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San Antonio, Texas 78288

April 30, 2012

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Proposed Rule; Request for Public Comment; Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (Regulation YY; Docket No. 1438; RIN 7100-AD 86)

Dear Ms. Johnson:
United Services Automobile Association (USAA) is pleased to provide our comments with respect to the Board of Governors of the Federal Reserve System (the Board) Proposed Rule on Enhanced Prudential Standards and Early Remediation Requirements [1] (the Proposed Rule).

USAA is a membership-based association, which together with its family of companies, serves present and former commissioned and noncommissioned officers, enlisted personnel, retired military, 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 Federal Savings Bank (FSB), an indirect wholly owned subsidiary of USAA, is a federally chartered savings association organized to offer personal retail banking services. FSB was chartered in 1983, and is USAA's only savings association. USAA is, therefore, a grandfathered unitary savings and loan holding company.

In this letter, we urge the Board to allow flexibility for the timing of when covered institutions can perform the stress testing and limit the amount of required public disclosure. In addition, USAA is concerned with the application of enhanced prudential standards and early remediation to savings and loan holding companies (SLHCs) by future rulemaking under the Home Owners' Loan Act (HOLA) when such rulemaking is not mandated by the Dodd-Frank Act. We note that SLHCs are unique in many ways, and this uniqueness should be considered in any future regulation. We are particularly concerned with the Board's ability to influence capital distributions, specifically, "dividends" to policyholders and members under the proposed early remediation rules.

[1] Proposed Rule; Request for Public Comment; Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594 (January 5, 2012).

A. Timing of stress tests

The Proposed Rule provides that the annual stress test is to be based on data as of September 30, and requires submission of stress test results to the Board on or before January 5 of the following year. However, in explaining the Proposed Rule, the Board states that the sets of economic and financial conditions ("scenarios") to be utilized by SLHCs to perform stress testing will be provided by the Board no later than mid-November. If the scenarios are provided in November, the SLHC will have only two months to execute the stress tests, validate results, socialize with senior management and the board of directors, prepare action plans, and document the results in the required report to the Board. Requiring the testing and reporting to take place during the fourth quarter of the year also is likely to strain the resources of most institutions. Furthermore, the fourth quarter timing may render it very difficult for covered institutions to make modifications to institution strategic and operational plans for the following year that address any issues identified in the test results. We recommend that the timing for performing the stress testing and reporting results be lengthened and that covered institutions be permitted to choose when during the year they will conduct the stress testing and reporting exercise. At a minimum, the scenarios should be provided to covered institutions not later than September 30.

B. Limit public disclosure of stress test results.

The Dodd-Frank Act mandate for public disclosure of the results of annual stress tests is very general. The statute simply states that the Board may prescribe, by regulation, periodic public disclosures.[2] We believe the general and non-mandatory nature of this statutory requirement is an acknowledgment that any public disclosure of covered institution stress test results creates the potential for unintended and unwarranted loss of consumer or marketplace confidence in particular covered institutions or in the nation's financial system generally. The statute enables, but does not require specific public disclosure. The language is an acknowledgment that the Board is in the best position to prudently define the nature and extent of such disclosure. A fair interpretation of the language is that the Board publicly disclose aggregate stress testing results but not individual institution results. Such disclosure would be a prudent course for instilling public confidence rather than highlighting any one institution's test results, which could have unintended or exacerbated negative consequences.

In the alternative, if the Board does require disclosure of individual stress test results, we urge the Board to require only the level of detail absolutely necessary to further the policy purpose, as appropriate, for the public disclosure. The stress testing requirements are new and untested. At least initially, we expect that the Board and SLHCs will engage in an iterative process of performing the stress testing exercise, reviewing the test results, adjusting the testing methodologies and retesting so that accurate and meaningful test results are produced. The Board and all covered institutions also will need to ensure the methodologies and practices used to conduct the stress tests are consistent so that even when general information about the stress test results is published by the covered institution, that information is comparable to stress test results information published by other covered institutions. Thus, public disclosure of such results should be very high level at the outset. With experience and, perhaps more importantly,

[2] Dodd-Frank Act Section 165(f).

general public familiarity with covered institution stress testing initiatives, the public disclosure could perhaps be prudently expanded over time.

C. Application of BHC and SIFI enhanced prudential standards and early remediation to SLHCs is inappropriate.

The Proposed Rule release indicates that the Board intends to issue a separate proposal for notice and comment to initially apply enhanced prudential standards and early remediation requirements to all SLHCs with substantial banking activity. As a savings and loan holding company, USAA has significant concerns regarding the implications of any future extension of the Proposed Rule to SLHCs.

1. The Dodd-Frank Act does not mandate enhanced prudential standards for SLHCs.

The Dodd-Frank Act Section 165(a)(1) requires the Board to apply enhanced prudential standards to (1) nonbank financial companies supervised by the Board and (2) certain bank holding companies (BHCs). The term "nonbank financial companies supervised by the Board" means those nonbank financial companies that the Financial Stability Oversight Council has determined under section 113 should be supervised by the Board[3] that are now commonly referred to as systemically significant financial institutions or SIFIs.

The Dodd-Frank Act does not mandate issuing enhanced prudential standards to any other financial companies, including SLHCs. If Congress had meant for the Board to establish a single set of enhanced standards to apply to all financial companies including SLHCs, it would not have defined a SIFI subset of financial institutions.

2. SLHCs are fundamentally different from SIFIs and BHCs.

Congress recognized that enhanced prudential standards are not appropriate for all financial companies. A grandfathered SLHC like USAA is vastly different from those large, interconnected institutions that will meet the definition of SIFI. Moreover, the business and risk profile of SLHCs is fundamentally different from that of BHCs.

USAA is both an SLHC – by virtue of being the ultimate parent of USAA FSB – and an operating property and casualty insurance company. USAA writes exclusively personal lines of property and casualty insurance, primarily automobile, homeowners, renters and personal property insurance. Generally speaking, historically USAA has earned over half of its revenue from its property and casualty operations. Therefore, although USAA meets the test for "substantial banking activity" as set forth in the Proposed Rule, USAA remains very much an insurance company.

As a savings association, USAA FSB is a retail bank and a residential home and auto lender serving our military members. Commercial banks typically extend loans to businesses as well as

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[3] Dodd-Frank Act Section 102(a)(4)(D).

consumers, which can result in risk concentrations within entities and particular industries, whereas, lending to consumers generally mitigates concentration risk.

As a personal lines insurance company and the holding company for a retail depository institution, USAA is not interconnected to the financial industry like many other banks. In fact, USAA does not meet the SIFI Stage 1 uniform quantitative thresholds established by the FSOC and therefore is not likely to be designated as systemically significant.[4]

We appreciate that the Board is tasked with ensuring the safety and soundness of financial institutions. However, USAA is not systemically interconnected to the banking system in the same way as those companies meeting the definition of SIFI and is not subject to the same capital and liquidity risks as large BHCs. Therefore, because we do not present the same risks as BHCs and SIFIs, applying the same set of enhanced prudential standards is not particularly valuable and would be unduly burdensome.

D. Consider the unique aspects of SLHCs and insurers.

USAA believes we are in a unique situation in the financial industry by being both an insurer and parent to a depository institution. Our mission is to be the financial services provider of choice for the military community. Therefore, it is fundamental that we offer a spectrum of insurance, banking and other financial services products to our members. Military servicemembers have specialized needs, and we believe having one financial institution to respond to those needs is invaluable.

Although we believe SLHCs should not be subject to enhanced prudential standards, if the Board uses HOLA to implement enhanced prudential standards on SLHCs, it is important that the Board consider certain unique aspects of insurer SLHCs. Particularly, we urge the Board to take into account the unique business, risk and liquidity profiles of insurer SLHCs as well as their non-bank characteristics.

1. Diversified Businesses.

In contrast to most BHCs and SLHCs, unitary SLHCs operate diversified businesses outside the banking industry as permitted by HOLA. For USAA, our insurance enterprises represent a significant portion of our consolidated revenue. The same would not be true for BHCs, which operate primarily in the banking industry. Unlike banking entities, the financial strength of property and casualty insurance companies is equally, if not more so, affected by the liabilities on the balance sheet (principally related to insurance claims) and the pricing of insurance risks in the form of policyholder premiums. Risks of personal property and casualty insurers occur somewhat independently of the economic cycle and vary most significantly by geography. Bank risks are highly correlated with the economic cycle and therefore, during a crisis, there is increased insolvency risk for depository institutions with asset concentrations in affected areas. In this way, unitary SLHC's diversified businesses are a considerable benefit.

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[4] 12 C.F.R. §1310 (2012).

2. Risk and Liquidity.

All insurance companies must deal with the risk that earned and retained premiums may not cover the cost of future and potential claims. Therefore insurance companies are subject to extensive regulation. A primary goal of this regulation is to ensure that investment portfolios provide adequate diversification and liquidity to preserve capital and pay claims.

Personal line property and casualty insurers rely primarily on premiums and capital retention to support the risk presented by insurance liabilities and investment portfolios. Insurance company portfolio assets are mostly comprised of fixed income and highly marketable securities in a diversified portfolio. Typically, only a limited portion of insurance company portfolio assets are at risk at any time given the highly regulated nature of insurance company balance sheets. Property and casualty insurance companies have a lack of pro-cyclicality of capital. While some banks may build capital buffers in strong economic times to prepare for economic downturns, property and casualty insurance companies build capital in proportion to the risk that natural catastrophes may impact claims. Threats from the natural environment do not coincide with the economic cycle.

In addition, the capital framework of property and casualty insurance companies is designed to capture unique insurance, liquidity and investment risks. Insurers manage these risks by employing underwriting, pricing adjustments, catastrophe management and loss reserving. These tools enable insurance companies to manage risk exposures much more effectively than through monthly liquidity stress testing. To the extent liquidity stress testing is applied to an insurer SLHC, we suggest using an annual liquidity stress test for the insurance operations (updated for material changes such as catastrophes, reinsurance, market disruptions or underlying business changes) and overlaying that information with more frequent (e.g., monthly) bank liquidity stress tests.

3. Bank-centric Basel III metrics.

Finally, we note that the current Basel III metrics for capital and liquidity are not built for insurers. The capital requirements for sufficiency and composition are applicable to banks. The liquidity coverage ratio and net stable funding ratio requirements are structured around bank balance sheets and are not centered around an insurance company's business model nor the insurer's potential "uses" of liquidity (in a normal or stressed environment) – that is, to pay claims. Insurer SLHCs cannot rely on these bank-centric ratios without some adjustment or consideration.

E. Exempt dividends to members and policyholders from the definition of capital distributions.

If the early remediation portion of the Proposed Rule is applied to SLHCs by separate rulemaking, USAA, as an insurer, has concerns about the broad definition of capital

distributions. The definition of capital distributions in the Proposed Rule includes "any similar transaction that the Federal Reserve determines to be in substance a distribution of capital."[5]

Like many insurance companies, USAA pays "dividends" and other similar distributions to its policyholders and members. As a state-regulated insurer, USAA's payment of these distributions is subject to regulation under state laws, primarily by the Texas Department of Insurance. USAA's decision to pay dividends and other similar distributions is influenced by a number of factors including the association's financial performance, claims and catastrophe costs, the investment market and the ongoing financial strength of the association.

We are concerned that such policyholder distributions could fall within the broad language of the proposed definition of capital distributions because they are approved annually by the board of directors and funded from annual earnings and policyholder surplus. These distributions, however, are unlike stock dividends. First, these distributions are not based on ownership rights, but represent a return of insurable premiums paid by policyholders, generally rendering them tax free to the policyholder. Second, because policyholder distributions effectively decrease the cost of insurance to the consumer, these dividends impact consumer pricing and insurer competitiveness.

Insurance is a highly competitive industry and insurers compete on price. Policyholder dividends help insurance companies keep the effective cost of insurance low for customers. Insurers base premium costs on estimated expenses, including claims and catastrophe costs. If, for example, an insurer has a year with less than expected catastrophe costs that result in excess premiums, rather than keep this excess earned surplus, policyholder distributions allow the insurer to pay the excess back to its policyholders. Therefore, the curtailing of insurer SLHC distributions effectively increases the cost of insurance for consumers.

Further, policyholder distributions help maintain strong customer relations. We believe a return of premium through policyholder dividends and distributions builds goodwill and encourages our members to renew their coverage. Maintaining insurance customers not only benefits and strengthens the SLHC, but decreases costs for consumers. Keeping an existing policyholder is less costly than adding a new customer.

Finally, imposing regulations on insurer SLHC distributions, which would not apply to non-SLHC insurers, puts insurer SLHCs at a competitive disadvantage. Strong insurance operations have a positive impact on an insurer SLHC and the depository institution it supports. We therefore urge the Board to expressly exempt dividends and other distributions to members and policyholders from the broad definition of capital distributions.

F. Risk Management

USAA currently has a robust risk management process, which includes oversight by various committees of the board of directors, in particular the audit and financial committee.

[5] Enhanced Prudential Standards, 77 Fed. Reg. at 661 (defining capital distribution in Regulation YY Section 252.161(c)).

USAA believes this structure is best suited to monitor and assess enterprise-wide risks. We believe a stand-alone risk committee is not the most effective means of risk oversight, and we request that the Board give flexibility to companies to structure risk management oversight in a manner that best fits their governance, strategy and risk profiles.

G. Allow SLHCs an opportunity to comment on future proposed rulemakings.

If the Board extends the requirements of the Proposed Rule to SLHCs as suggested in the Proposed Rule Supplementary Information, we respectfully request the Board allow SLHCs and impacted entities sufficient opportunity to comment on the specific implications of such a rule.

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USAA appreciates the important role the Board plays in providing for the safe and sound operation of the banking system in the United States. We appreciate the Board's consideration of our comments and look forward to working with the Board in the future. Should you have any questions or wish further clarification or discussion of our points, please contact Michael Broker at 210-498-0029.

Sincerely,

Steven Alan Bennett
Executive Vice President
General Counsel & Corporate Secretary