



March 26, 2007

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

Jennifer J. Johnson, Secretary  
Board of Governors of the  
Federal Reserve System  
20th Street & Constitution Avenue, NW  
Washington, DC 20551  
Docket No. R-1261

Public Information Room  
Office of the Comptroller of the  
Currency  
250 E Street, SW  
Mailstop 1-5  
Washington, DC 20219  
Attention: Docket 06-09

Regulation Comments  
Chief Counsel's Office  
Office of Thrift Supervision  
1700 G Street, NW  
Washington, DC 20552  
Attn: No. 2006-33

RE: Risk-Based Capital Guidelines; Capital Maintenance: Domestic Capital Modifications

Dear Sir or Madam:

The Conference of State Bank Supervisors (CSBS) appreciates being made part of the process to modernize the risk-based capital rules for domestic institutions. Given significant changes in the market place and enhanced risk management tools utilized by insured financial institutions, we agree with the goal of providing a capital scheme which enhances risk sensitivity. The challenge before us is to meet this goal without exponentially increasing the burden on domestic institutions or jeopardizing the safety and soundness of the banking system. A successful domestic capital framework will not only benefit individual financial institutions which effectively utilize risk management tools, but will also benefit the banking system as a whole by improving the ability to effectively and efficiently manage capital.

State bank commissioners are pleased that the proposal does not alter the existing leverage capital requirements. We believe the current framework of requirements for both leveraged capital and risk-based capital have served the system well. Maintaining express limits for leveraged capital provides an important and fundamental measurement of capital adequacy which preserves comparability of capital levels for bank supervisors and the investing public. This is especially true with respect to the rapidly changing market place and the evolution of financial products, as new products may not always be accurately slotted in the current risk-based capital framework.

As you know, 70% of all bank charters are issued and actively supervised by state authorities. We believe in a strong supervisory role in determining capital adequacy. The proposal remains true to this principle by addressing "minimum capital." Actual capital levels are best stipulated and judged by the agency issuing the charter.

## **CONFERENCE OF STATE BANK SUPERVISORS**

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## **Response to the Advanced Notice of Proposed Rulemaking**

In January 2006, CSBS stated its support for developing a framework with enhanced risk sensitivity and the overall direction of the advanced notice of proposed rulemaking. We believe an appropriately risk sensitive framework will meet the operational needs of the institution and the supervisory needs of state and federal regulators. We advocated for maintaining the current rules for institutions which, due to their capital structure and risk profile, desire that framework. Financial institutions should be able to make this decision based on market needs or demands.

## **Assessment of the Current Proposed Rule**

State supervisors are pleased that the proposed rule allows institutions to “opt-in.” This provision will allow those institutions which do not need or require greater risk sensitivity in determining capital adequacy to avoid the burden of additional data collection and reporting.

The proposed rule is fairly limited in its scope and impact on risk-based capital calculations. Significant changes are limited to:

- Loan-to-value risk weighting for residential real estate;
- External credit ratings for assets; and
- 10% credit conversion factor on short-term commitments.

The agencies excluded several asset categories, which were included in the advanced notice, concluding any increase in risk sensitivity is outweighed by the additional burden. These asset categories include: multifamily residential mortgages, nonperforming loans, commercial real estate, and other retail exposures. In addition, several issues and questions in the ANPR remain unresolved and are repeated in the NPR. These include:

- Questions regarding the above asset categories;
- Utilizing credit worthiness and loan-to-value to risk-weight residential mortgages; and
- Possible approaches for risk-weighting small business loans.

With so many questions remaining and significant asset categories omitted from the proposed rule, we believe more outreach and study is required to more fully develop a meaningful risk-based capital rule suitable for non-Basel II banks. We do not believe the current version of the proposed rule is sufficiently risk sensitive to warrant adoption of a final rule.

## **Moving Forward**

The proposed rule asks a series of questions regarding alternatives to Basel II other than the advanced approaches. We believe the Standardized Approach to Basel II is more transparent and appears to be sufficiently risk sensitive. Offering this as an option in the United States will not only provide a possible transition opportunity for Basel II core banks, but may be a viable option for a greater number and variety of banks.

Opponents of a Standardized Approach will use the threat of an operational risk charge to rally community banks against the proposal. We believe a U.S. rule which includes the basic indicator (15% of the 3-year average gross income) will dispel the concerns over the required data collection and complexity of the Advanced Measurement Approach.

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A public dialogue on the specifics of the Standardized Approach in the Basel II Framework and potential changes for a U.S. version will help to educate policy makers, the industry, and other interested parties. CSBS would be interested in developing a model calculation for banks and supervisors to estimate potential changes in minimum required capital, as we did with the ANPR and NPR for the domestic capital modifications.

Thank you for allowing CSBS to comment on this very important interagency proposal. With the passage of the Regulatory Relief Act, the chairman of the State Liaison Committee (SLC) was made a voting member of the Federal Financial Institutions Examination Council (FFIEC). And although this NPR was developed and issued before SLC involvement, the states very much look forward to working with the federal financial agencies on future development of regulatory policy.

Best regards,

A handwritten signature in black ink that reads "Neil Milner". The signature is written in a cursive style and is positioned to the left of a vertical red line.

Neil Milner, CAE  
President & CEO

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