5

Evans, Sandra E

From: Ardith Heuton [aheuton@iroquoisfed.com]
Sent: Monday, October 27, 2003 12:53 PM
To: Chief Counsel's Office Office of Thrift Sup
Subject: Risk-Based Capital Guidlines; Implementation of New Basel Capital Accord

Ardith Heuton
Senior Vice President
Iroquois Federal Savings & Loan Association
201 E Cherry St. P O Box 190
Watseka, IL 60970

October 27, 2003

Chief Counsel's Office Office of Thrift Sup

1700 G Street, NW
Washington, DC 20552

Dear Chief Counsel's Office Office of Thrift Sup:

Dear Sir or Madam:

Iroquios Federal Savings and Loan Association welcomes the opportunity
to
comment on the Advance Notice of Proposed Rulemaking (ANPR) addressing
the
implementation in the United States of the new Basel Capital Accord (New

Accord) being developed by the Basel Committee on Banking Supervision
(BCBS) at the Bank for International Settlements.

The New Accord would replace, for some financial institutions in the
United States, the risk-based capital requirements adopted by the BCBS
in
1988. The ANPR proposes to apply the New Accord only to banks with
total
commercial bank assets of $250 billion or more or total on-balance sheet

foreign exposure of $10 billion or more (core banks). Other
institutions
can opt in to the New Accord if they can meet all of the eligibility
standards. As a result of the planned implementation in the United
States, we would for the first time have a bifurcated regulatory capital

framework.

Iroquois Federal Savings and Loan Association agrees with the approach
of
the New Accord in trying to more closely link minimum capital
requirements
with an institution's risk profile. We believe that the new Accord may
offer some institutions the potential for increased flexibility in
determining capital levels, which could enable certain institutions to
deploy capital more efficiently. However, we are concerned about the
potential of the New Accord to create competitive inequities since only
the largest financial institutions will have the ability to adopt a more

risk-sensitive capital framework under the proposal. The New Accord could
provide significant capital savings for institutions that focus on mortgage and other retail lending. While that is our core business, the

cost and complexity of opting in to the New Accord does not make this a viable option for us or most other community banks. We could end up holding higher capital under the current capital requirements as compared
with global and potentially more risky institutions. This could make us a
takeover target for institutions that can deploy capital more efficiently
under the New Accord. Also, we may find it more difficult to compete for
quality assets and be forced to operate with less capital in order to provide more competitive pricing.

The New Accord should not be implemented in the United States until more

information is gathered about its competitive effects. It is difficult for any one institution to have the information necessary to provide detailed comments about the effects due to lack of understanding of how this complex proposal applies to any specific institution. The agencies

should undertake this review and consider alternative approaches that do

not represent such a radical departure from the existing regulatory capital framework. Supervisors can get a substantial amount of the benefits expected from the New Accord's approach with a much lower level

of complexity.

While there may be problems with the current capital requirements, it seems that those problems could be resolved in a way that is easier and less costly to implement and exposes a greater number of institutions to

more risk-sensitive capital requirements. As Federal Reserve Board Vice

Chairman Ferguson has said in testimony before Congress, "The capital requirements should be a function of risk taken, and, under Basel II, if

two banks had very similar loans, they both should have a very similar required capital charge." Vice Chairman Ferguson went on to say, "[B]anks with lower risk profiles, as a matter of sound public policy, should have lower capital than banks with higher risk profiles." (emphasis added)

We agree with the statements of Vice Chairman Ferguson. Although smaller
institutions may choose to have capital levels higher than required by regulation, that is a choice that is made and should not be used to justify leaving in place higher capital requirements on these institutions
for the same types of lending. Allowing more institutions to benefit from
more risk-sensitive capital requirements will increase the safety and soundness of the banking system by providing incentives to a greater number of institutions to improve their risk management systems.

The U.S. banking regulators should work with the industry to develop a more streamlined approach that provides the benefits and incentives of the
New Accord to all financial institutions operating in the United States.

One alternative approach to the New Accord would be to revise the current
accord to make it more risk-sensitive for all institutions, and then add

more complexity to capture any additional risk at internationally active

banks. A revised accord could include more baskets and a breakdown of particular assets into multiple baskets when taking into consideration collateral values and loan-to-value ratios. An alternative is to allow U.S. banks and savings association to adopt the standardized approach in

the New Accord. Of course, some of the problems with the standardized approach, including the operational risk charge, would have to be resolved. Also, the conditions for opting in to an internal ratings-based
approach could be made less burdensome and the approach could be simplified to make it a more viable prospect for smaller institutions. At
a minimum, the agencies could remove the requirement that an institution

adopt the internal ratings-based approach for credit risk and the advanced
measurement approach for operational risk at the same time. We strongly

urge the agencies to consider these alternatives.

Thank you for the opportunity to comment on this important matter.

Sincerely,

Ardith Heuton,Senior Vice President

Sincerely,

Ardith Heuton
Senior Vice President
Iroquois Federal Savings & Loan Association