January 18, 2006

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Washington, DC 20219
Attention Docket No. 05-16
regs.comments@occ.treas.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors
Federal Reserve System
20th Street & Constitution Ave. NW
Washington, DC 20551
Attention: Docket No. R-1238
regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
comments@FDIC.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC
Attention No 2005-40
regs.comments@ots.treas.gov

Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications
70 FR 61068 (October 20, 2005)

To Whom It May Concern:

Introduction and Overview

The Ohio Bankers League ["OBL"] is a non-profit trade association that represents the interests of Ohio's commercial banks, savings banks, savings associations and their holding companies. The OBL has nearly 250 members that include the full spectrum of the financial services industry, from small savings associations that are organized under mutual ownership or locally owned and operated community banks to large multistate holding companies that have several affiliates and do business from coast to coast. A few of our members are planning to comply with the revised Basel Capital Accord as developed by the Basel Committee on Banking Supervision ("Basel II"). The vast majority of our members however will be directly affected by the changes to risk-based capital framework you have published in the Federal Register ("Basel IA").

The advanced notice of proposed rulemaking ("ANPR") is among the most important proposals that the agencies have ever released. The revised capital standards, if not implemented thoughtfully have the potential to put almost every depository institution complying with Basel IA at a serious competitive disadvantage to Basel II banks. For this reason our association took the extraordinary step of soliciting and seeking out the input

of over 60 bankers while we were drafting this comment. As a result, the input here reflects an excellent cross-section of the Ohio financial services industry.

The OBL would first like to compliment the agencies for taking this step to revise risk-based capital requirements for all depository institutions that do not have the resources or want to avoid the significant burden of complying with Basel II. Compliance with the new capital standards will be a huge undertaking. Having consistent and complementary capital standards are critical to the long-term health of the financial services sector. Given the complexities of the task however, we hope that all of the banking agencies proceed thoughtfully and view this as just one more step in the process of developing a new risk management framework.

The OBL believes the final regulation should have two objectives: First, the capital standards should require a level of capitalization that reflects the risk profile of each depository institution. The second objective should be to treat non-Basel II banks as nearly the same as Basel II banks as is feasible, so as not to leave them at a competitive disadvantage.

Concerns Regarding the Current Proposal

Our primary concern with the ANPR as initially proposed is that the banking industry is too diverse and complex for a single alternative to Basel II. The business and strategic plans of depository institutions vary widely, resulting in widely divergent risk profiles. The capability to manage that risk also varies widely among institutions. As important as capital regulation is, one size simply cannot fit all of the non-Basel II institutions.

The largest shortcoming of the proposal is that it does little to encourage better overall risk management. In addition, the proposal does little to reward those banks that have already invested heavily in both developing the systems and hiring the expertise to better analyze and manage risk. It is also a concern that this proposal addresses only credit risk, ignoring other important components of overall risk such as interest rate risk or operational risk.

In short, the ANPR doesn't measure the *quality* of any depository institution's risk management. There is no part of the current proposal that takes into account whether a bank is better or worse at managing risk against its peers. Further, there is nothing in the proposal that tests the accuracy of a bank's own models and projections against actual losses. As a result, the risk capital required under the ANPR could be too high or too low compared to the risk that is being assumed by the bank.

Finally, to take advantage of the ANPR, community banks will be required to seek out new data to justify lower risk-capital ratings. As we describe below, in some cases this data will be expensive and difficult to obtain. There are also some issues of scale: the smaller the institution, the higher the marginal cost. In other cases, we question the value of this data as a predictor of loss. As an overall policy goal of the revised risk-capital standards, we would urge the regulators to better utilize internal data and systems already maintained by banks and thrifts.

Policy Recommendations
In light of the above concerns, we would urge all of the regulators to reevaluate the ANPR, and to develop a proposal that better fits the industry as it currently exists in markets like Ohio. As described below, don't ignore the good analytical work that has already been done; just build on it.

Currently you have proposed a "two-tier" system, one for the multinationals and another system for the other 9,000 depository institutions. We would urge you to consider a broader system that has multiple tiers. Below, we describe how a three-tier system might work. This system would have many advantages for both the regulators and the regulated. First, a multi-tier system would better align capital with its risk. Second, the framework we describe would encourage banks to better manage risk and reward banks that have already invested in better risk management. Finally, a multi-tier system would give the regulators the flexibility to offer incentives for developing more effective risk management techniques that are appropriate to a bank's size, market and asset mix.

The first tier we recommend would be the current Basel I structure, in effect permitting banks to opt out of any change by staying with the current risk-capital structure. Some banks are privately held, and therefore are less sensitive to higher levels of capital. There are also some community banks in Ohio that just prefer to hold excess capital. There are also a segment of our smaller members that simply can't justify the cost of any new system. For these banks, which are a very important part of the communities they serve, there are already too many regulatory requirements. Ohio can't afford to have this proposal be the idea that forces community banks to merge just because they can't compete with banks that are given a competitive advantage through lower capital requirements.

The middle tier would link capital standards to overall enterprise risk management. To the extent possible, this would rely on data and systems already maintained by banks and thrifts. It would rely on both quantitative & qualitative analysis tied to internal risk management process. Examiners would determine the overall risk profile of the bank's portfolio, and then compare it to the overall strength of the bank's risk management. Fundamental to this approach is how well the bank measures and predicts losses historically. Any analysis would also include a review of hedging against interest rate risk.

The third and final tier would be the Basel I A proposal as revised below.

Comments on the Proposal Published

One to Four Family Residential Mortgage Lending[1] The ANPR would replace the current risk weighting system with one that decreases risk capital as the loan-to-value ratio decreases. Our members found this approach to be logical, but it could potentially be

[1] Currently there is a 50% risk weighting for all loans secured by a mortgage on one to four family dwellings.

quite onerous. Since there is a clear market value at the time of the initial sale, capturing the "value" portion of the equation at the inception of a purchase money transaction is of course quite easy. As a loan becomes more seasoned, it is amortized, and the "loan" portion of the equation decreases, lowering the risk-weighting.

The challenge will come in how the regulators will account for the increases of value of the real estate over time, which should also lower the risk weighting. In some markets, this could be the most important part of the analysis. If periodic appraisals are required, that updating will be very expensive. The whole process becomes more onerous, and in many cases impractical. Appraised values are highly subjective, so Ohio bankers were skeptical about basing lower capital requirements on periodic re-appraisals. The ANPR would provide the greatest incentive to periodically update appraised values to lenders that are active in the most rapidly appreciating markets. We would submit that over-heated markets are where the risks can be the greatest.

In the ANPR, the agencies specifically solicited comment on whether PMI should be permitted to decrease the numerator in the LTV analysis. PMI is a product that is specifically utilized to reduce risk, so it should appropriately be taken into account for the risk-capital analysis. We understand and appreciate that the regulators may want to require that the insurance underwriter meet some standard of financial strength to assure that it will be able to honor its contracts during times of stress. We would want to see the specifics of that proposal before we could comment on it. The OBL however would urge that PMI be recognized for all types of mortgage loans, without regard to the terms of the mortgage.

The proposal also raises alternatives for the treatment of second liens, which vary depending on whether or not the lender also holds the first mortgage. We agree with the approach that permits a lender that holds both the first and second lien to have the option of combining the two loans together to determine the LTV ratio, treating the risk the same as if the loan was a single mortgage.

Finally, Ohio bankers expressed concern "non-traditional" mortgages might be given different treatment under the ANPR. Among other problems, this has the serious potential to make CRA lending even more difficult. For this reason alone, OBL strongly suggests that all residential mortgages be treated the same under the proposal.

Multifamily Mortgages[2]*:* The proposal suggests that certain seasoned loans should qualify for a lower risk weighting. Ohio bankers generally agree that loan seasoning is a good tool for measuring risk in this area. Ohio lenders have found that risk of default declines after about three to five years. Ohio lenders do not however see a correlation between the size of the loan and risk.

The OBL would suggest to the regulators that there are several valuable risk management tools for multi-family residential lending that the proposal ignores. For example, occupancy rates are a good predictor of success. Also, additional collateral can provide

[2] Multifamily residential mortgages currently receive a risk weighting of 100%

important protection, and whether or not rents are assigned is an important indicator of risk. As with loans on one to four family properties, LTV can be a valuable tool to measure risk of future loss. Finally, in Ohio our bankers still use personal signatures of borrowers to mitigate risk. Therefore such support ought to be considered a factor for lowering risk capital requirements.

With these additional risk management tools the regulators might also want to consider more than one level of reduced risk-weighted capital. With these additional factors, the regulators should be comfortable assigning additional levels of reduced risk capital, much like the framework for one-to-four family lending.

Retail Lending[3]*:*
This area is one where it is difficult to develop valid risk management tools that can be used across the board to justify different capital risk weightings. One alternative would be to use loan term to differentiate risk, with shorter terms being given lower capital requirements. Loan to value ratios or debt to income ratios at the inception of the loan are another alternative. One proposed alternative OBL would discourage would be the use of credit scores. While credit scores may have some predictive value, they simply will not work in all segments of the country. In depressed areas, all credit scores will be lower than national averages. Yet, many lenders in those markets still manage to have lower loss ratios than their peers. Our bankers point out that in some markets the lack of employers that offer health insurance alone can have an adverse affect on credit scores community wide.

Commercial Real Estate Lending: Due to supervisory concerns on loans for the acquisition, development or construction of commercial property, there has always been a 100% risk weighting for ADC loans. This proposal suggests raising capital requirements above 100% unless the loan meets certain conditions.

In this instance, we would encourage the regulators to look to the track record of the lending bank. In ADC lending, rapid growth is a good predictor of future loan problems. Thus, if a bank was experiencing unusual growth, then higher risk weighting could be justified. If the bank on the other hand had a good track record of longer-term success, and the loan complied with interagency real estate lending standards, lower ratings could be justified if the borrower had enough equity in the property. If there were enough other strengths in the loan file, that equity could be as low as 15%. In other cases experienced lenders have suggested that requiring 20% to 25% equity to qualify for the lower risk-capital would be reasonable.

The comment also mentioned that LTV ratios would also be a determinate of risk in this area. Experienced Ohio lenders cautioned that LTV will be an accurate predictor of risk only if it is considered in the context of the entire lending relationship, rather than the basis of an individual loan.

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[3] This category includes automobile lending, general consumer lending and credit cards.

Small Business Loans[4]*:* The OBL agrees with the proposal to reduce the risk weighting for small business loans to 75% if certain conditions are met. Our members concur conditioning this lower risk weighting on such factors as appropriate underwriting guidelines and no default. We are not certain however that you need to have full collateralization to lower the risk sufficiently to warrant the lower capital standard.

One of the preconditions for lowering the risk capital to 75% is to have the loan fully amortize within seven years. Lenders in Ohio cannot support this standard because it will eliminate loans to entire industries from the lower risk-capital standard, even though there is no additional risk. In this part of the country the best example of this problem would be agricultural loans. As long as these loans are current and the bank has a demonstrated track record of success in managing an agricultural portfolio, Basel I standards should not discriminate against this class of loans.

Given the reality that much of small business lending relies on the strength of the guarantor or principal owner of the business, we would recommend two additional factors the regulators should consider to lower the risk-weighting for these loans. The regulators should also rely on either the credit score or the debt-to-income ratio of the principal owner or guarantor.

Use of Credit Ratings for Large Commercial Loans: Unfortunately, the commercial loan portfolios for most lenders we surveyed do not include many loans from large, rated companies. Therefore the Ohio Bankers League cannot support the use of credit ratings in determining the risk of commercial loans, without some alternate method for determining risk for unrated companies. Without that balance, this proposal would discourage lending to smaller, unrated companies. In addition, the OBL would point out that rating agencies measure potential for default, not potential for loss to well-secured lenders. Therefore we would oppose making loans to small and medium size companies more expensive through higher risk capital ratings.

Short Term Commitments[5]*:* In spite of competitive pressures, few Ohio banks offer lines that are not unconditionally cancelable by the bank, or which automatically cancel when a borrower's credit deteriorates. Most Ohio banks also have collateral coverage for a line of credit. From a practical perspective, most of our members surveyed suggested that a 20% credit conversion factor be applied to all commitments regardless of term, except those exempted because of the coverage noted above.

Other Issues Raised by the ANPR: In the proposal, the regulators indicated they are considering assigning higher risk weights to loans that are either on nonaccrual or are more than 90 days past due. Ohio bankers do not support this approach. Current

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[4] Current regulation assigns small business loans a 100% risk weighting, unless the loan is covered by qualified collateral or guarantees.

[5] Currently there are no risk-based capital requirements for commitments lasting less than one year. For commitments greater than a year, commitments are converted to an on-balance sheet credit, using a 50% credit conversion weighting.

regulatory guidelines require banks and thrifts to set aside reserves and take other steps to mitigate harm to the financial institution, so no further adjustment is needed here.

We agree and support the regulators' proposal to permit a greater use of collateral and guarantees to reduce capital requirements. We would encourage the regulators however to broaden the types of recognizable collateral beyond just securities that are rated by a recognized rating agency. The proposal is too narrow. The revised capital standard should recognize other types of collateral and guarantees as long as they have any *objective* source of valuation.

Finally, we continue to support a minimum leverage requirement to serve as a "floor" for banks under Basel II, Basel I A.

The staff and leadership at the Ohio Bankers League appreciate this opportunity for comment. We plan to remain involved in this discussion and debate. Should you have any questions, do not hesitate to contact us.

Sincerely,

/s/ Michael M. Van Buskirk

Michael M. Van Buskirk
President

/s/ Jeffrey D. Quayle

Jeffrey D. Quayle
Senior Vice President &
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