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September 26, 2011

Gary A. Kuiper, Counsel
Attention: Comments, Room F-1086
Federal Deposit Insurance Corporation,
550 17th Street, NW.
Washington, DC 20429

Communications Division
Office of the Comptroller of the Currency
Mailstop 2-3 Attention: 1557-0081
250 E Street SW
Washington, DC 20219

Jennifer J. Johnson Secretary,
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Consolidated Reports of Condition and Income, 3064-0052 ; (FFIEC 031 and 041)

Ladies and Gentlemen:

U.S. Bancorp ("USB") appreciates the opportunity to comment on the joint notice of proposed agency information collection activities ("Joint Notice") related to the revisions to the assessment system applicable to large institutions previously adopted by the Federal Deposit Insurance Corporation (the "FDIC"). USB recognizes the importance to the FDIC of identifying and differentiating risk among covered institutions and supports methods to make assessment pricing more risk sensitive. However, we believe the definitions of "*subprime*" and "*leveraged lending*" in the information gathering instructions (and the assessment pricing rule) are fundamentally flawed because they will not produce information that will allow the FDIC to differentiate risk related to these activities across the banking spectrum and will have unintended consequences. Specifically, the definitions:

- do not consider appropriate risk characteristics and therefore will not identify the types of loans with elevated risk the FDIC seeks to identify
- will result in reporting of many loans that do not have increased risk
- do not appropriately consider how risk is evaluated for loan renewals – relationships could effectively "downgrade" into subprime or leveraged lending as a result of broad economic weakness.
- may inappropriately affect the types of loans institutions are willing to make, and the prices at which they are willing to make loans with certain characteristics not otherwise reflective of institutionally-determined credit risk

We recommend the definitions in the instructions and assessment rule be modified as follows:

Subprime

- Apply the criteria in the 2001 Interagency *Expanded Guidance for Subprime Lending Programs*, specifically inclusive of the phrase "may include one or more" in the evaluation of credit risk characteristics.
- Alternately, as a majority of the covered institutions have recently suggested to the FDIC, allow reporting of segmentation of retail loans by credit scoring bands – using credit reporting agency scoring or probability-of-default equivalents – and adopting a scaling approach to incorporating different proportions of each band into the risk assessment calculation.
- Regardless of approach, evaluate only based upon the credit risk characteristics as they existed at the origination date, not upon restructuring, modification, or renewal.

Leveraged lending

- Apply the criteria in the February 2008 Comptroller of the Currency's *Leveraged Lending, Comptroller's Handbook*, specifically inclusive of the supervisory accepted interpretation that the "purpose test" (criterion that loan proceeds are used for buyouts, acquisition or recapitalization) is a requisite feature for application of the other criteria.
- Limit application to loans greater than five million dollars in original commitment. Most institutions within the scope of the large bank pricing rule do not gather the type of information needed to apply the mathematical leverage tests for loan commitments below this amount because smaller loans are underwritten using different approaches and data.
- Evaluate only based upon the credit risk characteristics as they existed at the origination date, not upon restructuring, modification, or renewal.

Further Discussion

USB believes existing supervisory guidance and oversight, and long-developed institutional procedures, appropriately identify subprime and leveraged loans. These types of loans did not contribute to the credit crisis or individual institution stress because the <u>definitions</u> were incorrect, but because risk management for those types of lending was not sufficient at some organizations. It is unnecessary to implement arbitrary and duplicative definitions, when using existing definitions and adapting the FDIC's pricing adjustment mechanism to those definitions can better achieve the FDIC's objectives.

Though the grandfathering aspect of the Joint Notice's transition rule is absolutely necessary if the instruction and assessment rule definitions are not changed to allow continued application of existing supervisory identification rules (because it would be immensely costly, and perhaps not possible, to apply alternate definitions on a retroactive basis), it will result in inconsistent information for the FDIC for many years which will make it difficult for the FDIC to adequately tune pricing assessments exposing the insurance fund to increased risk. Utilizing existing definitions would allow the FDIC to obtain comprehensive consistent information which will produce better quality risk measurements for the FDIC.

Subprime Consumer Loans

The definition of subprime in the instructions and assessment rule relies on very specific, individual characteristics/events related to the borrower and ignores the more complex overall underwriting process that goes into evaluating each loan. As a result, individual characteristics can inappropriately lead to a subprime designation. For example, a high-net worth borrower with an 800 FICO, plentiful liquid assets to service debt as needed and low LTV, but minimal income (perhaps self employed, or retired) would likely be designated subprime. Likewise, a borrower who had inadvertently missed payments on a couple small obligations – or perhaps had a dispute with a medical service provider – might be designated subprime in spite of meticulous payments on many other much larger debts. Current bank underwriting processes, as well as third-party credit scoring systems, are sophisticated, and incorporate many borrower and loan feature characteristics. We believe the information the FDIC uses to differentiate risk should utilize the finer level of precision those processes produce rather than using arbitrary and independent thresholds.

Leveraged Commercial Loans

The definition of leveraged lending in the instructions and assessment rule independently applies separate characteristics from the *Leveraged Lending, Controller's Handbook* rather than considering the nature and type of loan – aspects which are critical to differentiation of credit risk. The characteristics of some industries and collateral allow certain borrowers to be able to reliably support higher leverage. For example, some price-regulated industries (such as pipelines and utilities) have very reliable cash flow streams warranting leverage levels that might exceed the instruction definitions. Other industries necessarily require high inventory levels – compared to cash flow – because they are high volume, lower margin business. Because of the pledged collateral these loans typically are relatively low risk, though they may exceed the instruction definitions. Instead, loans which have high leverage and exhibit higher business risk often are related to lending that relies on enterprise value or growth projections such as from acquisition, buyout or recapitalization. For that reason, enhanced risk management and monitoring processes for leveraged lending have for many years been focused on loans made for those purposes. We believe excluding a purpose test from the definition of leveraged lending would result in data that would not be useful to the FDIC because it would be inconsistent across institutions (as a result of different markets and targeted lines of business) and include many loans without increased risk.

Renewals

The large bank pricing rule mechanics contain extensive adjustments to capture risk associated with degradation of borrower credit quality following loan origination, including adjustments for supervisory asset quality rating, delinquent loans, and non-performing loans. Incorporating loan renewals into the definition of subprime and leveraged lending will result in double-counting of loans which did not have evidence of higher risk when underwritten but have experienced subsequent credit weakness. In extreme situations, such as severe and persistent broad economic weakness, large portions of the banking industry's loan portfolios would likely degrade into the subprime and leveraged lending categories as defined in the instructions and rule. This would prevent the FDIC from identifying which institutions were taking on more risk though changes in underwriting or business model. Therefore, regardless of what definitions are used for subprime and leveraged lending, we believe the FDIC's objectives would be better achieved by applying those definitions only to the characteristics of the borrower/loan at origination rather than renewal (or restructure/modification).

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We would be pleased to discuss our comments with you at your convenience. Please contact me at (612) 303-5238 with questions or if you would like additional information.

Sincerely,

/s/ Craig Gifford

Craig E. Gifford
Controller