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January 6, 2006

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
RE: Docket No. 05-16, RIN 1557-AC95

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
RE: Regulations H & Y, Docket No. R-1238

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RE: RIN 3064-AC96

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2005-40

Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications.

Ladies and Gentlemen:

AmSouth Bancorporation (AmSouth) appreciates the opportunity to comment on the advance notice of proposed rulemaking (ANPR) issued jointly on October 20, 2005, by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of Thrift Supervision (the Agencies).

AmSouth is a bank holding company with total assets in excess of $50 billion as of September 30, 2005. Although we are one of the larger regional banks in the United States, our fundamental

business model is not complicated. We are engaged in the delivery of a traditional mix of banking services and credit products to individuals, small businesses and middle market businesses primarily within our six state geographic footprint. We do not have international operations, trading desks, investment banking departments or equity investments.

We support the intent of the ANPR, namely to:

1. promote safe and sound banking practices and a prudent level of regulatory capital,
2. maintain a balance between risk sensitivity and operational feasibility,
3. avoid undue regulatory burdens,
4. create appropriate incentives for banking organizations, and
5. mitigate material distortions in the amount of risk-based capital requirements for large and small institutions.

We question, however, whether the appropriate incentives are created when only two of the three measures of capital adequacy are implicitly addressed in the ANPR — the Risk-Adjusted Tier 1 Capital Ratio and the Total Risk-Adjusted Capital Ratio. By not considering revisions to the leverage capital requirement ratio (Tier 1 Capital to Total Assets), this exercise in re-weighting various exposures is incomplete. Institutions with low risk portfolios may be required to carry higher capital requirements under the leverage ratio than amounts required by the final Basel 1A. Accordingly, we favor phasing out the ratio based on total asset leverage in favor of determining capital adequacy solely on the risk-adjusted capital ratios. We do recommend that regulators retain their existing discretion to require higher capital levels if a specific institution's risk-weighted calculation doesn't adequately reflect the risk and volatility of the credit portfolio.

Given the general lack of specifics provided and the many areas left open for comment throughout the ANPR, AmSouth's perception is that it is meant to gather industry feedback as part of the development of a definitive proposal. We commend the Agencies for this collaborative approach and look forward to providing comments that will help determine how risk-weighted assets will be calculated at institutions that are not eligible for, or have business models which do not necessitate the more complex capital measurement approach of the Basel II capital accord.

In addition to the Agencies' objectives, our comments and recommendations also considered the following:

- risk-weighting formulae must recognize the gradations of risk inherent in various types of exposures more precisely than under the current accord,
- risk-weighting calculations should utilize, where possible, standardized metrics used by financial institutions in determining the risk of exposures at inception, such as credit scores on consumer loans. Use of these common measures will ensure that risk-weighted capital amounts are aligned to risk consistently between institutions,
- calculation of risk-weighted exposures must be within the capabilities of most institutions,
- in situations where recommended risk-weighting classifications are not as universal (internal risk ratings), institutions should be able to support their classifications to the satisfaction of the pertinent agency.

We have developed the following specific recommendations which we believe effectively align risk-based capital with the underlying risk inherent in various products in a manner that is consistent with

the objectives of the Agencies. Ultimately, this framework should result in lower risk-weighted capital requirements for Institutions that have high quality and collateralized exposures, and higher risk-weighted capital requirements for institutions with lower quality and unsecured exposures.

In developing our proposal, we utilized the underlying tenet that the level of ALLL should be adequate to cover expected losses inherent in a portfolio, while the required level of capital should be adequate to compensate for its volatility (unexpected losses). We further equated the loss characteristics of a specific exposure (product) with its need for capital to cover its volatility. Exposures with higher loss characteristics merit higher capital requirements for volatility.

This comment letter has been organized to follow the structure of the ANPR.

Section II – Domestic Capital Framework Revisions

Subsection A – *Increase the Number of Risk-Weight Categories*

We support an increase in the number of risk-weight categories as a means of more closely aligning capital requirements with risk. We feel that the nine weights proposed in Section II.A. of the ANPR would adequately capture the stratification of risk in the relevant portfolios without adding undue complexity to the process.

Subsection B – *Use of External Credit Ratings*

The Agencies have proposed using risk weights based on a borrower's bond rating. While Nationally Recognized Statistical Rating Organizations (NRSRO) ratings are a recognized and valid measure of risk, their application in the risk-based capital calculation of financial institutions has material limitations, notably;

- Regional and Community banks and institutions have minimal exposures to publicly rated borrowers.
- NRSRO ratings generally apply to term debt issued in the capital markets. Financial institution credit exposures to rated companies are generally shorter term, senior to bonds, controlled with covenants and monitored. The difference between NRSRO bond risk and bank loan credit risk is particularly significant for lower rated borrowers, at which point a financial institution extending credit would likely add collateral protection and tighter covenants to the structure as risk mitigants.
- Commercial exposures to unrated borrowers are individually analyzed and structured, are frequently secured by company assets including real estate and are enhanced with personal guarantees — all of which layer them senior to the typically unsecured exposures envisioned in external ratings.

For 1A to achieve its stated objectives, we feel the Agencies must develop an approach that allows institutions to risk-weight all commercial and commercial real estate exposures. The mechanism must include borrowers that are not externally rated, since such borrowers represent the

overwhelming majority of commercial and commercial real estate exposures at institutions that are the intended adopters.

Commercial Exposures Dynamically Risk Rated – Many institutions have established a granular risk-rating scale for ranking the risk of commercial borrowers. The assignment of a risk rating is updated throughout the life of the exposure based on ongoing analysis of continuing financial information submitted by the borrowing entity and guarantors, together with highly interactive management of the relationship. Typically, at the inception of the exposure the institution's credit decision is based upon an analysis of historic financial statements and trends for the obligor and principal(s) and the exposure is then structured with appropriate risk mitigants (term, collateral, guaranties, covenants, financial reporting requirements). As the exposure seasons, receipt and analysis of updated financials and communication with the obligor allow the institution to modify the risk rating as warranted.

Assuming an institution's internal risk-rating systems have been found by the regulators to be in substantial compliance with Federal Reserve SR 98-25, we feel that such internal risk-rating systems should be the basis of the risk-weighted capital calculations for the institution's business exposures. We propose that the risk-weighting of all business exposures that are subject to dynamic internal risk rating (including such Commercial, Commercial Real Estate and Small Business exposures) be based upon the following grid (utilizing *transactional* risk ratings):

Commercial & CRE Exposures	
Exposure	**Risk Weight**
Pass - Lowest Risk	35%
Pass - Moderate Risk	50%
Pass - Standard Risk	100%
OLEM	150%
Substandard	200%
Doubtful	350%
Non Accrual / >90 DPD	350%

The above grid envisions three buckets for pass-rated exposures. The level of capital required for an exposure increases as the risk of the exposure increases (from 35% for the lowest risk transactions to 100% for pass-rated standard risk exposures). The mapping of risk ratings to weighting buckets may vary by institution depending upon the number of risk-rating grades for pass-rated exposures. For an institution similar to AmSouth, which utilizes nine risk grades for pass-rated exposures, each weighting bucket would contain two to four successive grades.

The definitions of OLEM, Substandard, Doubtful and Non-Accrual are generally consistent throughout the industry and past due status is universally available. Recommended weighting for these non-pass exposures should increase, from 150% at OLEM to 350% at Doubtful, Non-Accrual or 90 Days Past Due. This premium weighting should be reduced by the amount of any reserves directly allocated to cover losses on such exposures. Exposures written down to net realizable value should carry a standard weighting of 100%.

We would expect that during the implementation phase each institution and its primary regulator would jointly determine the appropriate mapping between internal pass risk grades and risk-

weighting buckets. Although many applicable institutions will not be able to provide meaningful probability of default (PD) or loss given default (LGD) metrics, their loss history should provide ample evidence of the risk characteristics of their portfolio which should support a separation into the lower and higher risk components. It will be incumbent upon the regulator, as part of their SR 98-25 review, to address the adequacy and validity of the risk-rating scale in providing an accurate measurement of the granularity of risk.

Commercial Exposures Not Subject to Dynamic Risk Rating Systems – Certain commercial exposures (generally small business loans) are subject to a more abbreviated approval process and are underwritten using a combination of credit bureau and/or custom scores of the guarantor, a valuation of any collateral and a briefer credit analysis. Due to their greater number and smaller size, these loans are usually managed as a homogeneous portfolio similar to consumer portfolios. While these loans may be monitored and managed using information such as payment history, they are typically not dynamically risk-rated. Given the loss behavior we have observed and how the underwriting/ account management process parallels processes in the consumer portfolio, we believe it is appropriate to risk-weight on a basis similar to consumer loans as discussed in subsection D of this comment letter. Weighting percentages for these exposure classes would be determined primarily as a function of the initial credit bureau score of the guarantor.

The credit bureau score to be utilized in the risk-weighting process would be from a nationally recognized credit bureau that scores obligors in a manner that effectively gradates risk. For illustrative purposes, all weighting matrices proposed below that utilize credit scores incorporate FICO scores, since these scores are commonly used in the industry, including by AmSouth. The credit bureau used by each institution would need to have the ability to stratify obligors into five score bands corresponding to sub-prime, near prime, prime, above prime and super prime. The Agencies would map score bands for each acceptable bureau to the FICO score bands utilized herein to insure risk-weighting consistency among institutions. (The terms FICO and credit score are used interchangeably herein. Scores utilized in the proposed Small Business and Retail score bands proposed herein are FICO scores).

Institutions that have developed and rely upon a proprietary custom scoring system for stratifying obligor risk may want to substitute the custom score for the credit bureau score in various of the weighting matrices. In order to insure consistency within the industry, these banks would need to validate with their regulator the effectiveness of their custom scoring system and its ability to map to appropriate risk-weighting bands in a more predictive manner than do credit bureau scores.

Institutions that refresh credit scores could be given the option by their regulators of utilizing the refreshed scores to determine the risk-weighting on a more dynamic basis.

- *Real Estate Secured* – Commercial loans adequately secured by a first lien position in real estate have historically generated lower losses and lower loss volatility, particularly when compared to unsecured loans to similar borrowers. In small business lending, these exposures are generally underwritten utilizing the credit score of the guarantor and LTV of the real estate. The FICO score may also be supplemented by a custom score unique to the particular lending institution. The following weighting matrix is proposed for small business commercial loans secured by a first lien position in real estate that are not dynamically risk-rated by the institution.

Small Business- Secured by Real Estate						
LTV ↓	FICO →	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
>85% or Missing		350%	200%	100%	100%	50%
75% to 85%		200%	100%	75%	50%	35%
<75%		150%	100%	50%	35%	35%

The "Missing" categories above (and in weighting charts to follow) represent exposures where the relevant information is not retrievable or was not obtained at the initial underwriting. These exposures should be weighted at the highest weight within the proper weighting band (i.e. a 700 FICO with missing LTV would be weighted at 100% above). This conservative treatment should encourage institutions to improve the capabilities of their risk measurement and management systems.

- *Secured by Other Assets* – These small business exposures are typically secured by other company assets that may include equipment, receivables, inventory, etc. Performance of these loans is generally a function of the credit (or custom) score band of the guarantor. The collateral generally moderates losses to a smaller degree than does real estate collateral.

Small Business- Other Secured					
FICO	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
	200%	150%	100%	50%	35%

- *Unsecured Exposures* – These exposures are generally underwritten using FICO scores, supplemented by custom scores. Included in this category would be unsecured business lines. Loss characteristics are the least favorable in the small business segment and are not moderated by collateral.

Small Business- Unsecured					
FICO	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
	350%	200%	150%	100%	50%

Subsection C – *Expand Recognized Financial Collateral and Guarantors*

We agree with the statement by the Agencies that the types of collateral and guarantors that would be eligible for reduced risk-weighting should be expanded. We feel that additional types of collateral and guaranties taken in order to reduce risk by the institution extending the exposure should be given implicit value through the utilization of risk weights based on internal risk ratings and/ or weighting grids as further discussed in this comment letter.

Subsection D – ***One to Four Family Mortgages: First and Second Lien***

We agree that a single risk weight for most One to Four Family Mortgages, as is presently used, does not adequately recognize gradations of risk due to LTV, lien position, certain non-traditional mortgage products or differences in borrower credit scores. We agree with the Agencies that these measures of credit risk should be combined in determining risk weights

One to Four Family Mortgage Exposures, both first and second lien, are generally underwritten utilizing two primary factors, loan to value of the collateral and credit score of the applicant (commonly FICO score). Inherent risk declines as LTV decreases and as FICO score increases. As is contemplated in subsection D of the ANPR, we would agree that a matrix approach to risk-weighting these exposures be utilized. We recommend the agencies consider the following grids for loans to individuals secured by residential properties.

RFM – For traditional residential first mortgages (RFM) we would suggest that a matrix grid be utilized to determine risk-weighted exposures as follows:

Residential First Mortgage Exposures						
LTV ↓	**FICO** →	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
Over 100% or Missing		200%	150%	100%	75%	50%
91% - 100%		150%	75%	50%	35%	20%
81% - 90%		100%	50%	35%	20%	20%
≤ 80%		50%	35%	35%	20%	20%

In terms of relative importance of the two underwriting factors, FICO has a strong correlation to default risk and LTV has a strong correlation to loss severity. Residential First Mortgages to the prime customer have a long history of low and stable loss rates across the industry. Inherent in this loss history is a long history of stable to increasing real estate values in the United States. The Federal Reserve's own studies find that housing price "busts" are rare and occur in certain markets usually impacted by a severe economic event.

The capital weightings reflect this lower risk. Losses are usually minimal regardless of FICO score where LTV is 80% or less (generally the point at which FNMA and FHLMC would require private mortgage insurance (PMI)). Losses are also minimal in the highest FICO score bands as default risk is lower.

Relative to areas of specific comment requested in the ANPR:

- The LTV should be determined net of PMI coverage. Counterparty risk should be recognized on the amount of PMI exposure based upon the Counterparty's external (NRSRO) risk rating. The risk weights presented by the Agencies in Table 1 of the ANPR should be utilized to determine the counterparty risk weight.
- The mortgage market is dynamic and as underwriting expertise has grown so have the approaches to underwriting and loan structuring. The Agencies query if certain non-traditional loans such as interest-only and loans with lower documentation at underwriting

should be considered higher risk. We agree that certain mortgage products should receive an additional risk-based capital assessment, noting that there is no consistent definition of what constitutes a non-traditional mortgage and which of those equates to higher risk. In our opinion, there are products that do represent higher risk including;

- Mortgage exposures underwritten at greater than a 100% LTV, which are accounted for in the weighting grid above.
- Mortgages with negative amortization, which should carry a capital cost based on an increased LTV, determined by the amount of expected principal build-up.
- Other programs, including interest only and low-documentation loans, however, should be examined at each institution to determine how the product was implemented and if that implementation generated a portfolio with higher risk. For example, if interest-only loans are primarily customers who have superior credit histories, significant liquidity, and equity in their property, does this represent higher risk? We suggest that the relevant agencies review how an institution implemented a program and whether a program resulted in a material increase in risk.

- In the spirit of the Basel 1A proposal, the revisions should be feasible and cost-effective for institutions to which they will apply. Periodic refreshing of FICO scores should not be mandated, nor should periodic updates of LTV since these would add undue expense and complexity to the risk-weighting process without commensurate benefits to risk stratification.
- All VA/FHA insured exposures should continue to carry the present 20% risk weighting.
- We feel that the use of LTV and FICO to determine risk-weighting is appropriate and that the inclusion of other factors such as debt to income would not have a material beneficial effect on the risk assessment. Such additional factors would add complexity and subjectivity to the process.

Home Equity Exposures (Home Equity Lines and Loans) – Similar to RFM exposures, home equity exposure underwriting and approval utilizes two major risk measures, loan to value of the collateral and credit score of the applicant (commonly FICO score). First lien equity exposures should behave in a fashion generally similar to RFM exposures, with the risk of loss and volatility declining as LTV decreases and FICO score increases. We recommend that a matrix approach to risk-weighting these exposures be utilized, with separate risk-weighting grids differentiating first lien and junior lien positions.

First Lien Exposures would include:

- Home Equity loan and line exposures secured by first residential mortgages and
- those secured by junior mortgages where the institution holds both the first and the junior mortgages with no intervening liens:

Home Equity Products- 1st Lien						
LTV ↓	**FICO** ⟶	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
Over 100% or Missing		200%	150%	100%	75%	50%
91% - 100%		150%	75%	50%	35%	20%
81% - 90%		100%	50%	35%	20%	20%
≤ 80%		50%	35%	35%	20%	20%

Where the Home Equity exposure is collateralized by a junior mortgage (and another institution holds the first mortgage), we propose that an increased risk weight is appropriate to reflect the subordinated claim position on the property.

Home Equity Products- 2nd Lien						
LTV ↓	FICO →	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
Over 100% or Missing		350%	200%	150%	100%	75%
91% - 100%		200%	150%	100%	75%	50%
81% - 90%		200%	150%	75%	50%	35%
≤ 80%		100%	75%	50%	35%	20%

In instances where an exposure is covered by credit insurance, the portion so covered should be assessed a risk weighting based upon the external rating (NRSRO) of the counterparty. The remainder of the exposure should then be subject to the risk weighting indicated in the appropriate grid above.

Subsection E – *Multifamily Residential Mortgages*

Multifamily residential mortgages may be found in either the retail or the commercial lending portfolios of an institution. Such exposures, when found in the commercial system, are generally underwritten as income-producing properties and are subject to the bank's internal risk-rating system which will consider such factors as sponsor financial condition (liquidity, global debt service ability) LTV, occupancy rates, net operating income and cash flow coverage. When such exposures are dynamically risk-rated, we propose that they be risk-weighted on the Commercial & CRE Exposures rating grid provided in the Section B comments above.

Where such loans are underwritten in the retail or small business areas and are not subject to a dynamic internal risk rating system, we feel that the most widely used predictive indicators of inherent risk will be the property's LTV and the credit (or custom) score of the guarantor. We would propose use of an LTV and FICO based weighting grid for these exposures as follows:

Multi-Family Residential Mortgages						
LTV ↓	FICO →	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
>85% or Missing		350%	350%	150%	100%	50%
75% to 85%		200%	150%	100%	50%	35%
<75%		150%	100%	50%	35%	35%

Subsection F – *Other Retail Exposures*

We propose consistency with the methods used above for RFM and equity exposures when determining risk weighting for other retail exposures. Where collateral is present, the underwriting decision normally includes the two primary factors of loan to value of the collateral and credit score

of the applicant (commonly FICO score) in defining expected loss and loss volatility. For other retail exposures, it's also necessary to consider the quality, control and salability of the collateral type when setting risk-weight ranges. For example, loans fully secured by deposit accounts should have a low risk weight due to stable value and institutional control of the collateral, regardless of score band. Direct and indirect automobile, marine and RV loans should have a somewhat higher weight since they lack the control and stability of value seen in deposits, but acknowledging the fact that the collateral does have marketability and an ease of valuation and sale. Exposures that are unsecured or secured by collateral with limited marketability or with a more subjective value should bear a yet higher weight within the same score bands.

Direct and Indirect Automobile Exposures – The risk drivers for automobile exposures are value of the collateral and credit assessment of the obligor. We propose the following grid to determine risk weights for direct and indirect automobile exposures.

Consumer Direct & Indirect Auto Exposures						
LTV ↓	FICO →	Under 640 or Missing	640 - 679	680 - 719	720-759	760 & Over
Over 110% or Missing		200%	150%	100%	75%	50%
>100% and ≤110%		200%	150%	100%	50%	50%
≤ 100%		150%	100%	75%	50%	35%

LTV at inception would be determined based upon dealer wholesale invoice for new cars or average black book wholesale value for used car loans. We have based the above matrix solely on direct and indirect auto exposures. AmSouth has minimal exposures secured by RVs, marine and aircraft. A similar weighting matrix would also apply for such products based upon gradations of risk as indicated by credit score and loan to value.

Retail Exposures Secured by Deposit Products or Marketable Securities – The risk weight for these exposures should be set at 20% for all retail loans fitting into this category that are fully secured (100% or lower LTV) by qualifying depository instruments, including certificates of deposit, depository accounts not subject to withdrawal (blocked accounts) or by marketable securities that are properly controlled, margined and revalued. LTV for marketable security secured loans would be determined after applying appropriate margin requirements to current market value. Exposures secured by such collateral but with a LTV greater than 100% would be risk weighted as unsecured. Such exposures that are subject to the institution's dynamic risk-rating system would be weighted in the same manner as other risk-rated exposures.

Unsecured Retail Exposures or Exposures Secured by Other Collateral – Valuation of other collateral, which might include household goods, art or antiques, is more problematic than a residence, automobile or deposit account and is subject to greater fluctuation due to the comparatively limited resale market. The risk driver for these exposures and for unsecured exposures is the obligor's credit assessment.

Retail- Unsecured or Other Secured Loans	
FICO Score	Weight
≥760	75%
720-759	100%
680-719	100%
640-679	200%
<640/Missing	350%

Subsection G – ***Short Term Commitments***

We believe that the duration of the commitment should be measured from the point that the weight of the unfunded exposure is being determined. Due to the short duration and probability of additional aggregate usage on unused commitments with a remaining term of one year or less, the present Credit Conversion Factor (CCF) of 0% should continue to apply. As these facilities do incur additional usage, the risk-weighted exposure of the resultant loans would increase the institution's risk-weighted assets. In addition, on unused commitments of any remaining duration that are unconditionally cancelable or provide for automatic cancellation upon the deterioration of the borrower's credit assessment, the present CCF of 0% should also continue to apply.

For unused commitments with a remaining maturity greater than one year, it is proposed that the present 50% CCF continue to apply, but that the resultant exposure be risk weighted in the same manner as are any amounts that are or could become outstanding under such commitment. This would require the segmentation of the applicable unused exposures into the risk-weight bands dictated by the product. For example, a two year, $100,000 unused commitment to an obligor internally rated as "Pass — Lowest Risk" would have a 50% CCF applied to the unused balance ($100,000 X 50% = $50,000) with the resultant exposure then risk-weighted at 35% ($50,000 X 35% = $17,500).

Commercial & CRE Unfunded Exposures			
Exposure	CCF	Risk Weight	Effective Risk Weight
Pass - Lowest Risk	50%	35%	17.5%
Pass - Moderate Risk	50%	50%	25%
Pass - Standard Risk	50%	100%	50%
OLEM	50%	150%	75%
Substandard	50%	200%	100%
Doubtful	50%	350%	175%
Loss / Non-Performing / >90 DPD	50%	350%	175%

Standby letters of credit would retain their present CCF's, but again the resultant exposures would then be risk-weighted as would actual draws that might occur under the facility.

Subsection H – *Loans 90 Days or More Past Due or Non-Accrual*

Any business or consumer exposure that reach 90 days past due or attain a non-accrual status should carry an accelerated risk weighting, with the proposed risk weight being 350%. This premium weight should be reduced by the amount of any reserves directly allocated to cover losses on such exposures. Should the exposure have been written down to net realizable value, a standard weighting of 100% should apply.

Subsection I – *Commercial Real Estate*

The ANPR cites the Agencies' long standing concerns with ADC loans and suggests elevated risk weights either across the board or where cash equity is less than 15% at any time during the duration of the facility. Although, we agree with the ANPR that certain commercial real estate exposures, including ADC exposures, could potentially constitute increased risk for an institution, we feel that utilizing an elevated risk weight across-the-board would not give appropriate credit to the individualized underwriting and structuring that these exposures receive or the varying degrees of risk that will exist within any exposure type. Improved underwriting including those aspects guided by regulations such as FDICIA and Reg H have lowered the risk in ADC exposures at many institutions.

Risk in ADC lending can be effectively mitigated by measures that include:

- **Borrower selection:** High quality builders and high liquidity sponsors reduce risk.
- **Contractor or subcontractor bonding:** Reduces completion risk and risk of cost overruns.
- **Minimum pre-sale coverage requirements:** Reduces risk of market acceptance. Risk at 100% presale coverage is at a reduced level compared to risk at lower coverage requirements.
- **Eligibility requirements for presales:** Larger deposits reduce risk of presale contract cancellation. A 20% non-refundable deposit requirement versus 10% reduces risk.
- **Project Feasibility:** Support by credible third party feasibility studies decreases market acceptance risk.

- **Sponsor experience level:** Projects consistent with sponsor's experience reduce risk.
- **Project and Global cash flow underwriting:** Higher level of coverage on project with backup coverage outside project reduces risk.
- **Stress analysis:** Superior ability to weather potential interest carry, cost and market price fluctuations improves risk.

Therefore, it is not reasonable to conclude that all ADC loans are higher risk. Rather, the attributes of the borrower, project and structure all will influence risk. The capital treatment for ADC loans needs to differentiate high risk exposures from lower risk exposures. Institutions consider all of these factors in assigning a risk rating to an ADC loan. Applying a punitive CCF could potentially penalize institutions with well-structured exposures of the type in question and reward institutions further out on the risk curve. We propose that, rather than relying on adjusted weights for specific loan types, the risk weighting should consistently be determined by the institution's internal dynamic risk ratings. It should be the role of the regulator to ensure that the risk-rating system at a specific institution meets the requirements of SR 98-25, is applied consistently across all types of internally rated exposures and maps appropriately to the proper risk-weighting bands.

Subsection J – *Small Business Loans*

Lending to small businesses with total commercial borrowings of less than $1 million is, and will continue to be, a focus of our commercial strategy. We feel that the risk weighting of this segment should be determined by the risks inherent in such exposures, not by the size of the exposures. We therefore feel that risk weighting these exposures should utilize the same methodology that is proposed for general commercial exposures, namely weightings based upon internal risk ratings (if the exposures are internally risk-rated). Should the exposures not be internally risk-rated, then the weighting should be based upon the original approval metrics. This type of exposure is covered in the comments to Subsection B, Use of External Credit Ratings, above.

Subsection K – *Early Amortization*

As the ANPR notes, instances of early amortization are infrequent so it would not be appropriate to assign higher capital to all securitizations that have an early amortization provision. Of course, as the loans return to the balance sheet during an early amortization period they will be assigned higher capital levels commensurate with the risk of the loans. In theory, the assignment of a CCF tied to the excess spread to capture the risk of an early amortization event seems to have merit. However, we recommend the Agencies commission a group of subject matter experts consisting of institutions who are active in the securitization markets to consider the capital questions posed in the ANPR, review prior events of early amortization, and formulate a recommendation. As an institution that has not participated in the securitization market, we do not consider ourselves subject matter experts on this question.

Section III – *Application of the Proposed Revisions*

Our comment letter has attempted to make use of universally accepted underwriting metrics and validated internal risk-rating systems to calculate risk-based exposures. There are, however, wide ranges of needs and capabilities among the banks that will not adopt the Basel II accord. We would, therefore, support the Agencies in permitting banks to continue the use of all or part of their existing risk-based framework rather than moving to Basel II or Basel 1A. Rather than establishing a maximum size above which a move to Basel 1A would be required, we feel that each bank needs to assess its own capabilities and come to a joint decision with its primary regulator on the framework to apply. Factors to be weighed would be the complexity of its business, its data capture capabilities and potential costs and benefits of moving to a more advanced framework.

We would recommend, however, that for specific exposure types where the Agencies determine that the risk-weighted exposure has been inadequate under the existing framework and the 1A framework would require an elevated risk weighting, the weighting under the 1A framework should also apply to banks opting to continue the use of the existing framework. This would prevent institutions from selecting Basel 1A provisions that would allow for lower risk weights and avoiding provisions that would carry additional risk weight.

Comment is also being sought on how any capital floor should be defined and implemented. As stated earlier in our comments, the goal is to recognize more precisely the gradations of risk inherent in various types of exposures and to more precisely link them to an institution's required capital,

such capital floors should be established solely through the use of risk-based capital ratios. We propose keeping these ratio requirements in place and unaltered as to amount, but abandoning or phasing out the Tier 1 leverage ratio, which fails to differentiate exposures by inherent risk. Such action would not only size capital requirements to risks but would also motivate institutions to constantly improve their risk measurement and management capabilities.

Section IV – *Reporting Requirements*

We understand that an improved recognition of the gradations of risk inherent in various types of exposures will require an increased amount of detail on Call and Thrift Financial Report filings. Our comments attempt to effect these gradations by utilizing universally accepted risk drivers (LTV and FICO) and performance indicators (internal risk ratings, past due and accrual status) that should be easily retrievable by institutions that would opt to use the revised risk-weighted exposure rules.

Section V – *Regulatory Analysis*

The potential provisions of Basel II as they relate to institutions in the United States are still under discussion. This ANPR contemplates changes to the existing framework that would mitigate the potentially material distortions in the amount of risk-based capital requirements that might arise between smaller banks and the larger banks that adopt Basel II. Until the provisions of Basel II are set and the modifications to the existing framework needed to accomplish this goal are defined, it will be impossible to determine a range of potential costs associated with the changes discussed. Our comments have attempted to tie risk stratifications to approval or risk-grading mechanisms used with regularity throughout the qualifying institutions in an attempt to minimize the need for systems modifications and additional reporting costs.

Summary

We support the Agencies in their attempt to recognize the gradations of risk inherent in various types of exposures more precisely than under the current accord and to thereby mitigate material distortions in the amount of risk-based capital requirements that will arise between large (Basel II) and small institutions.

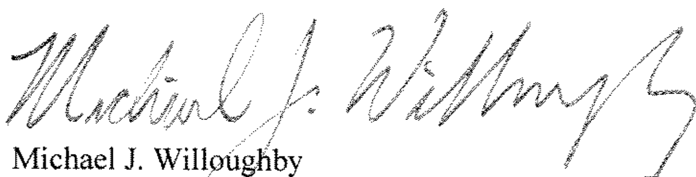
We feel strongly, however, that:

- The ANPR must be redirected to address in specific terms the exposures that are prevalent at institutions to which it will apply.
- The metrics utilized for determining risk weights for each relevant exposure class should adequately differentiate the levels of risk, be commonly used within the industry, and be readily accessible by the institution.
- The goal of the risk-weighting process should be to tie capital requirements to risk of unexpected loss in the portfolio. Where individual products are conservatively underwritten, unexpected loss will moderate and capital requirements should be reduced. Where such products are underwritten on the high end of the risk scale, unexpected loss will rise and capital requirements should increase.

- The weighting process should be structured to provide a continuing incentive for a Basel 1A adopter to improve and upgrade risk-measurement and management processes.
- Institutions should be able to support their risk-weighting classifications to the satisfaction of their primary regulator(s). Where the regulator feels that the application of the weighting mechanism presents an incomplete or errant picture of the institution's risk level, it should maintain its ability to independently determine that institution's capital adequacy.

We have appreciated this opportunity to comment on the ANPR.

Sincerely,



Michael J. Willoughby
Executive Vice President