1STBANK

LOAN CENTER

P.O. BOX 151515 LAKEWOOD, COLORADO 80215 303-235-4500

October 17, 2012

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

Dear Ms. Johnson:

This letter is written in response to the request for comments on the proposed Regulatory Capital Rules concerning the Standardized Approach for Risk Weighted Assets (Docket No. R-1442; RIN No. 7100 AD 87). This letter is a supplement to the letter previously issued by our organization dated September 24, 2012. We continue to have concerns about the overall proposal and potential cumulative impact of the rules on the industry and availability of credit. This letter focuses on some concerns we have about the treatment of certain residential mortgage exposures.

Proposed Elimination of 120 Day Exclusion for Sold 1-4 Family Mortgage Loans

Under current capital rules, financial institutions that sell 1-4 family residential mortgages on a non-recourse basis do not need to factor these loans into the risk-based capital calculations, even if the representations and warranties of the contract allow for the seller to require repurchase of the loan in the event of a payment default occurring within 120 days of the sale taking place. This "early default" provision is a standard term in most secondary market sale contracts. The proposal seeks to eliminate the exclusion and require institutions to factor these loans into the calculations as if they are 100% owned by the institution for the full 120 day warranty period. We believe it is unnecessary to eliminate the exclusion.

Our organization has been originating and selling residential mortgage loans in the secondary market for over 15 years. In that entire time, our records indicate that we have never sold a loan that had an early payment default. If adopted as proposed, we would need to treat these loans as if they have one hundred percent chance of early payment default, despite the fact that our history of sold loans demonstrates a zero percent likelihood that there will be an early payment default. It seems counterintuitive and rather punitive to require an institution to hold full supporting capital for transactions that have minimal or zero potential risk of repurchase. The overall proposed rulemaking will require us to hold higher capital levels. Based on our anticipated volume of secondary market transactions, this provision alone will require us to hold approximately 0.20% more capital than is really necessary. This equates to roughly $375 million of annual secondary market originations, assuming an average risk weighting of 50% for the underlying loans being sold.

The agencies have access to more data than we have relative to loan sales conducted by other financial institutions and are in a better position to understand the overall market. Our belief is that other institutions have a similar experience with early payment default, if the loans being sold are properly underwritten. We also believe that if a particular institution routinely sells loans with early payment defaults, the purchasers will stop purchasing loans from them. This makes the issue somewhat self-correcting, as the institutions will modify practices, stop originating or carry them on their books, where the loans would be accounted for in the risk based capital calculations.

We encourage the agencies to fully analyze the potential impact of eliminating the early payment default exclusion. The analysis should include the impact on the availability and cost of credit. As mentioned above, we anticipate that we will be required to hold an additional 0.20% of capital for a category that has minimal to no risk. Our desire to sell loans on the secondary market is influenced by a number of factors, including our risk appetite for concentrations of credit, interest rate risk, and impact on liquidity. Other institutions may be significantly impacted by this provision, depending on relative loan-to-deposit ratios and the need to sell more loans on the secondary market. Those that already have high loan-to-deposit ratios will likely be more severely impacted by this provision, as they are carrying a significant relative dollar amount of full recourse, fully risk-weighted assets on their balance sheets. As more loans are sold to manage funding availability, imposing full recourse risk weightings for assets that have minimal to no real risk of repurchase will require institutions to hold more capital than necessary. The institution will need to be able to achieve an appropriate return on the loans being sold to compensate it for the cost of capital and an appropriate return. If that cannot be achieved, then it is likely that the institution will exit the business, decreasing competition and availability of credit.

When analyzing competition, the agencies should consider whether the rule will place depository institutions at a competitive disadvantage compared to other lending institutions. If similar rules do not apply across all entities, then the depository institutions will have a higher cost for originating the same type of credit. This cost difference would likely be factored into pricing, which would result in higher rates being offered to customers. Should the pricing difference be significant, it is quite possible that more loan volume will shift to lesser regulated institutions. Granting this type of pricing advantage to lesser regulated institutions does not seem fair or warranted.

Finally, the agencies should analyze other rulemakings in light of this proposal. For example, there are already proposed risk retention rules waiting to be finalized, which impact loans sold on the secondary market. While there is a general exemption from risk retention requirements for loans sold to the GSE's, the exemption only applies while the entities remain under governmental conservatorship. Once that conservatorship ends, the exemption goes away and the loans sold will be subject to the risk retention requirements. If a portion of a loan is already subject to risk retention requirements, then there should not be a need to carry the sold portion of the loan in the risk weighted calculations.

We strongly encourage the agencies to retain the current 120 day exclusion for mortgage loans sold on a non-recourse basis. If the agencies believe that it is necessary to eliminate the exclusion, then consideration should be given to the risk of the underlying transaction. Prime loans, especially those meeting the qualified mortgage definition, should be excluded, as these carry the lowest risk of default. It is not necessary or appropriate to require full capital support for such loans. Having not engaged in higher-priced or subprime lending, we are not in a position to know what percentage of loans actually incur early payment default. While not seeking to add further complexity to these already complex rules, we would not be opposed to the rules requiring some form of inclusion for these types of higher-risk credits, provided the underlying market performance data supports that such loans frequently encounter early payment default. However, consideration should also be given to applying a lower Credit Conversion Factor for such loans. Unless the data suggests that there is a significant risk of early payment default, we believe it would be appropriate to apply a 20% Credit Conversion Factor as opposed to the proposed 100% factor.

Reclassification of Mortgage Exposure at Time of Modification

Under the proposal, if residential mortgage loan is restructured or modified, the risk weighting must be reclassified as of the date of restructure or modification. The minimum risk weighting assigned must either be 100% for a category 1 loan or 200% for a category 2 loan. In order to apply a lower risk weighting, the institution must obtain a new valuation for the collateral and recalculate the loan-to-value as of the modification date. We don't believe that the rule should require a new valuation in circumstances where the loan being modified is a performing credit. We also believe that it is not necessary to categorize any loan with a risk weighting of greater than 100%.

We offer a streamlined, non-qualification modification program for our mortgage portfolio customers. Under the program, the customer is able to pay a fee to obtain the current market rate and modify the loan without the need to go through qualification or paying fees associated with refinancing the debt. This has been a benefit to our customers, as it saves them both money and time. It also allows us to retain our customer relationships and good quality assets that may have otherwise been at risk of being transferred to another lender through refinancing. These are performing credits, many of which have years of clean payment histories. When they are originated, they typically qualify for the 50% risk weighting under the current capital rules. Should the proposal go through, we would be required to assign a 100% risk weighting, which would change the underlying cost for these performing assets. We would need to increase their rate to compensate for the higher risk weighting, unless we require them to pay for a new valuation and calculate a new loan-to-value. Alternatively, we would need to consider discontinuing the program. For performing credits, where the primary source of repayment is income, it does not seem necessary or appropriate to require reclassification or a new valuation at the time of modification.

It may be appropriate to reevaluate risk classification at the time of restructure or modification for a borrower exhibiting financial difficulties. In these situations, we typically are reevaluating the collateral and financial circumstances of the borrower. The modifications may be considered troubled debt restructurings (TDR) or otherwise adversely classified. Assigning a 100% risk weighting to these loans may be appropriate, given the higher risk associated with them. However, we don't believe that any asset should be required to carry a risk weighting of greater than 100%, especially those assets where there is a primary and secondary source of repayment. In addition, if a loan is classified or treated as a TDR, an appropriate reserve allocation or impairment is already being recognized. These allocations account for any potential loss in the loan. For a standard mortgage loan, the change in risk weighting to 100% would effectively double the amount of capital required to support the asset, even though the potential loss has already been accounted for with a specific allocation. That seems to be more than enough capital support, and there is no need to require even higher risk weightings.

One of the criticisms of the current Prompt Corrective Action rules during the recent crisis was that it required institutions with depleting capital due to deteriorating credit quality to increase capital levels at the same time losses were preventing the institutions from doing so. Our understanding is that the Dodd-Frank Act sought to correct that problem by allowing for countercyclical capital requirements. The agencies have chosen not to adopt that standard for all institutions and apply a capital conservation buffer standard instead. Automatically increasing the risk weightings for assets being modified will likely create a similar challenge in the future. As proposed, the risk weighting for these assets will, at a minimum, require twice the capital support as previously allowed. In certain circumstances, the proposal would require four times the amount of capital currently required to carry such assets. The rule has the potential to effectively punish institutions for undertaking prudent modifications of mortgage loans by increasing the underlying capital requirements. An institution with tightening capital levels in an economic downturn may avoid modifying mortgages, except when absolutely necessary, in order to avoid the increased capital requirements. The rules should not be implemented in such a manner as to discourage institutions from engaging in prudent modification practices.

We understand and support the goal of strengthening the capital of banking institutions. However, the industry is also facing numerous other changes as a result of the Dodd-Frank Act. Many of these provisions implement practices that seek to reduce risk. Increasing capital while taking on less risk has the potential to negatively impact the availability of credit and the economy. We do not believe that anyone really understands the cumulative impact of all of these rules taking effect. We encourage the agencies to take the time and carefully analyze the potential impact prior to implementing any changes.

Thank you for taking our comments into consideration. If you have any questions or need clarification on anything contained in this letter, please call me at (303)235-1321.

Sincerely,

David A. Kelly, CRCM
President – Loan Operations