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March 26, 2007

Office of the Comptroller of the Currency
250 E Street, SW.
Mail Stop 1–5
Washington, DC 20219
OCC Docket No. 06-09

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

Robert E. Feldman, Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429
FDIC RIN 3064-AC73

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

Re: Risk-Based Capital Standards: Advanced Capital Adequacy Framework issued September 26, 2006

Ladies and Gentlemen,

SunTrust Banks, Inc.1 (STI) would like to thank you for the opportunity to comment on the Risk-Based Capital Standards for Credit Risk and Operational Risk. SunTrust recognizes that adopting the New Accord represents a large undertaking for all of the US regulatory agencies. SunTrust also appreciates the significant effort that has been put forth by the Agencies in drafting the NPR and addressing the national discretions proposed in the New Accord as well as simplifying certain

1 SunTrust Banks, Inc., (STI) headquartered in Atlanta, is one of the nation's largest banking organizations, serving a broad range of consumer, commercial, corporate and institutional clients. As of 12/31/06, STI had total assets of $182.2 billion and total deposits of $124.0 billion

practices, such as Securitization. We have a few general comments on the new Standards as currently proposed and have prepared responses where we felt further refinements could be accommodated.

The section below represents those issues that SunTrust feels are critical and believes should be considered when implementing Basel II in the U.S.

Leverage Ratio

Retaining the leverage ratio on Tier 1 capital effectively limits a bank's ability to recognize the very capital savings that the advanced internal ratings based approach, as described in the New Accord, was designed to provide. It is inconsistent with the principles of the New Accord because it breaks the connection between risk and capital requirements. As a result of retaining the leverage ratio on Tier 1 capital, an arbitrary regulatory capital floor will be created. Consequently, banks with conservative risk appetites will have economic capital less than the leverage ratio floor and would therefore be encouraged to adopt greater risk-taking practices as the only means to close this gap. Without the foundational incentive to manage capital against measurable risk, banks that traditionally have had conservative risk appetites would not be incented to maintain their business practice, but rather to take on additional risk. In effect, the bank ends up managing the Tier 1 threshold, rather than managing their portfolios.

SME Portfolios

Question 25: The agencies request comment and supporting evidence on the consistency of the proposed treatment with the underlying riskiness of small- and medium-size enterprise (SME) portfolios. Further, the agencies request comment on any competitive issues that this aspect of the proposed rule may cause for U.S. banks.

The proposed rule appears to put U.S. banks at a competitive disadvantage to foreign banks. We estimate our regulatory capital would be approximately three times economic capital under this proposal. There is fairly strong evidence to justify lower Asset Value Correlations (AVCs) and enhanced granularity for SME exposures, consistent with Basel II instead of the US NPR.

On theoretical grounds, loans to small and medium sized business should have AVCs that are lower than for loans to large companies, because large companies' asset values are tied closely to movements of the macro economy (they are less idiosyncratic in their determination than the asset values of small firms). Thus, as a practical matter, best-practice banks' internal Economic Capital models employ lower effective AVCs for such loans than for large loans. The U.S. treatment of SME loans is another case in which there is a clear competitive disadvantage for U.S. banks due to the higher capital requirement for SME loans than in the rest of the Basel II countries. Note that a foreign bank doing SME business in the U.S. will be able to avoid the higher AVCs for SME loans in the U.S. through various devices such as conducting such lending via a division of an offshore bank, or by the use of "double-leverage" of the consolidated entity – in which the corporate parent issues debt and down-streams the proceeds in the form of equity into a U.S. banking subsidiary of the foreign holding company.

Competitive Inequities

Many of the divergences identified between the NPR and the New Accord seem likely to create

competitive inequities between U.S. banks and International banks. In most cases of divergence, the NPR is more prescriptive than the Accord and is more conservative in its view of capital adequacy. This results in more stringent guidelines and higher regulatory capital requirements for U.S. banks relative to comparable international banks.

The NPR's overly prescriptive nature is evidenced in its retail segmentation requirements. According to the NPR, banks are only permitted to risk rate portfolios after segmentation, which creates an unnecessary burden of changing existing business practices for banks that operate otherwise. The NPR is also more prescriptive in regards to the treatment of default. The New Accord does not differentiate the definition of default between wholesale and retail loans, whereas the NPR has different days past due requirements for retail and wholesale.

An instance of the NPR's conservative capital requirements is reflected in the difference in the definition of ELGD and LGD. The LGD definition in the New Accord is equivalent to the NPR definition of ELGD. The NPR definition of LGD is more conservative which will result in both higher capital requirements and more extensive modeling requirements and costs for US banks than for their foreign competitors. Additionally, U.S. banks are subject to higher capital floors during the transitional floor periods, which keep them from realizing any capital benefits in a timely fashion. Again, this will result in higher capital numbers for U.S. banks as compared with similar international banks.

SunTrust supports aligning the definition of Small- and Medium-sized Enterprise (SME) loans with the Call Report definition. However, the additional requirement that SME loans be managed on a pool basis to qualify for lower capital treatment represents a major divergence from the international rule. The lower systemic risk and greater granularity of SME exposures is not dependent on whether such loans are managed on a pooled or individual basis. The US NPR would force banks to choose between changing business processes and accepting punitive capital treatment for SME exposures that are managed outside of retail pools. SunTrust recommends that if a loan meets the SME definition, it should qualify for the lesser capital treatment regardless of how the loans are managed.

STI believes that implementing Basel II as promulgated by the Basel Committee on Banking Supervision (BCBS) will result in more consistency in capital requirements and supervision across international boundaries.

Prescriptiveness of the NPR

STI is concerned that the prescriptive nature of the NPR combined with the Use Test expectations may place the regulatory agencies more in the position of regulating business processes and practices rather than supervising safety and soundness.

For example, the NPR states that banks must segment retail loans into portfolios prior to risk rating, versus risk rating then segmenting. Similarly, the NPR requires pooled treatment of SME loans to qualify for the capital relief granted all such loans in the New Accord. Also, the removal of the five (5) Specialized Lending asset classes in the NPR requires banks to classify loans into two (2) - HVCRE and non-HVCRE. The Specialized Lending asset classes should be re-introduced, since it would allow for banks to be as granular as their portfolios allow, thereby resulting in more accurate risk measurement.

Such explicit requirements will force banks to change business practices in order to comply with a

set of “rules” without any corresponding change in risk profile. STI recommends that the clean lines between banks and regulators continue to exist as they do today without adopting the prescriptiveness of the NPR.

Treatment of Equities

The New Accord and the U.S. Basel II ANPR provided for the exemption of particular equity investments from the IRB treatment, for a maximum of ten years, as long as the proportional share of ownership in a portfolio company does not increase. The omission of this exemption in the NPR, however, creates a significant divergence from current business practice. In addition, the omission creates significant uncertainty regarding treatment of equity investments and potentially creates a competitive disadvantage for US banks vis-à-vis foreign banks. SunTrust recommends that this clause, commonly referred to as “grandfathering,” be made available to banks that currently have long-held equities on their books. The inclusion of this transitional time frame will provide sufficient time for the bank to evaluate its long term business decisions. The omission of the grandfathering clause would cause an immediate reclassification of the long term investment that would result in a 3 or 4 fold increase in risk weighting without any change in safety and soundness. This recommendation is being made so that banks will not have to change their existing business practice or existing long term goals for that equity.

The ‘averaging’ concept for the materiality test is also not addressed in the NPR. The omission of the prior year average from the materiality definition, subjects a banks risk weighting on equities to increased volatility between quarters as a result of normal changes in stock prices. For banks hovering at the materiality threshold, its risk weighting on equities may change from 100% to 400% based on a small upward trend in the market. STI recommends including the ‘averaging’ concept, as detailed in the New Accord and the ANPR in the final rules to add a level of needed stability in a volatile area.

Question 16: The agencies seek comment on and supporting empirical analysis of (i) the proposed rule’s definitions of loss given default (LGD) and expected loss given default (ELGD); (ii) the proposed rule’s overall approach to LGD estimation; (iii) the appropriateness of requiring a bank to produce credible and reliable internal estimates of LGD for all its wholesale and retail exposures as a precondition for using the advanced approaches; (iv) the appropriateness of requiring all banks to use a supervisory mapping function (SMF), rather than internal estimates, for estimating LGDs, due to limited data availability and lack of industry experience with incorporating economic downturn conditions in LGD estimates; (v) the appropriateness of the proposed supervisory mapping function for translating ELGD into LGD for all portfolios of exposures and possible alternative supervisory mapping functions; (vi) exposures for which no mapping function would be appropriate; and (vii) exposures for which a more lenient (that is, producing a lower LGD for a given ELGD) or more strict (that is, producing a higher LGD for a given ELGD) mapping function may be appropriate (for example, residential mortgage exposures and HVCRE exposures).

The proposed definition of ELGD and LGD are inconsistent with the New Accord’s goals of matching risk and capital requirements. The LGD approach in the NPR is not consistent with that of the Accord and will result in higher RWAs for U.S banks, relative to comparable non-U.S. banks. Further, requiring both LGD and ELGD calculations increases compliance costs for U.S. banks. Higher RWA and increased compliance costs place US institutions at a competitive disadvantage. The use of a separate "downturn" LGD is a surrogate for proper modeling, which would capture the PD-LGD correlation. Requiring both ELGD and LGD is not the appropriate

method to do so. We believe consistent and reliable ELGD estimates are appropriate for the purposes of qualification and determining capital requirements. Banks should be permitted to begin the qualification process without the ability to produce consistent and reliable LGD estimates for all credit segments. Use of a supervisory mapping function from ELGD to LGD ignores portfolio and recovery differences across institutions. If a supervisory mapping is used, consideration should be given to exposures that deserve more or less lenient treatment.

Agency staff members have indicated that the use of the SMF is an "all or nothing" treatment – if the bank has to use the function for any one sub-product it must therefore use it for all of the sub-products within an AIRB-approach product category. While we understand the agencies' need to avoid "cherry-picking," we believe this treatment is too simplistic. Neither does it make much analytical sense when it is understood that the SMF's main reason for existence is to treat the problem where the bank has limited internal data to be able to specify a downturn LGD. Thus, it would make most sense if the bank uses a downturn LGD where it has downturn data, while using an SMF-derived LGD when the bank has only recent non-downturn data on losses-given-default. It is our understanding that the Canadian regulatory agency, OSFI, is considering an exemption to the SMF based on materiality. The U.S. should also consider such an exception, if it does not decide to eliminate the SMF entirely.

The 10% LGD floor for residential mortgage loans seems to be overly prudent, when considering the low risk characteristics of low LTV mortgage loans. There are numerous cases where low LTV loans have resulted in zero or near-zero losses for banks. Though STI understands the need to have safety parameters around some areas, the results of an LGD floor may prove the exact opposite of what was intended by good public policy. Placing a floor on LGD will effectively drive banks away from these very low risk assets in order to realize capital arbitrage.

Question 17: The agencies seek comment on the extent to which ELGD or LGD estimates under the proposed rule would be pro-cyclical, particularly for longer-term secured exposures. The agencies also seek comment on alternative approaches to measuring ELGDs or LGDs that would address concerns regarding potential pro-cyclicality without imposing undue burden on banks.

Generally, banks favor a less prescriptive, more "principles-based" approach to specification of LGD and other risk-parameter estimates. This is consistent with the view held by the Basel Committee. Therefore, the non-U.S. rule, that LGDs should be determined individually by the bank -- subject to the Pillar 2 examination process -- is preferable to the U.S. use of ELGDs and the SMF. Sufficient safeguards exist – in Pillars 2 and 3, and stress testing requirements – so that the U.S. banks should not have to be burdened by the combination of 3 LGD systems (one in the U.S., another in the other Basel II countries, and a 3rd for internal management decisions (e.g. Economic Capital)), let alone worrying about the possible pro-cyclical effect of the capital rules. Please see our response to Question 3 for additional discussion on this issue.

That said, the use of the NPR's formulation of LGD is pro-cyclical. By requiring the use of downturn LGDs and stressing of those LGDs, the US implementation will result in excessive LGD estimates at all times. The difference will be worse in downturn periods. The U.S. should instead adopt the approach incorporated in the New Basel Accord.

In addition to the above points, SunTrust feels there are additional areas of the NPR that warrant further consideration. These points are made in the following section.

Different Approaches

For many banks, the advanced approach is not necessarily feasible for both Credit Risk and Operational Risk. STI believes that banks, based on their risk profile, should be allowed to align the appropriate risk process with portfolios and not jeopardize the bank's overall qualification for the advanced approach. For example, portfolios that are new, have no growth, or will run off typically will not meet the criteria for the advanced approach but could, as circumstances change. In addition, as banks are increasingly focusing their efforts to be AMA qualified for Operational Risk, flexibility in the risk approach would assist banks in meeting the Basel II guidelines without jeopardizing their overall advanced qualification due to an "all or nothing" approach. The New Accord allows for the use of lesser approaches for some areas, and diverging from that would place U.S. banks at a severe disadvantage. STI would like to see the original three approaches, as outlined in the New Accord, be made available to U.S. banks.

Retail Definition of Default

The definition of default in the New Accord differs from the definition of default used in the "Uniform Retail Credit Classification and Account Management" policy, issued in 2000 by the Federal Financial Institutions Examination Council (FFIEC), and the NPR.
The NPR's language around the retail definition of default is not as straightforward as that of the New Accord and may introduce additional problems for banks. STI feels that implementing the definition as outlined in the New Accord would provide for an easier transition into the advanced approaches and could likely prevent any unnecessary confusion.

Qualification Disclosure

SunTrust agrees with the agencies to require qualified banks to disclose any failure to comply with the advanced approaches on an ongoing basis. However, the purpose of the transitional floor period is to provide an environment where banks, while supervised by their regulator, can transition to a stand-alone practice of the advanced approach. This three (3) year period requires regulatory approval to move from one transitional period to the next. Since the Parallel Run and Transitional Floor periods will be used to provide regulators with increased transparency into the banks advanced systems and any progress in these defined periods requires regulator approval, it would be more appropriate to implement this specific disclosure requirement immediately after the completion of the Transitional Floor periods, when a bank is expected to stand alone.

Question 3: The agencies seek comment and supporting data on the appropriateness of this limit. [pg 55835: If a bank's eligible credit reserves exceed its ECL, the bank would be able to include the excess eligible credit reserves amount in tier 2 capital, up to 0.6 percent of the bank's credit risk-weighted assets. This treatment is intended to maintain a capital incentive to reserve prudently and seeks to ensure that ECL over a one-year horizon is covered either by reserves or capital. This treatment also recognizes that prudent reserving that considers probable losses over the life of a loan may result in a bank holding reserves in excess of ECL measured with a one-year horizon. The BCBS calibrated the proposed 0.6 percent limit on inclusion of excess reserves in tier 2 capital to be approximately as restrictive as the existing cap on the inclusion of ALLL under the general risk-based capital rules, based on data obtained in the BCBS's Third Quantitative Impact Study (QIS–3).]

STI feels that the proposed ruling treats accounting and economic loss as the same concept without adequate supporting evidence. STI does not feel that there is necessarily a strong relationship between accounting and economic losses because of differences in loss components and loss periods, and generally expects the accounting loss to be a lower number.

In addition, STI would encourage the regulators to consider requiring capital to cover Total Loss (both EL and UL), and to allow inclusion of ALLL as regulatory capital without limit. A total loss view of capital with inclusion of ALLL would have the added benefit of addressing the pro-cyclicality problem of capital for which many people are concerned. As the first type of capital for absorbing credit losses, the ALLL should be considered on equal footing with common equity. Indeed, the ALLL was treated as part of "Primary Capital" in the U.S. in the 1980s. Some of the rating agencies typically view the ALLL, along with tangible equity, including permanent preferred and trust preferred, to be "true" equity.

Alternately, STI would propose a symmetric treatment of excess and underfunded credit reserves. At a minimum, there should never be any limit on the amount of the ALLL that counts as Tier 2 capital. The 0.6% of RWA limit is distorted in the U.S. by the fact that the U.S. requires higher capital to cover unexpected losses (UL). There is no economic reason to have a cap on the amount of the ALLL eligible for inclusion in Tier 1 capital.

Question 4: The agencies seek comment on the use of a segment-based approach rather than an exposure-by-exposure approach for retail exposures.

The inclusion of the segmented approach to Retail capital calculation was added to the New Accord to align risk measurement with the variety of management practices used by banks within the Retail portfolios. However, the NPR is overly explicit in its Retail Segmentation requirements, by forcing a bank to use a segment-based approach to risk rating, regardless of the bank's current business practice. STI strongly believes that institutions should have the flexibility to choose the approach that is most consistent with their risk management practices. As noted previously, the prescriptiveness of the NPR results in regulators setting business practices without any added benefit to safety and soundness standards. Further, permitting exposure-by-exposure risk rating prior to segmentation provides more granular risk management capabilities and would ease compliance with use test requirements for banks that use exposure-by-exposure approaches. As with SMEs, the lower systemic risk associated with retail exposures is inherent, and does not depend on bank segmentation and exposure management practices.

Question 5: The agencies seek comment on this approach to ensuring that overall capital objectives are achieved.

The objective of the New Accord was to match risk sensitivity with regulatory capital requirements. Arbitrary limits in the NPR on aggregate capital changes are inconsistent with the intent of the New Accord and place U.S. banks at a competitive disadvantage to foreign institutions. As written, the NPR strives be capital neutral. This cannot be achieved without being punitive to some institutions to offset capital relief at other institutions. This is a fundamental problem with the basics of a "capital neutral" view of the NPR. STI believes that regulatory oversight provisions of Pillar 2, along with the use of capital transitional floors as described in the New Accord, provide an appropriate oversight process to adjust the risk parameters outlined in Pillar 1 without the punitive treatment inherent in a 10 percent ceiling on changes in systemic capital or the retention of the

leverage ratio.

Question 6: The agencies seek comment on all potential competitive aspects of this proposal and on any specific aspects of the proposal that might raise competitive concerns for any bank or group of banks.

The proposed US implementation of the New Accord, as promulgated in the NPR, would place US institutions at a competitive disadvantage to foreign institutions. For example, the various transitional floors in the U.S. are more stringent than those in the international community; the US NPR proposes retaining a leverage ratio; and the NPR is more restrictive in its treatment of exposures to SMEs. There are many divergences between the NPR and the New Accord, with each divergence placing U.S. banks at an increasing competitive disadvantage. STI's overall recommendation is to align the NPR more closely with the international implementation of the New Accord.

STI believes that the proposed rules should support all three options available under the New Accord to alleviate any competitive concerns that banks may have. Whatever standards the U.S. Agencies decide to implement, they should apply the same standards consistently to all banks operating in the U.S., whether domestic or foreign, to prevent any further competitive inequities (see Q9).

Question 7: The agencies request comment on whether U.S. banks subject to the advanced approaches in the proposed rule (that is, core banks and opt-in banks) should be permitted to use other credit and operational risk approaches similar to those provided under the New Accord. With respect to the credit risk capital requirement, the agencies request comment on whether banks should be provided the option of using a U.S. version of the so-called "standardized approach" of the New Accord and on the appropriate length of time for such an option.

Requiring large banks to comply with only the most advanced approaches places them at a competitive disadvantage to foreign institutions. The benefit of the AIRB or AMA approaches may not be substantial enough to cover the increase in cost and burden for some portfolios. Also, new or acquired portfolios that are not compliant with the advanced approach due to a lack of data or history are better suited to be treated under the standardized approach until the data standards are met. Not being able to treat these portfolios under the advanced treatment should not hinder a bank from achieving the advanced qualification in other areas. STI believes the inclusion of the standardized approach adds needed flexibility without compromising the overall qualification of the bank.

Question 9: The agencies seek comment on the application of the proposed rule to DI subsidiaries of a U.S. BHC that meets the conditions in Federal Reserve SR letter 01-01 and on the principle of national treatment in this context.

STI believes that U.S. subsidiaries of foreign banks, bank holding companies, or financial holding companies should comply with the same regulations and rules as U.S. institutions. To do otherwise would exacerbate the competitive disadvantage created by the U.S. NPR.

Question 19: The agencies solicit comment on all aspects of the proposed treatment of operational loss and, in particular, on (i) the appropriateness of the proposed definition of operational loss; (ii) whether the agencies should define operational loss in terms of the effect an operational loss event has on the bank's regulatory capital or should consider a broader definition based on economic capital concepts; and (iii) how the agencies should address the potential double-counting issue for premises and other fixed assets.

STI concurs with the proposed definition of operational loss. STI also believes there is value in benchmarking operational losses and operational risk capital with other financial institutions and trending internal loss event data and operational risk capital by event types over time. The proposed definition of operational loss is appropriate and enables such benchmarking.

STI believes that agencies should define operational loss in terms of the effect an operational loss has on regulatory capital only. Though we typically support the use of economic capital concepts, and agree with efforts made to bring Basel II regulatory capital in line with economic capital methodologies, in this case it may overly confuse the issue. Operational risk economic capital is not a well-developed field. To use it as the basis for Basel II regulatory capital could easily lead to the situation where methods evolve and regulatory capital is forced to change or be out of step with emerging practices.

The agencies could address the double-counting issue for premises and other fixed assets by eliminating the calculation of capital based on risk-weighted assets under section 31(e)(3) of the proposed rule. The risk of loss from damage to physical assets should be included only in Operational Risk Capital.

In addition, the Basel II Capital Accord and the European Capital Requirements Directive (CRD) allow institutions to implement AMA initially with only three years of historical loss data. In contrast, the Basel II NPR has proposed that "a bank's operational risk data and assessment system must include a minimum historical observation period of five years of internal operational losses". STI suggests that the Basel II NPR minimum historical observation period proposal be brought into line with the Basel II Capital Accord and the European CRD, for institutions' initial implementation of AMA.

Question 20: The agencies seek comment on the appropriateness of the 24-month and 30-day time frames for addressing the merger and acquisition transition situations advanced approaches banks may face.

The 30-day period after consummation of the merger to file an implementation plan is much too short. The timing and effort associated with gaining approval of a merger, then consummating the merger, tends to utilize many of the same resources needed to develop and implement a Basel II plan and to measure risk in all parts of the bank. For this reason, STI believe that the 30-day period should be extended to 180 days.

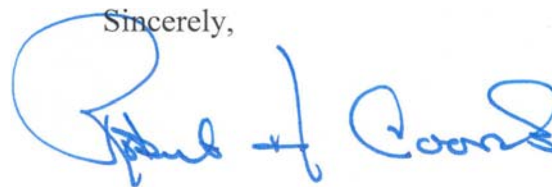
Question 24: The agencies seek comment on how to strike the appropriate balance between the enhanced risk sensitivity and marginally higher risk-based capital requirements obtained by separating high-volatility commercial real estate (HVCRE) exposures from other wholesale exposures and the additional complexity the separation entails.

STI's experience would not support the need to separate HVCRE from other Commercial Real Estate (CRE). The higher risk of HVCRE is accounted for in PD and LGD and the correlation of LGD to PD (during years of higher than average default, LGD is also higher than average), so separating HVCRE from other CRE is effectively double counting of risk. STI has the capability to segment the CRE portfolio as required by the NPR.

In order for an Acquisition, Development, and Construction (ADC) loan (within the commercial real estate category) to be not treated as HVCRE, it must meet the specific exception requirements. The burden of exception-identification may be very large in some cases, forcing the bank to treat all ADC loans as HVCRE. This burden could be greatly reduced, and a greater alignment of regulatory capital charges with best-practice capital charges could be achieved, if all Multi-Family (MFL) ADC loans were treated as non-HVCRE.

SunTrust would like to thank the agencies for spending the time and effort to develop a more risk-enhanced environment and appreciates the ability to comment on the NPR.
If you would like to discuss any of these issues further, I can be contacted by email at Robert.Coords@SunTrust.com

Sincerely,



Robert H. Coords

Chief Risk Officer
SunTrust Banks, Inc.