed. Reg. at 37695.
[29] Id. at 37696.
[30] Id.

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As an example of the need for incentive-based compensation standards to be appropriately tailored for different types of institutions, the Board previously noted, "deferral . . . may not be effective in constraining the incentives of employees who may have the ability to expose the firm to long-term or 'bad tail' risks, as these risks are unlikely to be realized during a reasonable deferral period."[31] The Board further noted that, "[t]hese differences highlight the need for flexibility in approaches by financial institutions. As in many areas, one size certainly does not fit all. Indeed, there is no generally accepted view as to the optimal way to make incentive compensation arrangements appropriately risk sensitive at an individual firm or across the financial sector."[32] These statements further support Nationwide Mutual's view that the Board should not impose a prescriptive one-size-fits-all approach to ISLHCs that are not systemically risky and that have very different risk profiles from banks.

III. The Enhanced Standards would apply only to a small number of ISLHCs and not to all insurance companies, which would place these ISLHCs at a significant competitive disadvantage in their ability to attract and retain high performing executives and key employees.

Currently, the Board supervises twelve ISLHCs and only a handful of these ISLHCs would be considered Level 1 or Level 2 institutions subject to the Enhanced Standards based on their respective "average total consolidated asset" sizes. The Board has previously stated, "[S]upervisors can provide a common prudential foundation for incentive compensation arrangements across banking organizations. In this way, supervisors can help address collective action, or 'first mover,' problems that may make it difficult for individual firms to act alone in addressing misaligned incentives."[33] While such an approach may be appropriate when applied to similarly situated institutions across an industry, it is not appropriate when applied to only a handful of companies that are predominantly operating insurers with comparatively small depository institutions.

In testimony before the House Financial Services Committee, both the Board and Congress recognized that applying incentive-based compensation restrictions to a limited subset of an industry can create competitive disadvantages:

> THE CHAIRMAN: . . . So, the Board of Governors has imposed restrictions on all financial institutions that minimizes this as between – if the compensation restrictions are the same you don't get [competitive disadvantage].
>
> But also I gather – and I was gratified, frankly, that you expressed support for those elements of H.R. 4173 – I know the Federal Reserve is not for all elements of H.R. 4173, our financial regulatory bill – but that you like the notion that we apply those across-the-board so that you would not have the theoretical competitive disadvantage, if there was

[31] Testimony of Scott G. Alvarez, General Counsel before the Committee on Financial Services, U.S. House of Representatives, Washington D.C. (February 25, 2010) http://www.federalreserve.gov/newsevents/testimony/alvarez20100225a.htm.
[32] Id.
[33] Id.

> one in retention, between the institutions that you regulate and other financial institutions. Is that accurate?
>
> Mr. ALVAREZ: That's absolutely right. There is what the economists call a first-mover problem here. Many people recognize that incentive compensation structures need to be changed, that incentives are not always properly aligned – sometimes very badly misaligned. But the first person who changes to fix those policies is concerned that they are going to lose personnel to others who don't change the incentives.
>
> So, one of the things we can do – and you have helped us do – is to set a policy that broadly applies across the industry, has everyone subject to the same policies and principles, and removes that difficulty.[34]

While the potential competitive disadvantage for the banking industry arguably can be mitigated by applying the Proposed Rules across the board, this is would not be the case for the insurance industry due to the small number of ISLHCs that would be subject to the Proposed Rules and their prescriptive Enhanced Standards.

Furthermore, application of the prescriptive Enhanced Standards to only a small number of insurers that are not systemically risky could in fact reduce, rather than enhance, the safety and soundness of these institutions. Such an approach will place these institutions at a significant competitive disadvantage in their ability to attract and retain high performing executives and key employees when those individuals can otherwise accept employment with insurers not subject to the Enhanced Standards. A core component of the Board's rating system for ISLHCs is the strength of senior management. This assessment includes "management's understanding of risk inherent in the [holding company's] activities, as well as the general capabilities of management. It also includes consideration of management's ability to identify, understand, and control the risk undertaken by the institution, to hire competent staff, and to respond to changes in the institution's risk profile or innovations . . . ."[35] If ISLHCs are unable to attract or retain high performing insurance executives and key employees due to compensation standards that are not common across the industry, then the Proposed Rules have the potential to weaken their senior management in the long-term and, as a result, the safety and soundness of these institutions.

Moreover, in order to overcome this competitive disadvantage relative to other insurers, ISLHCs may need to consider offering higher levels of fixed compensation or higher levels of overall compensation. Neither the Board nor the ISLHC would find either of these outcomes desirable. Offering higher levels of fixed compensation would mean that less compensation is tied to actual performance (financial or non-financial) at these institutions, which is not a desirable risk management outcome. Likewise, higher overall levels of compensation, combined with the substantial regulatory compliance costs associated with the Proposed Rules, would result in a significant increase in human resources costs for these institutions.

On the other hand, if ISLHCs are able to structure their incentive-based compensation programs utilizing principles-based guidance that can be appropriately tailored to the insurance industry, then the Board can still ensure the safety and soundness of a regulated institution

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[34] https://www.gpo.gov/fdsys/pkg/CHRG-111hhrg56767/pdf/CHRG-111hhrg56767.pdf (pages 15-16).
[35] Supervision and Regulation Letter (SR) 04-18, Bank Holding Company Rating System, December 4, 2004. http://www.federalreserve.gov/boarddocs/srletters/2004/SR0418a1.pdf.

through properly incentivized risk-taking while maintaining the institution's ability to attract and retain high performing executives and key employees.

Furthermore, in the event the International Association of Insurance Supervisors ("IAIS") develops core principles on incentive-based compensation for insurance groups in the future, and/or if the National Association of Insurance Commissioners ("NAIC") and state departments of insurance decide to extend such standards to U.S. insurers via model laws, regulations or guidelines, then any such requirements or standards will potentially provide a common incentive-based compensation framework for insurers. Best practices on incentive-compensation practices in the insurance industry are likely to further develop over time, and ISLHCs should not be disadvantaged in their ability to leverage these best practices because they are constrained by the prescriptive Enhanced Standards designed for banks.

For these reasons the Board should exclude ISLHCs from the application of the prescriptive Enhanced Standards designed for systemically important banks. Instead, the Board should rely on principles-based supervisory guidance that can be appropriately tailored for ISLHCs to ensure their safety and soundness while preserving their ability to attract and retain high performing executives.

IV. Any safety and soundness benefit of applying the prescriptive Enhanced Standards to ISLHCs is significantly outweighed by the regulatory compliance costs that these institutions would incur as a result of having to reform their incentive-based compensation programs to come into compliance the Proposed Rules.

The prescriptive Enhanced Standards will impose a significant regulatory compliance burden on those institutions that are subject to the Proposed Rules. For this reason, any decision to apply the Enhanced Standards to any category of institutions must be made in consideration of the regulatory benefit of doing so and whether a similar, less burdensome benefit can be achieved by other means.

In a recent speech on capital rules for ISLHCs, Governor Tarullo noted that "these firms have not been designated systemically important and . . . the depository institutions they own tend to be relatively small parts of the total firm, [as a result] the compliance costs of requiring a move to some non-U.S. GAAP form of consolidated approach may well not be worth the incremental safety and soundness benefits of doing so."[36]

The same logic applies to the application of the prescriptive Enhanced Standards to ISLHCs. While a common prudential framework for incentive-based compensation may be necessary for firms that pose a risk to the financial stability of the U.S., such an approach is overly burdensome for ISLHCs that are not systemically risky. This is especially the case when the use of principles-based supervisory guidance would result in an arguably superior safety and soundness outcome because such an approach could be appropriately tailored to an ISLHC's size, complexity, risk profile, and scope of operations.

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[36] *Supra* note 6.

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V. Congress did not intend for the Board and other banking agencies to apply and enforce Section 956 against functionally regulated insurance companies.

As noted in the Preamble, the Proposed Rules implement Section 956(b) of the Dodd-Frank Act, which imposes prohibitions on compensation arrangements that provide for excessive compensation or that could lead to material financial loss to the institution. Further, Section 956(d) indicates that any guidelines and regulations issued pursuant to Section 956 shall be enforced under section 505 of the Gramm-Leach-Bliley Act ("GLBA") and a violation of Section 956 shall be treated as a violation of subtitle A of title V of such Act.[37]

Section 505 of the GLBA provides that the Board shall have enforcement authority over "***bank holding companies and their nonbank subsidiaries*** or affiliates (except broker, dealers, ***persons providing insurance***, investment companies and investment advisers)."[38] In addition, it shall be enforced "[u]nder State insurance law, in the case of any person engaged in providing insurance, by the applicable State insurance authority of the State in which the person is domiciled, subject to section 104 of [GLBA]."[39]

Here, Section 505 provides the Board with enforcement authority over bank holding companies and their nonbank subsidiaries or affiliates, but this enforcement authority does not extend to persons providing insurance. The OCC and the FDIC have similar limitations on their enforcement authority under Section 505, and they have properly recognized this limitation in their definitions of "covered institution", which are defined as follows:

> **OCC: Part 42 – Incentive-Based Compensation Arrangements**
>
> (i) *Covered Institution* means: [. . .] (2) A subsidiary of a national bank, Federal savings association, or Federal branch of a foreign bank that: (i) Is not a broker, dealer, ***person providing insurance***, or investment adviser; and (ii) has average total consolidated assets greater than or equal to $1 billion.[40]
>
> **FDIC: Part 372 – Incentive-Based Compensation Arrangements**
>
> (i) *Covered Institution* means: [. . .] (2) A subsidiary of a state nonmember bank, state savings association, or a state insured branch of a foreign bank, as such terms are defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. 1813 that: (i) Is not a broker, dealer, ***person providing insurance***, or investment adviser; and (ii) has average total consolidated assets greater than or equal to $1 billion.[41]

On the other hand, the Board does not recognize this limitation on its enforcement authority and defines a "covered institution" to mean the following:

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[37] 12 U.S.C. § 5641(d).
[38] 15 U.S.C. § 6805(a)(1)(A).
[39] 15 U.S.C. § 6805(a)(6).
[40] Proposed § 42.2(i).
[41] Proposed § 372.2(i).

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Board: Part 236 – Incentive-Based Compensation Arrangements

> (i) *Covered Institution* means a regulated institution with average total consolidated assets greater than or equal to $1 billion.
>
> [. . .]
>
> (dd) *Regulated Institution* means: [. . .] (3) A savings and loan holding company, as defined in 12 CFR 238.2(m), and a subsidiary of a savings and loan holding company that is not a depository institution, broker-dealer, or investment adviser.[42]

Of note, the Board does not exclude "persons providing insurance" in its definition of covered institutions or regulated institutions.

While the Board does have authority under Section 10(g) of HOLA to issue regulations to carry out the purposes of the Act and to require compliance therewith and prevent evasions thereof, Congress was explicit in Section 956 of the Dodd-Frank Act that it was to be enforced under Section 505 of the GLBA, which does not provide the Board with enforcement authority over persons providing insurance.[43] Moreover, Section 10(b) of HOLA provides the Board with <u>examination</u> authority over functionally regulated subsidiaries, including the authority to monitor the subsidiaries' compliance with Federal laws that the Board has specific jurisdiction to enforce against the company or subsidiary.[44] However, because the Proposed Rules are to be enforced under Section 505 of the GLBA, and because Section 956 does not provide the Board with regulatory enforcement authority over persons providing insurance, the Board would not have authority to enforce Section 956 and the Proposed Rules against functionally regulated insurance subsidiaries under HOLA.

Likewise, it is not clear that the Board would have authority to enforce the Proposed Rules against insurance companies that are themselves SLHCs. Section 505 provides the Board with enforcement authority over bank holding companies, but not SLHCs. Through enactment of the GLBA, Congress appears to have recognized that SLHCs take on a variety of structures and often have functionally regulated financial institutions as the top-tier holding company, such as an insurance company. As a result, it would not be appropriate to permit these federal banking agencies to enforce the GLBA's customer protection regulations in Title V against SLHCs that are insurance companies. Similarly, it would not be appropriate for the Board to apply and enforce Section 956's compensation restrictions against insurance companies that are functionally regulated by the state departments of insurance.

The Board previously recognized that it does not have enforcement authority under the GLBA for SLHCs and their non-bank subsidiaries. On July 22, 2011, the Board issued a notice of intent and request for comment titled "Continued Application of Regulations to Savings and Loan Holding Companies."[45] In this release, the Board states "[it] does not expect to enforce

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[42] Proposed § 236.2(i) and (dd).
[43] See 12 U.S.C. § 1467a(g).
[44] See 12 U.S.C. § 1467a(b).
[45] 76 Fed. Reg. 43953 (July 22, 2011).

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[former Office of Thrift Supervision (OTS) regulations found in] parts . . . 568, . . . 570, 571, . . . 573. ***The Board believes that these provisions only apply to the supervision of savings associations and are not applicable to SLHCs or their non-depository institutions***."[46] The former OTS regulations cited by the Board above are those regulations implementing Title V (Sections 501 to 510) of the GLBA. Therefore, the Board has previously recognized that the OTS did not have authority to issue and enforce the GLBA against insurance companies that are SLHCs and their non-depository subsidiaries that are persons providing insurance. By indicating that the Board would not enforce these provisions against SLHCs and their non-depository subsidiaries, the Board appropriately recognized that these provisions of the GLBA would be enforced by state departments of insurance for ISLHCs pursuant to regulations developed by the state departments of insurance. By requiring that the Proposed Rules be enforced under Section 505 of the GLBA, Congress is similarly recognizing that any incentive-based compensation regulations for insurance companies must be devised and enforced by the state departments of insurance and not the federal banking agencies.

VI. Nationwide Mutual's proposed approach to provide appropriate treatment for ISLHCs.

Both Congress and the Board have consistently made sensible adjustments to recognize the distinguishing characteristics of ISLHCs. The treatment of incentive-based compensation is now another place where separate treatment is warranted. We believe that the Board should exclude ISLHCs from the scope and application of the Proposed Rules. Alternatively, we believe that, at a minimum, any assets related to insurance company operations should be excluded from the calculation of "average total consolidated assets" for purposes of determining an institution's "level" under the Proposed Rules. In addition, we believe that any application of the Proposed Rules to Nationwide Mutual's savings association or any other covered institution subsidiary must be based solely on the asset size of these subsidiaries and not on the total consolidated assets of the top-tier holding company

Under the latter approach, this would require removing from the definition of "average total consolidated assets" any assets held by a top-tier ISLHC that is an insurance underwriting company and the assets held by any of its subsidiaries that are insurance underwriting companies. To illustrate, consider the example of a federal savings bank with $6 billion in average assets, a registered broker-dealer with $4 billion in average assets, and an insurance underwriting company with $8 billion in assets that are all subsidiaries of an ISLHC that is a top-tier insurance company with $55 billion in assets. If we assume that the total consolidated assets of the ISLHC is $73 billion ($6 billion + $4 billion +$8 billion + $55 billion), but the insurance assets are excluded from the calculation of average total consolidated assets, then the institution would have total consolidated assets of $10 billion, which would make it a Level 3 institution under the Proposed Rules. Likewise, the $6 billion federal savings bank and the $4 billion broker-dealer would also be treated as Level 3 institutions based on their individual asset sizes, which would be more commensurate with the size and complexity of their operations.

[46] Id.

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This approach would preserve the Board's ability to utilize principles-based supervisory guidance to understand and address any safety and soundness concerns posed by the ISLHCs incentive-based compensation practices, and these institutions could utilize this guidance to appropriately tailor their incentive-based compensation programs in consideration of their complexity, risk profile, size and scope of operations. This approach would prevent ISLHCs that are not systemically risky from being subject to prescriptive Enhanced Standards that were clearly designed for systemically risky banking organizations.

Conclusion

For the above reasons, Nationwide Mutual believes that the Board should exclude ISLHCs for the scope and application of the Proposed Rules. Alternatively, we believe that, at a minimum, any assets related to insurance company operations should be excluded from the calculation of "average total consolidated assets" for purposes of determining an institution's "level" under the Proposed Rules. We believe it is important to do so in order to ensure both an appropriate cost-benefit result and competitive compensation practices within the insurance industry, the primary industry of ISLHCs. Lastly, we believe that any application of the Proposed Rules to any other covered institution subsidiary must be based solely on the asset size of these subsidiaries and not on the total consolidated assets of the top-tier holding company.

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

Very truly yours,
NATIONWIDE MUTUAL

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