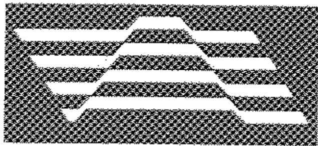

NEW SOUTH
FEDERAL SAVINGS BANK®
MEMBER FDIC

Location: 1900 Crestwood Boulevard
Birmingham, Al 35210

(205) 951-4000

January 17, 2006

Public Information Room
Office of the Comptroller of the Currency
250 E Street, SW
Mailstop 1-5
Washington, DC 20219
November 9, 2005

Attention: Docket 05-16

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

Jennifer J. Johnson
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1238

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

Dear Ladies and Gentlemen:

New South Federal Savings Bank ("New South") appreciates the opportunity to comment on the Proposed Modifications to U.S. Bank Risk-based Capital Standards: Basel 1A (Referred to as "Basel 1A"). We are likewise appreciative of the consultative process that has characterized the development of the proposed rules. In many ways, the proposal reflects concerns addressed by the industry during development. There are other ways, though, in which the "one size fits all" nature of the proposal falls short. In any event, we look forward to continuing a constructive dialogue as we work toward implementing the new Accord.

By way of introduction, New South is a $1.6 billion savings bank headquartered in Birmingham, Alabama. As an independent thrift institution, New South has distinguished itself as a leader in affordable lending initiatives in all markets that it serves. Likewise, New South is a strong institution, maintaining "well capitalized" status and strong earnings, never realizing a losing quarter in its 20-year history. The attention provided to affordable lending initiatives along with a strong focus on the bottom line has an impact on the composition of the bank's balance sheet, and consequently, on our comments on the proposed rules.

Generally, we agree that smaller institutions with limited resources like ourselves would be at a competitive disadvantage under the Basel II Accord. We believe that larger institutions will be in a position to implement Basel II in a manner that will more efficiently employ their capital, resulting in superior returns and a further competitive advantage. Even a slight advantage

benefiting larger institutions could, in a highly competitive market, endanger the survival of smaller, independent institutions. We believe that the proposed Basel 1A is a satisfactory attempt to address the competitive advantage issue, but remain concerned about the following aspects:

- Increased number of risk-weight categories.
- Using credit scores as a determinant of risk-weights.
- A single CCF for short-term commitments.
- Additional capital for loans 90 days or more past due.
- Revisions to commercial real estate loan risk weightings.
- Absence of consideration of interest rate risk.

Increased Number of Risk-weight Categories

While we generally agree that more specificity is in order in terms of risk-weighted categories, the proposal leaves the identification of assets (other than investment securities rated "B" or lower) that would fall into the 150% and 350% categories open to speculation. We believe, however, that we must comment on this aspect, and must also engage in this speculation, as described later in this letter, because the effect of the two higher risk-weightings would be onerous. We agree that there are currently too few risk weight categories, particularly in regard to real estate loans, and agree with former Director Ellen Seidman, who stated in 2001, "…real estate lending is, over long periods of time, very substantially less risky than commercial lending, by a factor greater than that recognized in the risk-based capital rules." Performing, prudently-underwritten real estate loans should not carry the same risk-weighting as a typical commercial bank loan and we are pleased to see the possibility of lower risk-weightings for lower loan-to-value real estate loans, as described in the proposed rule.

Using Credit Scores as a Determinant of Risk-Weights

The proposed rule indicates that the Agencies are considering alternative methods for assessing capital based upon the evaluation of credit risk, indicating by way of example, by combining credit scores with loan-to-value ratios. Based upon our experience, this aspect of the proposed rule is the one that we find the most disturbing. We are concerned that regulators will place undue reliance upon credit scores as a sole barometer of creditworthiness. In practice, there are a variety of factors that are considered in the underwriting decision in addition to credit scores, such as debt ratio, collateral value, term of employment, amount and stability of income, etc. Regulators would likely criticize an institution for relying solely upon credit scores, but would encourage them to do so if the final rule included credit scores as the key determinant of credit quality. Rather, the final rule should incorporate consideration of the factors that banks use to underwrite loans, and should incorporate internal loss data as much as possible.

Another concern that we have in regard to the use of credit scores as a determinant of risk weightings is that credit scores vary widely across regions. For example, according to Experian, the average credit scores for the following geographic areas are as follows:

Geographic Area	Zip Code	Average Credit Score
United States		677
Washington, DC	20515	692
Boston, MA	02110	706
Boulder, CO	80305	674
Birmingham, AL	35210	670
Miami, FL	33128	673
Dallas, TX	75201	649
Alburquerque, NM	87192	665
Memphis, TN	38120	662
Columbia, SC	29201	664
New Orleans, LA	70130	668

From our perspective, there are three issues involved in the disparity of scores and the use of nationwide credit score ranges. These issues arise not from the absolute value of the average credit scores, but from the implication by those averages that a greater percentage of the given population will fall into the lower credit score ranges. First of all, large institutions which are more able to branch into different regions, or institutions already operating in those regions, could use credit score models to more efficiently implement capital in higher score regions; versus smaller, community banks who are required by regulation to lend within their geographic footprint. It has not escaped our attention that credit scores in the southeast and southwest tend to be lower than scores in the northeast and mid-Atlantic states. The cost of capital, and hence the cost of lending, could increase in those parts of the country.

Secondly, it has been our experience that regulators have historically tended to focus on a definition of subprime loans as those with scores below 660. This focus arises out of guidance issued February 2, 2001, in which subprime loans are defined by a variety of characteristics, including credit scores of "660 or below". The other characteristics notwithstanding, regulators have interpreted this guidance to mean that a loan with a sub-660 credit score is a "subprime" loan, and at least requires additional scrutiny, if not additional capital. We are concerned that this "660 standard" will be used as a boundary for increased capital requirements. Loans to approximately one-half of the borrowers in areas such as Dallas, Birmingham, Jackson, or New Orleans, could require higher capitalization, assuming normal distributions, increasing the cost of credit or discouraging lending activities in those areas. We are concerned that regulators will develop a rigid credit score matrix that ignores these geographic differences. The capital markets, however, do not appear to be as rigid in this regard, and do not always begin the subprime spectrum at 660. For example, the average credit scores of asset-backed pools identified in the market as "subprime" tend to fall in the range of 560-620. If credit scores must be introduced as a component of the risk weightings, we strongly recommend a variety of ranges associated with differing risk weightings and consultation with securitization market participants in order to understand the capital markets approach, incorporating securitization ratings methodologies into the weightings. Otherwise, the competitive advantage issue introduced by Basel II will not be resolved.

Finally, so little information is provided in regard to differences in credit scores along racial and demographic lines that it is difficult to determine whether a score-based weighting standard will unfairly impact minority and lower-to-moderate income borrowers. Additionally, credit scores are often wrong, are extremely volatile, and reportedly can be manipulated over a short period of time. Consumer advocates should be concerned about a score-based standard that could allocate capital away from minority borrowers.

A Single CCF for all Commitments

We are not supportive of a single credit conversion factor ("CCF") for all commitments. Commitments greater than a year that are unconditionally cancelable by the issuing institution or in which each draw is predicated upon a separate underwriting decision do not currently require capitalization. Commitments longer than one year that do not meet that standard expose institutions to more credit risk and, as such, should demand higher capitalization. We are concerned about the alternative approach briefly mentioned in the proposed rule because it would essentially remove smaller institutions from the HELOC and construction lending markets, because their access to capital markets is much more limited than larger institutions. Excess capital is a scarce commodity, and cannot be tied up by unused commitments. We would prefer that the rules allowing a zero percent CCF remain in place.

Additional Capital for Loans 90 Days or More Past Due

The proposed rule indicates that the Agencies may require additional capital for loans past due 90 days or more, net of any allocated reserves. Because the proposal is not clear on the risk weighting that would be applied, we are left to speculate that it is proposing either the 150% or the 350% requirement. In either case, because an institution is generally required to adversely classify any severely delinquent loans, thereby setting aside specific reserves in many cases, and is required to reflect real estate owned and repossessions at realizable value, it would seem that assigning such assets to a higher risk-weighting category could be effectively "double counting" the loss exposure. If the institution has already taken the charge to earnings or capital via specific reserves, it is unreasonable to require another significant layer of loss protection. Any significant exposure is more emblematic of a flawed loan loss reserve methodology, rather than an indication of generous regulatory risk-weighting. We are opposed to an incremental layer of capital applied against severely delinquent loans.

Revisions to commercial real estate risk weightings

The proposal suggests two changes to commercial or multifamily risk weightings. We are supportive of the proposal to reduce the risk weighting assigned to multifamily residential loans. Our loss experience in this asset class has been minimal, and it is generally believed that their loss profile closely tracks that of residential 1-4 loans. Further, the growth of government-sponsored entity participation in the multifamily market has made bank financing at the 100% risk weighting an unattractive proposition. It is possible that a significant reduction in the risk weighting required for performing multifamily loans may bring banks back into the sector. We are not supportive, however, of the proposal to increase a component of the risk weighting assigned to acquisition, development, and construction ("ADC") loans. While the regulators have longstanding concerns in regard to ADC lending, we have not seen these concerns come to

fruition, despite years of dire predictions. The residential construction industry has been a steady component of the nation's economy for an extended period of time, and our loss experience in this asset class has been minimal. We would be concerned that requiring additional capital for a component of this asset class could stifle activity significantly.

Absence of Consideration of Interest Rate Risk
Unlike the proposed Basel II, the proposed Basel 1-A fails to address interest rate risk, focusing exclusively on credit risk. Ironically, interest rate risk in particular is one area in which institutions that would probably migrate to the 1-A framework already have adequate processes in place. For example, the Office of Thrift Supervision requires that institutions larger than $1 billion independently measure interest rate sensitivity, and also provides OTS interest rate risk management reports to the institution. We believe that a final rule that ignores interest rate risk considerations will not resolve the competitive advantage issue.

In summary, we believe that the proposed rule is a step in the right direction, but we are concerned that if it is not implemented properly, it may not realize the objective of providing equity between large and small institutions, and may in fact have an adverse impact on portfolios that are prudently-underwritten and well-managed. Further, we are very concerned that using credit scores as a basis for risk weights could have negatively affect lending operations in certain regions of the country.

We appreciate the opportunity to comment on this issue, and would like to thank the Agencies for their continued constructive dialogue with the industry. Please contact me at (205) 951-4009 if you have any questions.

Sincerely,

Robert M. Couch
President and Chief Executive Officer