The Partnership for Banking Excellence

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Subject: Risk-Based Capital Guidelines/Advanced Notice of Proposed Rulemaking

Ladies and Gentlemen,

I am writing in response to your solicitation for comments on proposed revisions to the risk-based capital guidelines for non-Basel II banks made public in the Federal Register on October 20, 2005. I am a banking industry consultant based in Santa Fe, NM with long experience in dealing with hundreds of financial institutions that will fall outside the scope of Basel II, and will therefore operate under the Basel Ia rules should they be adopted.

My general impression is that the changes contemplated in the Notice of Proposed Rulemaking (ANPR) will likely work to diminish the disparate impact between large and small banks that is likely to occur when Basel II is adopted. In addition, the finer gradations with respect to risk-weightings of different exposures described in the ANPR will more effectively calibrate capital levels with risk levels.

Despite these potential improvements to the regulatory capital standards, I am concerned that the ANPR excludes from its scope future competitive inequities and misallocation of capital to risk that will exist in the realm of identifiable intangible assets.

In this category there are two types of identifiable intangible assets, Purchased Credit Card Relationships (PCCRs) and Purchased Mortgage Servicing Rights (PMSRs) that are generally found only among banks in the Basel II type financial institutions and are not deducted from tier-one equity capital. Under the existing risk-based capital guidelines, these assets are 100% risk-weighted assets.

In addition to PMSRs and PCCRs, there is a third identifiable intangible asset, Core Deposit Intangible (CDI), that frequently is found at banks of all sizes, and is fully excluded from the calculation of tangible tier-one equity.

The amount of true economic capital needed to carry CDI is 16.67 times the amount needed to carry either of the other two assets in the identifiable intangible asset category.

Under the proposed revisions to the risk-based capital rules, owners of PMSRs and PCCRs may be able to obtain even more advantageous risk-weighting if those banks are able to secure guarantees for PMSRs and PCCRs from investment grade-rated third parties. If such guarantees could be secured for PMSRs or PCCRs, the disparity in capital treatment between them and CDI would increase even further.

Such guarantees of CDI value have already been secured from investment grade-rated third parties. However, given CDI's full deduction from tier-one equity, owners of guaranteed CDI assets will see no change in its regulatory capital status under the proposed rule. The ANPR's proposal constitutes an acknowledgement that the regulatory agencies are recognizing the risk mitigating character of such guarantees, and, further, the agencies are willing to extend additional capital benefit to guaranteed PMSRs and PCCRs. Competitive parity in this area will not exist between smaller and larger banks if guaranteed CDI is to be treated differently than guaranteed PMSRs and PCCRs.

This issue illustrates in real terms the twin concerns the agencies have expressed as paramount in both the Basel II literature and the ANPR. If disparate capital treatment between these assets is not addressed, competitive inequity will exist between Basel II and smaller banks, and capital requirements will not be aligned with the comparative risks exhibited by PCCRs and PMSRs versus contractually protected CDI.

Sincerely,

Alex Sheshunoff