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February 1, 2001

Ms. Jennifer J. Johnson
Secretary
Attn: Docket No. R-1084
Board of Governors of the
Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Office of the Comptroller of the Currency
Communications Division, Third Floor
Attn: Docket No. 00-24
250 E Street, SW
Washington, DC 20219

Mr. Robert E. Feldman
Executive Secretary
Attn: Comments/OES – 12 CFR Part 325
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of Thrift Supervision
Manager, Dissemination Branch
Information Management and Services Division
Attn: Docket No. 2000-90
1700 G Street, NW
Washington, DC 20552

Re: Advance Notice of Proposed Rulemaking – A Simplified Capital Framework for Non-Complex Institutions; 65 Federal Register 66193; November 3, 2000

Ladies and Gentlemen:

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the “Agencies”) have issued an Advance Notice of Proposed Rulemaking (“ANPR”) to assist the Agencies in developing a simplified regulatory capital framework to apply to non-complex banks and savings associations (“non-complex banks”) in the place of the existing capital framework or revisions thereto. The Agencies state that they believe that the size, structure, complexity, and risk profile of many banks and savings associations may warrant the application of a simplified capital framework that could relieve regulatory burden associated with the existing capital rules. The main objective of the ANPR is to obtain preliminary views from the industry and the public regarding such a framework. The American Bankers Association brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and bank holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the country.

The Agencies' ANPR for a simplified capital framework for non-complex banks must be placed into context in order to understand the Agencies' impetus for such a change and to understand the ABA's response to the ANPR. The present risk-based capital ("RBC") standard was meant to be applied to large, internationally active banks. Over the objections of the ABA and community banks, the Agencies in 1989 applied the current capital standard to all domestic banks, creating a major new regulatory burden for small, community banks. At that time and at the time of later amendments to the RBC standard, the continuation of a leverage ratio, and the further considerations of interest rate risk, market risk and concentration risk capital components, ABA and community banks have continued to object to what has seemed to be the application of an overly complex capital regime for traditional, non-complex banks. For the last 18 months, the Basel Committee on Banking Supervision has been considering a sweeping overhaul of the international risk-based capital framework to address the ever-increasing complexity of international large-scale banking institutions. The proposals under discussion have themselves grown in ever-increasing complexity, culminating in the release of a roughly 600 page Consultative Paper on the latest version of a revised capital framework, released just January 16, 2001.

The Agencies appear to have realized that this next revision of the international capital framework will be enormously more complex than the current capital framework and that for the Agencies to apply it to all domestic banking institutions will just not make sense. ABA most strongly agrees and supports the Agencies' efforts to minimize the burden on community banks. In anticipation of the release of the January 2001 Consultative Paper, the Agencies issued this ANPR on a simplified capital framework for non-complex banks. The Agencies propose three approaches to a simplified capital framework: (1) a risk-based ratio (that maintains a leverage requirement); (2) a leverage ratio; and (3) a modified leverage ratio that incorporates certain off-balance sheet exposures. The Agencies also recognize another alternative, that of (4) allowing non-complex institutions to retain the current risk-based capital framework. To explore these alternatives, the Agencies have asked for responses to a number of questions, organized around five main topics: overview, defining a non-complex institution, setting a minimum capital threshold, alternative methods of determining capital ratio, and implementation issues. ABA's comments will follow the Agencies' organizational approach.

General Comments

ABA has given careful consideration this ANPR. In order to be sure that ABA's comments would accurately reflect the position of its community bank members, ABA staff conducted several focus groups with smaller, traditional institutions and a number of additional discussions with Presidents and CFOs of ABA member banks. The unanimity of the responses from these bankers was almost perfect. First, they strongly support the Agencies' concept of not applying the eventual revision of the Basel Capital Accord to non-complex banks, irrespective of the size of the institution. While the approaches contemplated in the proposed revisions to the 1988 Basel Capital Accord may be appropriate for large, complex, internationally active banks, most non-complex domestic banks will not have or need the infrastructure to implement the proposal's sophisticated internal ratings-based approach to regulatory capital. In fact, some of these institutions suggest that a multi-tiered capital



framework may be appropriate, so that even mid-sized, somewhat complex domestic banks will not have to implement the full measure of the revised Capital Accord.

Second, although a decade ago community bankers considered the move to the risk-based Basel Capital Accord an unnecessary and burdensome regulatory imposition, today they have become accustomed to it; and the tracking and calculation of their banks' RBC is embedded in their systems. Thus, any regulatory change to the current system needs to be justified as necessary for appropriate supervision or truly less burdensome to bankers. Third, and related to the previous point, *any* systems change is itself burdensome, expensive and time consuming. As a result, proposed changes need to be not just less burdensome but significantly less burdensome in order to offset the burden of the change itself. Therefore, the bankers with whom we talked were consistently in favor of the Agencies' Option No. 4, continuing with the current RBC standard as the least burdensome alternative.

Specific Comments to the Questions

Overview - Questions Nos. 1 and 2: As indicated above, bankers, even from relatively small institutions, did not view the current RBC standard as unduly burdensome, as it is now embedded in their systems. At the same time, these bankers do not want to travel down the road of, for them, needless complexity as is currently being mapped out by the latest Basel Consultative Paper. In general these bankers favor remaining with the current system unless the Agencies were to demonstrate that any change would result in considerably less burden, in order to offset the costs of such changes.

Defining "non-complex" - Questions Nos. 3 and 4: Bankers were less sure about "defining" a non-complex institution. Most felt that the five general characteristics outlined by the Agencies were on target. However, several bankers indicated that some of the data items listed by the regulators that might indicate "complexity" in fact would have to be reviewed periodically, since instruments and contracts such as financial derivatives to manage risk, were being used more and more by traditional banks. Bankers recommend that, before a few Call Report entries cause an Agency to remove a bank from consideration as non-complex, the supervising Agency should consider examination reports or other supervisory data to determine whether the items really reflected an increase in the complexity of the institution.

Setting a minimum capital threshold - Questions Nos. 5, 6, 7, 8 and 9: The bankers agreed with the Agencies that there is a strong correlation between asset size of the institution and its relative complexity. Bankers we discussed this with were from institutions ranging in size from \$30 million to \$500 million with a couple of banks near to \$1 billion and one at \$3 billion. Almost uniformly, however, the bankers said that even institutions as large as the \$5 billion suggested by the Agencies might still be non-complex, so that there was no particular upper limit on asset size recommended by the bankers. Additionally, they acknowledged that even a small institution might be complex. The Agencies should, on a case-by-case basis, be able to reclassify a small institution as "complex" if its activities warranted such a classification. Bankers felt that if a size classification were used by the Agencies, then the classification of the bank should be on the size of each bank and not the

consolidated size of its holding company, if any. This may reflect the general unhappiness of bankers with the subjection of small banks to the large bank CRA examination on the basis of the size of the holding company, an approach uniformly thought to be incorrect. There was little support for including securitized assets in the asset size limit, provided the assets were properly off-balance sheet. Partly this depends on the final version of the pending recourse RBC proposal. As to Question No. 9, risk factors determining complexity, bankers seemed to support the same approach with any asset size. That is, while Call Report data could be used to flag an institution for review as to whether it was no longer “non-complex,” subsequent examination reports or other supervisory data should be consulted before the Agency determines that an institution is no longer non-complex.

Questions Nos. 10 and 11: For setting a minimum capital threshold for non-complex institutions, bankers made the following observations. First, under the current RBC standard, all but one of the institutions consulted found the current leverage ratio more confining than the current RBC ratio. This suggested that the current leverage ratio was perhaps all that was needed. None of the bankers seemed to think that they would opt for using the proposed Basel framework, although a number of institutions felt that they should have the option to retain the current RBC standard, until they were sure that any new simplified capital framework in fact was less burdensome than the current system.

Capital standard options - Questions Nos. 12, 13, 14, 15, and 16: As to the questions on which changes to the current RBC standard should be implemented, as already noted, bankers were not interested in such changes. There was some agreement that the leverage ratio was the “real” capital standard today, since it is more confining than the RBC standard. This suggested that the leverage ratio would be a sufficient method of setting a minimum capital standard. Bankers did not favor incorporating off-balance sheet items into the current leverage ratio, arguing that significant off-balance sheet items should instead be used to determine whether the institution is allowed to use the simplified capital framework. As to whether the foreseeable burden reductions outweigh concerns about establishing a simplified capital framework, the answer is presently a resounding “no.” The Agencies will need to prove a significant reduction in overall burden so as to offset the cost of changing or bankers will not be interested.

Implementation issues – Questions Nos. 17 and 18: A simplified capital framework could be implemented relatively quickly, if it truly is a significant reduction in burden, such as just dropping the RBC standard and retaining the current leverage ratio. Bankers were concerned about transitioning from a simplified framework to the complex framework, either through growth and other changes in the institution or through management’s adoption of a higher risk profile for the bank. Bankers felt that, much like the transition from the small bank CRA examination to the large bank examination, there should be a considerable period of time granted to the transitioning institution. Obviously, where supervisory data or examination reports show significant increase in risk profile, a transition period might have to be accelerated on a case-by-case basis, as warranted by the factual situation. Banks deemed no longer non-complex would, ABA hopes, move to a more complex capital standard but not the highest level of capital standard, as is being crafted for the largest, internationally active banks. As ABA has stated here and elsewhere, ABA supports several gradations in capital standards, as the size, complexity and businesses of the institution change.



Conclusion

The American Bankers Association deeply appreciates the work the Agencies have done to simplify the capital requirements for non-complex institutions. ABA will give careful consideration to all of the Agencies' releases on this issue. ABA hopes that these comments will help the Agencies proceed to the next step in simplifying capital standards for non-complex institutions, but ABA cautions that the Agencies will need to demonstrate significant reduction in burden, not mere tinkering at the borders, in order to obtain banker support of changes from the present system.

Nonetheless, the recognition by the Agencies that a single capital standard for all banks is not appropriate is an important improvement over the current system. A few modest changes in the capital standards might result in small savings in reporting burden; but if at the cost of forcing every institution to incur major programming and systems modifications, it would fail to reduce real burden. On the other hand, determining not to apply the proposed Basel framework to non-complex banks is itself major relief. ABA urges the Agencies to adhere to this determination as they proceed with revisions to the capital framework. If the Agencies have any questions about these comments, please call either James McLaughlin at 202-663-5326 or the undersigned.

Sincerely,

A handwritten signature in cursive script that reads 'Paul A. Smith'.

Paul A. Smith