Massachusetts Bankers Association

January 18, 2006

Ms. Jennifer J. Johnson Secretary Board of Governors of the Federal Reserve System **Attention: Docket No. R-1238** 20th Street and Constitution Avenue, NW Washington, DC 20551	Office of the Comptroller of the Currency **Attention: Docket No. 05-16** 250 E Street, SW Mailstop 1-5 Washington, DC 20219
Mr. Robert E. Feldman Executive Secretary Federal Deposit Insurance Corporation **Attention: Comments/Legal ESS** 550 17th Street, NW Washington, DC 20429	Regulation Comments Chief Counsel's Office Office of Thrift Supervision **Attention: No. 2005-40** 1700 G Street, NW Washington, DC 20552

To Whom It May Concern:

On behalf of our 210 commercial, savings, cooperative, and savings and loan members throughout Massachusetts and New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the Advanced Notice of Proposed Rulemaking (ANPR) on changes to the risk-based capital framework for depository institutions in the United States. We commend the agencies for working to develop risk-based capital requirements for those institutions that are not required or do not have the resources to comply with the Basel II capital accords. However, we are not sure the current proposal moves far enough to mitigate the competitive imbalance created by Basel II.

As you know, there has been considerable attention among banks, regulators, and legislators regarding the impact of the Basel II capital accord on US financial institutions. We understand the regulators' interest in moving the Basel II process forward, however we do believe that it will create competitive inequities between larger and smaller institutions as well as US banks and those operating overseas. For this reason, we believe it is critically important that Basel II should not be implemented unless an effective Basel I-A system is in place. This will allow those institutions not subject to the Basel II requirements to maintain a competitive balance with larger, international institutions.

We will focus our comments on the following three areas of concern: one-to-four family residential mortgage lending, commercial real estate exposures, and the use of external credit ratings. In addition, we are providing general comments on other issues raised by the agencies in the ANPR.

Residential Mortgage Lending

Residential mortgage lending remains a significant business line for the vast majority of both regional and community banks in Massachusetts. As you know, under the current Basel I capital rules, all first lien mortgage loans now have a 50 percent risk weighting. The agencies are proposing a system that would adjust the risk weight based on loan-to-value (LTV) ratios up to a 100 percent risk weighting. We believe that updating LTV ratios should not be mandatory. However, if an institution did wish to

Massachusetts Bankers Association, Inc.
73 Tremont Street, Suite 306
Boston, Massachusetts 02108-3906
Tel: 617-523-7595/Fax: 617-523-6373
http://www.massbankers.org

recalculate risk-weighted capital periodically, we believe LTV ratios are the most readily available of the proposed risk mitigation factors. In addition, the agencies should consider creating a system that places the least regulatory and cost burden on institutions that choose to recalculate periodically.

We are concerned that the small number of risk buckets in conjunction with the increase in risk weightings for higher-LTV loans will negatively impact our member banks. MBA supports an approach that would increase the number of risk buckets while lowering the highest risk weighting category to better reflect the low-risk nature of residential mortgages. This allows institutions to tailor their capital based on their portfolio while eliminating the significant capital increase that has been proposed. Calculations for several of our member banks indicate that in several cases, total risk-weighted residential mortgage assets increased significantly – sometimes as must as 50 percent under the proposed rule. If the intent of Basel I-A is to restore the competitive balance between Basel II banks and smaller institutions, risk weighting for mortgage loans should not increase so substantially.

In particular, we are concerned that capital requirements will double for loans with LTV ratios of more than 90 percent. Doubling the risk weighting for these loans will greatly reduce the ability of our member banks to make loans available to borrowers with limited downpayment resources and first-time homebuyers while discouraging institutions from developing targeted loan programs for underserved communities. As banks face increasing competition for low- and moderate-income homebuyers from non-regulated entities that have no Community Reinvestment Act (CRA) obligations, increasing the capital an institution must hold against most CRA-qualified loans will only force banks out of the market, leaving customers in underserved areas with higher cost mortgages from unregulated lenders.

<u>Private Mortgage Insurance</u>

The agencies have also questioned whether there should be limits on the use of Private Mortgage Insurance (PMI) to reduce LTV ratios. We believe that there should not be a limit if a highly rated company underwrites the PMI. MBA believes that pool-level PMI and other insurance products should also be allowed to lower risk weightings for mortgage loans. Institutions that purchase these insurance products are taking a proactive approach to risk mitigation and management and we feel that the agencies should recognize this approach.

<u>Second Liens</u>

The ANPR also addresses the treatment of second liens. Institutions that hold both the first and second liens could combine the loans to determine the LTV ratio and apply the appropriate risk weight as if it were a single first lien mortgage. However, this could result in substantial capital increases, making some institutions less willing to extend the second lien, thereby reducing consumer choice and convenience.

The agencies also propose changing the current 100 percent risk weight for stand-alone second liens or Home Equity Lines of Credit (HELOCs) where an institution does not hold the first lien. Under the proposal, second liens receive a 100 percent risk weighting if the LTV at origination for the combined first and second lien loans does not exceed 90 percent. If the LTV is over 90 percent, the agencies believe a risk weight higher than 100 percent would be appropriate. We do not support any approach that increases risk weights above 100 percent – this is simply not proportional to the risk of these products. If this proposal is adopted, Basel I-A banks will again be at a more significant competitive disadvantage with Basel II institutions as well as unregulated mortgage lenders.

<u>Commercial Real Estate Exposures</u>

We understand that the agencies have historically had concerns with loans made for the acquisition, development, and construction (ADC) of commercial property. These loans are currently subject to 100 percent risk weighting. The ANPR proposes increasing the risk weighting above 100 percent unless certain conditions are met, including complying with the interagency real estate lending standards and having borrower equity of at least 15 percent.

We strongly oppose increasing the risk-weighting above 100 percent because it will significantly reduce the amount of ADC lending at our member banks. We have calculated that under the proposal, risk-weighted capital could double at many institutions. This is an area where smaller institutions compete directly with Basel II banks and credit unions; therefore, any proposal should ensure that all institutions are subject to similar capital requirements.

Use of External Credit Ratings to Assign Risk Weights

The ANPR proposes allowing institutions to assign risk weights for certain assets based on external credit ratings issued by a recognized rating agency. We do not support the use of credit ratings in determining the risk of commercial loans because many of the loans made by our member banks are to small, unrated companies. Many commercial loans made by smaller banks are to businesses that are good credit risks with low probability of default but have not been rated. Capital requirements should not discourage lending to these companies. Capital requirements for commercial loans must be simple and applicable to loans for all creditworthy businesses, regardless of external credit ratings.

Other Issues

The agencies also request comment on whether institutions should be able to remain under the current Basel I system, and if so, should the option only apply to institutions of a certain asset size. We believe that initially, institutions should be given that choice. However, we strongly believe the agencies should develop a Basel I-A system that is attractive to the majority of institutions, regardless of asset size. We would suggest that a trifurcated capital system must be carefully considered to ensure that it would not pose problems for US institutions in the future.

Finally, we do not support requiring Basel II institutions to calculate capital under the Basel I-A framework. Mandating that these institutions develop new systems for Basel I-A reporting on a temporary basis will create an excessive cost and regulatory burden. We believe that Basel II institutions be given the choice to use Basel I or Basel I-A for risk-based capital calculations until Basel II is fully implemented.

We commend the agencies for issuing the ANPR and requesting comments at an early stage in the process. Any Basel I-A system must seek to maintain the competitive balance between Basel II institutions and other banks. In several areas, the proposal seems to move in the wrong direction.

Thank you again for the opportunity to comment. If you have any questions or need additional information, please contact me at (617) 523-7595 or via email at jskarin@massbankers.org.

Sincerely,

Jon K. Skarin
Director, Federal Regulatory & Legislative Policy

JKS