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Manager, Dissemination Branch
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Office of Thrift Supervision
1700 G Street, NW
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Attention: Docket No. 2000-90

Dear Sir or Madam:

Silver, Freedman and Taff, L.L.P. is pleased to comment on an advance notice of proposed rulemaking ("ANPR") issued by the Federal banking agencies ("Agencies) on adopting a simplified regulatory capital framework applicable to non-complex banks and savings associations. The firm represents financial institutions nationwide in mergers and acquisitions, mutual-to-stock conversions, charter conversions, mutual holding company formations, de novo charters and other financial transactions.

The stated purpose of the ANPR is to identify options for reducing the regulatory burden of existing capital rules for certain non-complex institutions by considering their size, structure, complexity of operations and risk profile.[1] However, the Agencies do not intend to lower capital standards or encourage a reduction in existing capital levels.

It is appropriate to view this effort relative to the proposed revisions to the existing capital standards being considered by the Basle Committee on Banking Supervision ("Basle Committee"). The proposed revisions to the 1988 Capital Accord are intended to "align regulatory capital requirements more closely with underlying risks, and to provide banks and supervisors with several

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[1] 65 Fed. Reg. 66193 (November 3, 2000).

options for the assessment of capital adequacy".[2] The Agencies acknowledge that the proposal may be applicable only to large, complex, internationally active banks.[3] The proposed "standardized approach" for measuring credit risk in the risk-based capital system places emphasis on claims on corporates, banks, sovereigns, multinational agencies, off-balance sheet items and various tranches in asset securitizations. The assessments of external rating organizations would be used to determine the specific risk weights to apply to these categories of credit risk. Institutions with more advanced risk management systems would, under rigorous supervisory standards, be permitted to use internally-generated risk ratings.

With these capital revisions under consideration, the Agencies should be concerned not merely with how to simplify the capital requirements for non-complex institutions, but also with a capital regime best suited to institutions, in general, that do not qualify for the proposed Capital Accord revisions. It is difficult to address the capital requirements for "non-complex" institutions without first considering this broader category of institutions.

It is reasonable to expect that only a small proportion of the U.S. banking industry -- money center and large regional banks -- would meet all the qualifications for the new Capital Accord. The new Accord specifies thorough criteria which an external credit assessment organization must meet to rate the various claims of banks. External rating organizations may only be capable of rating the asset claims of banks that have actively funded themselves through public debt issuances. Moreover, only the most sophisticated institutions will be capable of developing an internal credit-risk rating system that passes regulatory agency scrutiny.

The vast majority institutions that do not meet the qualifications for the Basle Committee capital revisions should still expect the Agencies to achieve the same goals -- to better align the capital requirements with underlying risks. The best opportunities exist for select consumer loans, mortgage loans, and small business loans. Institutions with high asset concentrations in these loan categories should also meet the criteria for non-complex institutions, which will be discussed later.

Notwithstanding aspects of the proposed revised Capital Accord that would not apply to most U.S. banks and savings associations, one feature has particular relevance to all institutions. This concerns the credit risk reduction, and concomitant lower risk weights, that may result from broader acceptability of collateral and third-party guarantees. The revised Accord would apply this broader range of collateral and guarantees to repurchase agreements, credit derivatives and on-balance sheet netting arrangements. A less complex approach should be considered which would apply more generally.

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[2] The New Bank Capital Accord, Basel Committee on Banking Supervision, Bank for International Settlements, January 16, 2001.

[3] 65 Fed. Reg. 66193, 66194, (November 3, 2000).

For example, the 50% risk weight which currently applies to residential mortgage loans should be reduced to 20% for seasoned mortgage loans with relatively low loan-to-property value ratios. A lower risk weight should also apply to that portion of a mortgage loan or home equity loan which is insured by an Agency-approved company (e.g.MGIC). The 100% risk weight which applies to all consumer loans should be reduced to 50% for closed-end, secured installment loans with short remaining maturities. Finally, the 100% risk weight which generally applies to commercial loans should be lowered to 50% for appropriately-collateralized or guaranteed small business loans up to a certain limit of an institution's total capital. These suggested modifications address the most fundamental problem with the current regulatory capital requirements -- the inability to differentiate loss exposure within broad asset categories.

These suggested revisions to the current capital requirements should not preclude further credit-risk differentiations that may be derived from institutions' internal rating systems that receive regulatory agency approval in accordance with the provisions in the proposed revised Capital Accord. The Agencies should work with sophisticated depository institutions and outside vendors to develop internal rating software that is acceptable for institutions not subject to the new Capital Accord.

A subset of institutions for which the proposed Capital Accord revisions would not apply may be defined as non-complex. In the ANPR the Agencies suggest both size and risk profile to define non-complex institutions for which a simplified capital framework would be available. Non-complex institutions would include those with consolidated assets of less than $5 billion, primarily traditional and nonvolatile assets, a moderate level of off-balance sheet activities, and a minimal use of financial derivatives.[4]

The risk profile rather than size of institution should be the primary factor in deeming an institution to be non-complex. It is not necessarily the case that only smaller institutions maintain less complex structures. The financial criteria proposed above could be supplemented by operating ratios calculated from Call Reports and Thrift Financial Reports, such as the proportion of assets consisting of commercial loans, construction loans and credit card loans. The losses on these loans are likely to be especially affected by changes in the business cycle and should represent a relatively small proportion of the balance sheets of institutions considered non-complex. Examination assessments may be helpful in identifying the risk profile of institutions. However the lags in receiving meaningful information, particularly for small institutions with longer examination cycles, preclude the inclusion of this information in the definition of non-complex institutions.

The ANPR considers a higher leverage ratio as a possible substitute for risk-based capital requirements for non-complex institutions. The Agencies suggest that the leverage ratio be high

[4] Id. at 66195.

enough to minimize supervisory concerns regarding capital adequacy.[5] However, as the Agencies correctly note, the leverage ratio " does not account for the wide spectrum of credit risk and creates an incentive for the institution to avoid investing in low-risk assets".[6] There is also the issue of how a leverage ratio alone could mesh with the Prompt Corrective Action regulations. Given the limitations of the leverage ratio, it is inconceivable how institutions could be delineated as "well capitalized", "adequately capitalized", "undercapitalized" and "significantly undercapitalized" based solely on this ratio. Moreover, unless institutions are prevented from choosing between a higher leverage ratio or risk-based capital requirements (a clearly objectionable situation), regulatory capital arbitrage incentives would prevail.

A preferable approach would be to modify the risk-based capital system according to the financial structure of non-complex institutions.[7] This approach would avoid the insurmountable problems associated with using a higher leverage ratio alone. For example, loan portfolios which consist primarily of residential mortgage loans, closed-end consumer and home equity loans, and to a lesser extent small business loans should be eligible for the next lowest risk weight based on performance parameters and other safeguards specified by the Agencies, or on internal credit rating systems that are less rigorous than those which would apply to institutions with more complex financial profiles.

In summary, revisions to the current risk-based capital system should be tailored to the complexity and risk profiles of institutions. Separate approaches should apply to three major categories of institutions -- large, complex institutions for which some form of the proposed revisions to the Basle Capital Accord would apply, institutions in general which would not qualify for the major provisions in the revised Accord, and non-complex institutions. Greater opportunities should exist for collateral and third-party guarantees to lower risk weights. The definition of non-complex institutions should be based primarily on risk profile not asset size, with risk-based capital requirements revised accordingly. The leverage ratio should be of secondary concern to the Agencies for non-complex institutions.

We appreciate your consideration of our comments.

Yours truly,

Silver, Freedman & Taff, L.L.P.

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[5] Id. at 66196.

[6] Id.

[7] Id.