TIAC comments on the interagency advance notice of proposed rulemaking on possible revisions to the current risk-based capital framework (Basel I) that are designed to enhance its risk sensitivity.

At the meeting of the Thrift Institutions Advisory Council on December 2, 2005, Jeffrey Records, Chairman and Chief Executive Officer, MidFirst Bank, Oklahoma City, Oklahoma, and Robert Couch, President and Chief Executive Officer, New South Federal Savings Bank, Birmingham, Alabama, presented the Council's views on possible revisions to the current risk-based capital framework (Basel I).

As we have reported to you in the past, Council members have a number of concerns about proposed Basel II. Chief among them is the negative competitive impact that the changes would have on community banks, particularly in the area of mortgage lending. We are pleased to see the agencies respond to these concerns by issuing the advance notice of proposed rulemaking (ANPR). The general approach taken in the ANPR is a good first step to offering more risk-sensitive capital requirements to all institutions and mitigating the anticipated competitive effects of Basel II. It will be helpful to have notices of proposed rulemaking for both Basel II and a new Basel I-A issued at the same time in the future so the industry can compare the different frameworks. Basel II should not be implemented until Basel I-A also is ready to be finalized to ensure that Basel II banks do not have a competitive advantage. We also believe that implementation should not be rushed. Appropriate capital requirements are essential to the safety and soundness of the industry and time should be taken to address all implementation issues before any changes are made.

All banks and thrifts should remain subject to the same leverage ratio and prompt corrective action processes. While the leverage ratio may restrain some institutions from receiving the full benefits of a Basel I-A or Basel II, a regulatory floor has worked well in the past and must remain in place to mitigate the imprecision inherent in the internal ratings-based systems that will be used by Basel II banks.

We support the approach taken in the ANPR for Basel I-A. More risk buckets, particularly in the mortgage area, based on loan-to-value ratios would be welcome and fairly easy to utilize. There would be increased cost and burden if other risk assessment measures, such as credit scores, were used in the mortgage lending area or with regard to other types of lending. Use of these factors would raise the question of how often an institution would have to update and report this information. Institutions should be able to decide how much burden they are willing to absorb to more closely align capital requirements to their risk profile. Institutions that would like to remain on Basel I as it currently exists should be permitted to do so. Other institutions should be permitted to implement some of the revisions offered in a Basel I-A while rejecting others. More choice will mean more stress on agency resources, so some limitations on choice may have to apply.

The Council also believes an additional approach should be included in a Basel 1-A framework not included in the ANPR. Greater alignment between risk and capital than possible under the expanded bucket approach should be attainable using modeling that is less complex and sophisticated than that proposed under Basel II but appropriate to community banks. The Council recommends that modeling approaches be permitted under Basel 1-A but again recognizes that some limitations on choice may have to apply to have a functional and consistent regulatory regime. One method to achieve both ends would be to allow development of capital requirement models by vendors that might be certified by the banking agencies for application, subject to supervision, by those banks that choose to make the investment in more sophisticated capital-management strategies.

Any changes to capital requirements should be implemented in the same way by each agency so that there is consistency across agencies and across regional offices of the same agency. More choice would bring great risk of inconsistent treatment. A good deal of cooperation would have to occur to ensure that institutions are treated in a fair and equitable manner. Resources would have to be available to monitor, supervise, examine and implement new capital requirements fairly and consistently across the board.