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September 21, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No, OP-1207

Ladies and Gentlemen:

The following comments are submitted on behalf of the undersigned law firm, headquartered in Mobile, Alabama, with additional offices in Montgomery and Birmingham, Alabama, Atlanta, Georgia, and Washington, D.C. For more than a quarter of a century, we have acted as counsel to a considerable variety of financial institutions, including commercial banks, thrift institutions, bank holding companies, thrift holding companies, and commercial finance companies, ranging in size and character from rural, single-office institutions with total assets of less than $10 million, to multistate bank holding companies having assets in the tens of billions of dollars, operating in both domestic and international markets.

In the course of acting as counsel to depository institutions and companies affiliated with them, we frequently have been asked to consult with and advise those entities in respect to matters arising between them and their respective chartering authorities, whether state or federal, as well as their respective primary federal regulators. In representing bank and thrift holding companies, we often have acted on their behalves in respect to supervisory issues arising with authorities of the Federal Reserve, including, at times, staff of the district Reserve Banks and, at other times, staff of the Board of Governors, and with staff of the Federal Home Loan Banks and of the Office of Thrift Supervision.

As a result of these activities, we have become familiar with various of the supervisory tools utilized by regulatory agencies, including what is frequently referred to as the BOPEC/F-M rating system that has been used by the Board of Governors and the Reserve Banks, as the principal regulator of Bank Holding Companies, since 1979.

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For the reasons discussed hereinafter, we suggest that, given the burgeoning complexities of the financial-services marketplace, and the concomitant difficulties of managing and supervising businesses engaged in the delivery such services, effecting any alteration of the BHC rating system is a prospect that must be approached not merely with the care and thoroughness that ordinarily is exercised in the course of considering any significant alteration of supervisory practices, but, we submit, with the utmost caution.

According to the supplementary information published by the Board of Governors with its announcement of the proposed changes to the BHC rating system, 69 Fed. Reg. 43,996 (July 23, 2004), the proposal is prompted, in part, by the steadily increasing complexity and concentration found in the banking industry. These characteristics are reflected in the rapid expansion of new activities authorized to BHCs and in the fact that, as the Board's release notes, BHCs that hold assets of $10 billion or more, as of year-end 2003, represented 83 percent of total BHC assets, up from the 66 percent held by such organizations at year-end 1992.

These developments unavoidably increase the risk profile for all institutions in the industry, and, certainly, they present more than ample ground for supervisory authorities to maintain their focus on recognizing, identifying, and evaluating the risks with which bank holding companies are confronted, and to seek, through the supervisory process, to encourage directors and management to develop and maintain awareness of the critical importance of effective risk-management policies and practices at every level of their organizations.

Much of our representation of bank holding companies has involved matters related to the supervisory process, including advising clients in formulating their responses to the periodic inspections conducted by the Federal Reserve, which, of course, include the ratings issued, or proposed to be issued, under the current BOPEC/F-M system. The numerical ratings used in that system, and in the CAMELS ratings assigned to depository institutions, in our view, have served the financial-services industry, the communities and customers that it serves, and supervisory authorities, in ways that, manifestly, have been both effective and beneficial.

The utility of such ratings, and of the systems that employ them, has been, in significant part, a result of the constant evolution and refinement of these systems, as supervisory authorities have closely monitored their use and development and have made appropriate changes to enhance their utility, both as a supervisory tool for the regulators, and as evaluative guideposts to be used by regulated institutions as a measurement of their progress and an indicator of where their resources need to be deployed in order to make needed improvements and enhance not only safety and soundness but also overall financial performance.

We do not differ with the appropriateness of the Board's determination that its rating system for bank holding companies should focus more directly and more prominently on the risk profiles of the institutions that are the subjects of those ratings, and should be designed to encourage those institutions to maintain the same kind of focus in all aspects of their operations. We are deeply concerned, however, that the proposed use of "qualitative" ratings for certain key components that are used in arriving at those ratings is unnecessary and could have unforeseen adverse effects on both supervisory objectives and on relations between bank holding companies and the regulatory and inspection staff of the Federal Reserve.

The proposal contemplates that the "R" rating to be assigned to BHCs, reflecting assessment of their risk-management practices, will be arrived at by the use of four "qualitatively rated" subcomponents: "Competence of Board and Senior Management"; "Policies, Procedures, and Limits"; "Risk Monitoring and Management Information Systems"; and "Internal Controls." These subcomponents, alone among all the evaluations to be rendered by the Federal Reserve in the course of its inspections of BHCs, are to be rated not on the numerical "1-to-5" scale historically used by financial supervisory agencies in the examination process, but, rather, according to a new three-level scale of "qualitative" ratings, under which the Federal Reserve will rate each of these categories as "Strong," "Adequate," or "Weak."

As counsel to financial institutions, their parent companies, and their affiliates, we have seen and experienced firsthand the workings of the regulatory process and have acquired an appreciation of the importance of establishing and maintaining effective working relationships between the individuals and institutions that are subject to the regulatory process, and the individuals and agencies that administer and enforce that process. We believe it fair to state that, over the years, a valuable store of mutual understanding has developed through common experience with that process, and with the tools, techniques, and methods that are employed in its administration.

We further believe that this understanding has served to promote and enhance mutual respect between the regulators and the regulated. Even more important, this common understanding has served to enhance the mutual confidence in the regulatory process that forms the essential foundation upon which the continued effectiveness of that process, and, indeed, the very ability of the process to function, ultimately depend.

We are concerned that the proposed implementation of a ratings system in which critical components would be evaluated only as falling within one of three nebulous categories -- "Strong," "Adequate," and "Weak" -- threatens to impair both the mutual understanding of the regulatory process that is shared by the regulators and those that they regulate, and the industry's confidence in that process, which is so essential to its effective functioning.

The change from the five numerical rating categories that historically have been used to three broad, descriptive ratings, in our view, unnecessarily would invite a perception -- certainly, among those who already may be inclined toward such a view -- of the inspection and rating process as unfair, subjective, and, sometimes at least, even biased. This concern is magnified where these ratings are to be assigned in evaluating a category such as "Competence of Board and Senior Management," which by its nature is destined to be perceived as an evaluation that will incorporate personal judgments, feelings, and attitudes toward individuals among the board members and senior management whose "competence" is the subject of the evaluation.

Similarly, the other three subcomponents that, under the proposal, are to be evaluated according to these "qualitative" ratings, all concern subjects that involve broad, fundamental operating policies and practices that, in the ordinary course of the operations of holding companies of any appreciable size, typically are formulated by senior management, from time to time are presented to and reviewed by the board of directors, and are revised and fine-tuned on the basis of the results attained.

As changes in the industry necessarily lead to increased risk profiles among holding companies, and as comprehensive risk management therefore assumes an increasingly important role in managing such institutions and, consequently, in the Federal Reserve's inspection and evaluation of those institutions and the effectiveness with which they are managed, we submit that it is incongruous, to say the least, that the Board now proposes to "streamline" its ratings practices, in respect to significant aspects of risk management, by substituting a range of three new "qualitative" ratings, to be used in evaluating those aspects, in place of the five quantitative ratings that the Federal Reserve, as well as nearly all other financial regulatory agencies, historically has used in assigning supervisory ratings to the institutions that it regulates.

Such a truncated ratings system would seem more appropriate were it proposed to be applied to areas of holding-company operations that are perceived to be evolving to become less complex, or to an industry that is becoming less concentrated, or to one that has every reason to expect that it will encounter less risk in the future than it currently experiences.

As the Board recognized in announcing the proposed new ratings system, however, bank holding companies operate in an industry that without question is increasing in complexity every day, that is becoming more concentrated as consolidation appears to proceed unabated, and in which all indications are that the incidence and complexity of risk, and, therefore, the importance of devising and employing rigorous techniques of risk management, continue to grow steadily.

In this environment, therefore, we respectfully question whether the proposed new ratings system, at least insofar as it provides for "qualitative" ratings of key aspects of risk management, will in fact serve either the needs of the industry or the legitimate supervisory objectives of the Board of Governors.

To the extent that elements of the proposed ratings system reasonably could give rise to a perception, at least among some in the industry, of subjectivity in the inspection and ratings process, we submit that adoption of such a system would represent a threat to the continued effective functioning of that process, by undermining industry confidence in the process and impeding the frank communication between the regulators and the regulated that is an essential foundation of its successful operation.

To the extent that the proposed system, in substituting evaluation of significant regulatory subcomponents according to a three-level scale, rather than the five-level numerical scale that historically has been used, would permit a diminution in the degree of detailed and particularized evaluation of institutional performance, it would appear wholly inconsistent with what is appropriate for an industry seeking to cope with growing complexity, increased concentration, and a rapidly expanding array of risks that arise both in its traditional lines of business and in the growing range of new activities authorized to bank holding companies and their affiliates.

We do not disagree with the concern of the Board of Governors that the increasing importance of effective risk management in the operation of bank holding companies merits recognition through changes in the Board's inspection process and in its ratings system for BHCs. For the reasons given above, however, we question whether the changes that have been proposed are calculated, first, to achieve what the Board seeks to accomplish, and, second, to maintain the effectiveness of the ratings system in achieving the goals of the supervisory process, and in furthering the interests of the financial-services industry and the customers and communities that it serves.

Respectfully submitted,

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By:
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