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America's Community Bankers®

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COMMUNICATION SERVICES DIVISION

February 1, 2001

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Attention: Comments/OES
550 17th Street, N.W.
Washington, D.C. 20429

Ms. Jennifer J. Johnson
Secretary
Board of Governors of
the Federal Reserve System
Attention: Docket No. R-1084
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Communications Division
Office of the Comptroller of the Currency
Attention: Docket No. 00-24
250 E Street, S.W., Third Floor
Washington, D.C. 20219

Manager, Dissemination Branch
Information Management & Services Division
Office of Thrift Supervision
Attention: Docket No. 2000-90
1700 G Street, N.W.
Washington, D.C. 20552

Re: Simplified Capital Framework for Non-Complex Institutions,
Advance Notice of Proposed Rulemaking
65 FR 66193 (November 3, 2000)

Dear Sir or Madam:

America's Community Bankers ("ACB")[1] is pleased to comment on the advanced notice of proposed rulemaking by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision (the "Agencies") regarding the proposal to develop a simplified regulatory capital framework that would apply to non-complex depository institutions.[2]

ACB Position Summary

ACB supports the underlying premise of this proposal, namely the desire to reduce regulatory burdens on community banks. Nevertheless, while there are some elements of the proposal that could result in reduced regulatory burdens for smaller community banks, we oppose the development of any capital rule for, as yet undefined, "non-complex" institutions that would replace the currently workable system with a standard that is overly-simplified, not risk-based, inflexible, and inadaptable to the nature and complexity of businesses conducted by a wide variety of community banks.

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[1] ACB represents the nation's community banks of all charter types and sizes. ACB members pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.
[2] 65 Fed. Reg. 66193 (November 3, 2000).

ACB also believes that an unintended risk of an overly simplified capital standard would be that so-called non-complex institutions that are publicly owned would face competitive disadvantages resulting from the potentially negative conotations of such a label.

In particular, ACB opposes reliance on a simple leverage ratio as a means of measuring capital adequacy.

Rather, ACB believes that the Agencies should work toward adding more flexibility to the current risk-based capital system and providing the ability to tailor capital requirements to the risks posed by individual institutions. Additionally, the Agencies should permit less complex institutions, at their option, to develop internal risk management models appropriate to their circumstances.

Our proposed changes are consistent with the overall approach and several of the key elements of the new proposed capital accord, which was issued by the Basel Committee on Banking Supervision ("Basel Committee") on January 16, 2001. Such risk-focused features as credit risk mitigation, we believe, would enable community banks of all sizes to maintain an appropriate level of regulatory capital without sacrificing the needed flexibility to respond to new business opportunities, market changes and other economic conditions.

This form of relief will insure that there is sufficient capital in place for all depository institutions in the United States, regardless of their asset size or balance sheet composition. Our detailed comments and suggestions are included below.

Background of Proposal

In 1989, the Agencies each adopted regulatory capital standards based on the 1988 Basel Capital Accord. The 1988 Accord established a general framework for measuring the capital adequacy of internationally active banks under which assets and off-balance-sheet items are risk-weighted based on their perceived credit risk using four broad risk categories. Although the 1988 Accord was developed for large and internationally active banking organizations, when the Agencies adopted the risk-based standards in 1989, they were applied to all institutions, regardless of size, structure, complexity or risk profile.

As explained in the preamble, the Agencies have come to believe that the size, structure, complexity and risk profile of many smaller banks and savings associations warrant the application of a more simplified capital framework, one which could relieve the regulatory burden associated with the existing capital rules.

The Proposal

In response to this view, the Agencies developed this proposal, and seek comments on whether – and how – the current risk-based capital standards impose undue burdens on small institutions. The Agencies specifically want to know whether current standards should continue to apply

across the board, subject to modifications that will result from the just-issued Basel Committee proposal, or whether a separate, new rule should be developed for non-complex institutions.

In seeking to define the class of institutions that might be covered by a new simplified standard, the agencies believe there are three key factors in determining whether a bank or savings association is complex: the nature of the institution's activities, its asset size, and its risk profile.

Based on these three factors, the Agencies would propose to define "non complex" banks and savings associations as institutions that:

- Have a relatively small asset size (e.g., consolidated assets of less than $5 billion);
- Have a relatively simple, low-risk balance sheet (e.g., primarily traditional, nonvolatile assets and liabilities);
- Have a moderate level of off-balance sheet activity that is compatible with core business activities (e.g., commitments in the case of residential lenders);
- Use financial derivative products on a limited basis, i.e., solely for risk management purposes; and
- Have a relatively simple scope of operations, and conduct nontraditional activities on a very limited basis.

For institutions that might meet the definition of non-complex, there are three capital standard rule options under consideration.

- Taking the current risk-based ratio and tailoring a new rule to the size, structure and risk profile of less complex banking organizations.

- Relying exclusively on a bank's leverage ratio for determining capital adequacy.

- The third option would introduce the modified leverage ratio. A modified leverage ratio standard would add other aspects that can address the presence of off-balance sheet exposures.

ACB Position

ACB's comments on the specific questions posed in the Agencies' proposal are addressed below.

Is the leverage ratio a sufficient method for determining capital adequacy?

No. ACB believes that any simplified capital rule that might be developed should not result in non complex institutions being forced to adopt an one-dimensional, overly simplified capital regulation, such as the exclusive use of the leverage ratio for measuring risk-based capital. This approach, in our view, likely will result in permanent overcapitalization for many well-run, highly capitalized banks and savings associations. In turn, such a rule could have the negative consequence of limiting future business opportunities and operational flexibilities for this group of institutions.

More fundamentally, ACB does not believe that a simplified capital rule that relies on the leverage ratio exclusively would accurately reflect the level of sophistication and diversity that exists in even the most "non-complex" of institutions. As well, such a formula would fail to take account of the risk variance within even traditional lines of business.

What are the advantages and disadvantages of using asset size to determine complexity? Does the proposed $5 billion threshold work?

ACB believes that asset size alone cannot accurately predict complexity. As noted, some of even the smallest community banks can have balance sheets and business profiles that are sophisticated and complex, particularly those institutions that may serve niche markets. Applying an overly simplified capital standard to institutions based solely on asset size would fail to accurately address varying levels of risk among these institutions. Moreover, this "bright line" could have the unintended result of disadvantaging these institutions vis-à-vis their competition.

To the extent the Agencies choose to develop an alternative capital structure for non-complex institutions, we would not oppose a general asset size guideline of $5 billion, but want to emphasize that asset size alone should neither compel a particular depository institution to adopt this standard, nor prevent such a choice.

Should there be a minimum capital threshold for non-complex institutions?

ACB does not believe that smaller, less complex institutions will be well served by submitting to a simple capital rule that comes at the price of an artificially high minimum capital standard. As we already have noted, we support a more measured approach than is contemplated by this question.

Should the asset test be applied to individual institutions or to holding company organizations on a consolidated basis? How should such a threshold be determined?

To the extent the Agencies develop a non-complex rule option, any asset threshold should be applied to an individual institution and not to the holding company. As well, all depository institutions should have the option of selecting this capital standard.

Should non-complex institutions, regardless of size, be eligible for treatment under the simplified rules? Should institutions have the option of electing to use the simplified framework?

ACB strongly encourages the Agencies to offer all community banks and savings institutions, regardless of asset size, the option of selecting whatever capital treatment rule is consistent with their strategic and business plans and capabilities.

Should off-balance sheet assets be included when calculating asset sizes?

Because we do not favor using asset size as a brightline test for determining complexity, we also oppose any special definition of asset size that would result in differing standards among banks and savings institutions.

What elements of the current risk-based framework should be retained in the proposed simplified capital rule?

Since the Agencies published this proposal for comment, the Basel Committee has issued its new proposed capital accord, which will, if adopted, result in significant changes to the current risk-based formula. ACB believes that the proposed revised Basel framework moves capital regulation in a direction similar to that which ACB believes also is appropriate for less complex depository institutions. The ability to tailor capital standards for individual institutions will have many strategic and supervisory benefits.

For example, the new Basel proposal introduces more risk sensitive approaches to the treatment of collateral. With the use of credit risk mitigation, banks of all sizes can more precisely identify specific risks associated with specific elements of their balance sheets. This would allow the institution to more finely calibrate its capital levels and enhance the ability to deploy resources efficiently and effectively.

Other Recommendations

This proposal does present an opportunity for the Agencies to develop more responsive approaches to capital regulation in less complex institutions. ACB believes the preferred approach to measuring regulatory capital in less non-complex community banks should, in many ways, mirror the approach the Basel Committee advocates for large, global institutions. We believe that any changes to the current capital structure should allow for a more tailored capital calculation approach. ACB encourages the Agencies to consider changes that would reduce regulatory burdens on less complex institutions, but would do so not at the expense of appropriate risk management or the competitive position of these banks and savings institutions. Examples of such changes include:

- Lowering the risk weighting of residential mortgage loans that have a loan-to-value ratio of 60% or less to better reflect the true risk of a highly collateralized, appraised loan.

- Lowering the risk weighting of commercial real estate loans that have a loan-to-value of 50% or less to better reflect the true risk of a highly collateralized, appraised loan.

- Lowering the risk weighting of collateralized commercial loans that have loan-to-value ratios of 30% or less.

- Lowering the risk weighting for investments in Certificates of Deposit of $100,000 or less maintained at other insured depository institutions.

Lowering the risk weighting of collateralized consumer loans that have a loan-to-value of 50% or less to better reflect their true risk.

Lowering the risk weighting associated with construction loans that are collateralized by pre-sold, versus, speculative properties.

of these specific suggestions reflects both a more accurate assessment of the true risk iated with such positions and is consistent with the Basel Committee desire to take account edit risk mitigation tactics undertaken by individual institutions.

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appreciates the opportunity to comment on this important proposal and will assist the icies in any way possible in developing meaningful, yet less burdensome, capital regulations naller, community based institutions throughout the United States.

u have any questions, please contact the undersigned at (202) 857-3121 or n@acbankers.org, or Michael W. Briggs at (202) 857-3122 or mbriggs@acbankers.org.

Sincerely,

Charlotte M. Bahin
tor of Regulatory Affairs
or Regulatory Counsel