SunTrust

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Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Attention: Comments
regs.comments@federalreserve.gov

Re: Docket No. R-1430; RIN No. 7100-AD87; and Docket No. R-1442; RIN No. 7100-AD87

Ms. Johnson,

On behalf of SunTrust Banks, Inc. ("SunTrust"), thank you for the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Board") with respect to the notices of proposed rulemaking that would revise regulatory capital rules. Specifically, the proposed rules addressed by this letter would establish the standardized approach for risk-weighted assets, market discipline, and disclosure requirements published in the Federal Register on August 30, 2012 (the "Standardized Approach NPR") and regulatory capital, implementation of Basel III, minimum capital ratios, capital adequacy, transition provisions, and prompt corrective action, published in the Federal Register on August 30, 2012 (the "Capital NPR", together with the Standardized Approach NPR, the "NPRs"). Please note that SunTrust has total assets of less than $250 billion and would be subject to the Standardized Approach NPR, absent any changes to the contrary in the final rule.

The NPR lists several requests for comments from the industry. In this letter, SunTrust comments on the following:

- The need for a quantitative impact study of the NPRs prior to implementation;
- Differences between the NPRs and recommendations by the Basel committee and implementation of similar regulations elsewhere;
- Proposed rules for residential mortgages;
- Proposed rules for High Volatility Commercial Real Estate ("HVCRE") Exposures;
- Proposed Capital Treatment of Accumulated and Other Comprehensive Income ("AOCI");
- Capital Conservation Buffer; and
- Timing and Scope of NPRs.

Need for a Quantitative Impact Study of the NPRs prior to Implementation

SunTrust recommends that a quantitative impact study ("QIS") be performed in order to assess the impact of the NPRs before any implementation of the proposed rules. Prudence requires that measured steps be taken before undertaking a fundamental change such as is proposed in the NPRs. The capital rules under which SunTrust operates have not substantially changed since their adoption in 1989. While SunTrust articulates views on other issues and questions posed in the NPRs, SunTrust argues that those views should be seen as informing how the Board may want to approach changes to the NPRs as informed by a QIS. More broadly, SunTrust urges thoughtful consideration of the implementation and interaction of the NPRs covered by this comment letter any additional rules which may be forthcoming regarding the treatment of liquidity in financial organizations. The entirety of rules currently being contemplated, and the resultant financial impacts, should be studied and fully understood by all interested parties before the rules are finalized. This could be achieved through a comprehensive QIS initiative.

Historical Precedent

SunTrust notes that prior to implementing the advanced approaches of the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" in 2007 ("Basel II"), the Board, along with other federal regulators, conducted a number of QISs to gain a better understanding of the potential effects of Basel II on United States financial institutions.[1] We note in particular that the fourth QIS began in October of 2004, was finalized in February of 2006 and it, along with prior QISs, greatly informed final adoption of Basel II in the United States in 2007. The Basel Committee on Banking Supervision ("BCBS") conducted several QISs prior to finalizing "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" ("Basel III"); however, the QISs conducted by BCBS were completed on a global basis and none were specific to the United States financial market and its idiosyncrasies. Significant differences exist between the Basel III reforms adopted by BCBS and the proposed U.S. NPRs. These differences present unique issues to the United States financial markets and American financial institutions in competition with their international counterparts, and provide additional support for the completion of a QIS exercise prior to implementation of the NPRs.

Proof of Concept

SunTrust recommends the Board sanction a QIS in order to determine that the desired outcome of the NPRs will indeed be achieved through their implementation. The QIS results and its effects on the U.S. economy and financial industry can be compared to the impact assessment done on the European Union's Capital Requirements Directive[2] to better understand the potential global impacts and alternatives. Specifically, a QIS would help the Board assess and respond to claims that the NPRs are far more restrictive than any of the existing domestic or international regulation and will adversely affect the competitiveness of U.S. financial institutions

1 See Joint Press Release of the Board, the FDIC, the Office of the Comptroller of the Currency and the Office of Thrift Supervision, dated February 24, 2006 entitled "Summary Findings of the Fourth Quantitative Impact Study," which press release also discusses the results of previous studies.
2 Commission Staff Working Paper Impact Assessment, dated July 20, 2011, COM(2011) 453 (final); SEC(2011) 953 (final).

in international markets. Furthermore, a QIS will inform adjustments that should be made to the NPRs in order to ensure U.S. financial institution competitiveness in the global marketplace.

Identify Impacted Markets and Systemic Risk

A QIS would identify different financial markets that could be adversely affected by the NPRs due to the increase in capital requirements on banks and how the financial needs of those markets may be addressed, either inside or outside of the regulated banking industry. It is worth investigating whether or not comments by Fitch Credit Ratings that suggest the NPRs will increase borrowing costs for "plain vanilla" mortgage products[3] have any merit and whether or not this is the right approach from a macroeconomic standpoint, given the recent real-estate centered economic weakness and efforts by the Federal Reserve to support the real estate market through purchases of mortgage-backed securities. A market void could be created from a lack of products which simultaneously would create opportunities for new, unregulated entrants to meet and service the financial needs no longer provided by regulated banks.[4] A QIS could also be used to identify how the NPRs would affect specific demographics and communities to the extent the NPRs change incentives by increasing capital-related costs for particular products or serving certain demographics.

In light of how the most recent crisis was, in part, fueled by the shadow banking system and its undercapitalized, riskier portfolios, SunTrust believes it would be worthwhile to perform a QIS exercise and project the Basel III ratios of industry participants in a stressed environment to better understand if a potential for systemic risk exists. If a potential for systemic risk exists, a QIS could also reveal the severity of such risks. In brief, SunTrust believes that performing a QIS before full implementation is the prudent course of action rather than learning about potential issues through a negative market response after the fact.

Assess and Potentially Reduce the Administrative Burden

SunTrust shares the industry belief that the NPRs will impose a significant administrative burden and cost to implement. However, the Board could address this concern and assess the burden by commissioning a QIS. QIS provides the opportunity for individual banks to assess both the administrative impact and to what extent, if any, the NPRs would limit the ability of banks to compete with unregulated financial institutions. Commissioning a QIS is also useful to the Board and industry because it would jump-start compliance or at least initial assessments of what would need to be changed. This aspect is particularly important for banks that are not subject to Basel II that would be facing this level of technical oversight for the first time. Importantly, a QIS would help identify potential issues with the availability and quality of data before the data would be expected to be reported and allow time to come up with solutions. A

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3 BusinessWire, "Fitch U.S. Mortgage RWA Rules to Discourage High-Risk Lending," September 19, 2012.

4 SunTrust notes Chapter 4 of the IMF report entitled "Changing Global Financial Structures: Can they Improve Economic Outcomes?" (October 2012), in which the report concludes that nontraditional funding structures is correlated with increased financial stress and nontraditional funding structures that depend on other interest-bearing liabilities may be unfavorable to economic outcomes. http://www.imf.org/external/pubs/ft/gfsr/2012/02/pdf/c4.pdf. The implication of the report is that having banks primarily fill the financial intermediation role in an economy is a favorable economic trait and disincentivizing banks from participating in certain sectors of the economy would be a negative outcome.

QIS would also permit the Board to handle such problems uniformly and transparently as opposed to ad hoc solutions that may be required after the fact and which may not be consistent from agency to agency. In addition, SunTrust is concerned that some of the complexities of the NPRs require data to be processed that is either not captured or digitally accessible. A QIS could identify some of the data limitations and adjust rules to either (a) use other forms of available data to capture risk or (b) use a more realistic time-frame for implementation of those areas where financial institutions would need to adopt systems to capture data.

Differences between the NPRs and Recommendations by the Basel Committee and Implementation of Similar Regulations Elsewhere

In many respects, the NPRs reflect the promulgation of Basel II for all financial institutions in the United States. The fundamental problem with this approach is that Basel II presumes modeling is used to determine risk-weights and those risk-weights work in conjunction with loan loss reserves to create a coherent system. The Standardized Approach NPR uses no modeling, thus creating several "cliff effects" or specific points of loan-to-value ratio ("LTV") where there is no corresponding reduction in capital charges despite incremental reduction in risk. An example would be that a loan originated with a 61% LTV is treated the same for risk-weighting purposes as a loan originated with a 79% LTV. "Cliff effects" tend to drive banks to originate one kind of loan versus another in a certain way regardless of other risk-mitigating options because there is no incentive to do otherwise. Whereas the Standardized Approach NPR may work very well as a floor for banks subject to the advanced approach modeling method of calculating risk-weights, SunTrust believes that the static risk-weights of the Standardized Approach NPR will cause significant dislocations of capital and assets for both banks and the economy generally.

Consider the risk-weights for single family mortgages and commercial real estate, which is discussed in more detail below. "The Risk-Based Capital Standards: Advanced Capital Adequacy Framework" proposed by the Board and published in the Federal Register on December 26, 2006[5] ("Basel IA") was a similar attempt at mapping a risk-weight on a loan based only on the LTV. As discussed below, this scheme was not viewed positively because it considers only the collateral of the loan and the exposure of the loan, but not the capacity of the borrower to repay. For similar reasons, re-proposing this old method with the added layer of product distinction does not solve the issues which were pointed out with respect to Basel IA and which led to the Board, prudently, to withdraw the rule. In addition to considering other factors in risk-weighting a loan, risk-weighting must incorporate additional strata to avoid capital and asset dislocations. While modeling may be more precise, for the benefit of the many institutions that will be subject to this rule, a simple, but elastic formula would be sufficient.

Another issue stems from the problems that arise by adopting part, but not all, of Basel II. An example of this is the treatment of small and medium enterprise loans that exists in the Basel rules, but not in the NPRs. In the United States, regional and community banks make a significant number of loans to small and medium sized enterprises. Failing to treat them differently than large corporate loans puts a tremendous amount of stress not only on regional and community banks, but on the way banks will be driven to price such loans and the resulting impact on small and medium sized enterprises. These smaller firms face different economic

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5 71 FR 77518.

realities than large firms and are, generally, far more dependent upon loans as a source of capital and liquidity than large firms. In addition, small and medium sized enterprises have, collectively, an outsized effect on the economy. The effect of not including a separate risk-weight regime for small and medium sized enterprises should be the subject of a QIS by the Board prior to implementation of the NPRs.

In brief, the differences between the NPRs and the rules set by the BCBS support the utilization of several QISs prior to implementing the rule for the sake ensuring minimal unintended economic disruption. As argued above, a QIS would inform the Board whether or not some of the differences in capital rules cause real problems, or whether the effective promulgation of Basel II on all banks without the use of elastic models, which provide dynamic risk-weights, support effective capital regulation. SunTrust suggests that these differences are significant and urge the Board to reconsider the inclusion or exclusion of concepts from Basel II using empirical data obtained through a comprehensive QIS exercise.

Proposed Rules for Residential Mortgages

Focus should be on Underwriting rather than Product

SunTrust notes that the Standardized Approach NPR correctly identifies some of the root causes of the recent market stress, including those attributable to market practices, such as inadequate underwriting standards, certain loan products that provide for negative amortization and issuing mortgage loans on the basis of unverified or undocumented income. It is SunTrust's view that Loan to Value ("LTV") along with other factors reflecting the borrower's ability to repay should be used to evaluate the riskiness of loans rather than a near exclusive reliance on product and LTV as outlined in the Standardized Approach NPR. While the LTV speaks to exposure, there should be a more complete measure of credit quality used to evaluate loans[6], which SunTrust believes is far more predictive of the future performance of a loan. SunTrust believes the proposed Standardized Approach is too narrow and, thus, could be manipulated without addressing other root causes of the most recent crisis. Our recommendation is that the Board consider moving away from a simple two category system that ignores crucial information about a borrower's capacity to repay.

An example of the importance of having a deep understanding of the borrower's capacity to repay and credit quality comes from the Staff Report No. 529, "A New Look at Second Liens,"[7] (the "Report"). The Report illustrates that borrowers with poorer credit and poorer capacity to repay coupled with relaxed underwriting standards will, generally, perform very poorly; however, loans to borrowers with means to repay in similar loan structures will, generally, perform very well.[8] The Report reinforces SunTrust's view that any approach taken to this issue must focus first on the borrower's ability to repay and then on other factors such as LTV and product type, rather than a strict focus on LTV and product type as is currently proposed.

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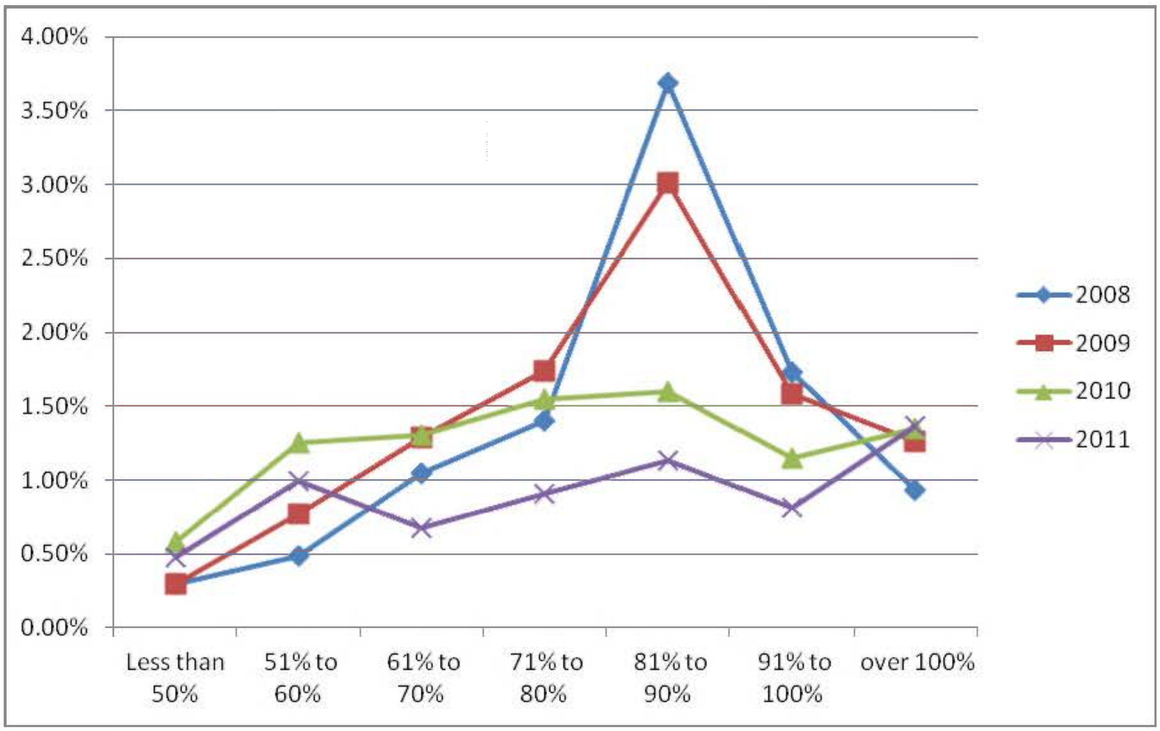
6 SunTrust notes that days past due, an indicator of credit, is captured within the rule; however, relying only on days past due is not a very good predictor of credit quality at origination, when no loan is yet past due, and is a backwards looking evaluation of credit that fails to adequately project future risk.
7 Donghoon Lee et al., Federal Reserve Bank of New York, August 2012.
8 Id. at 6.

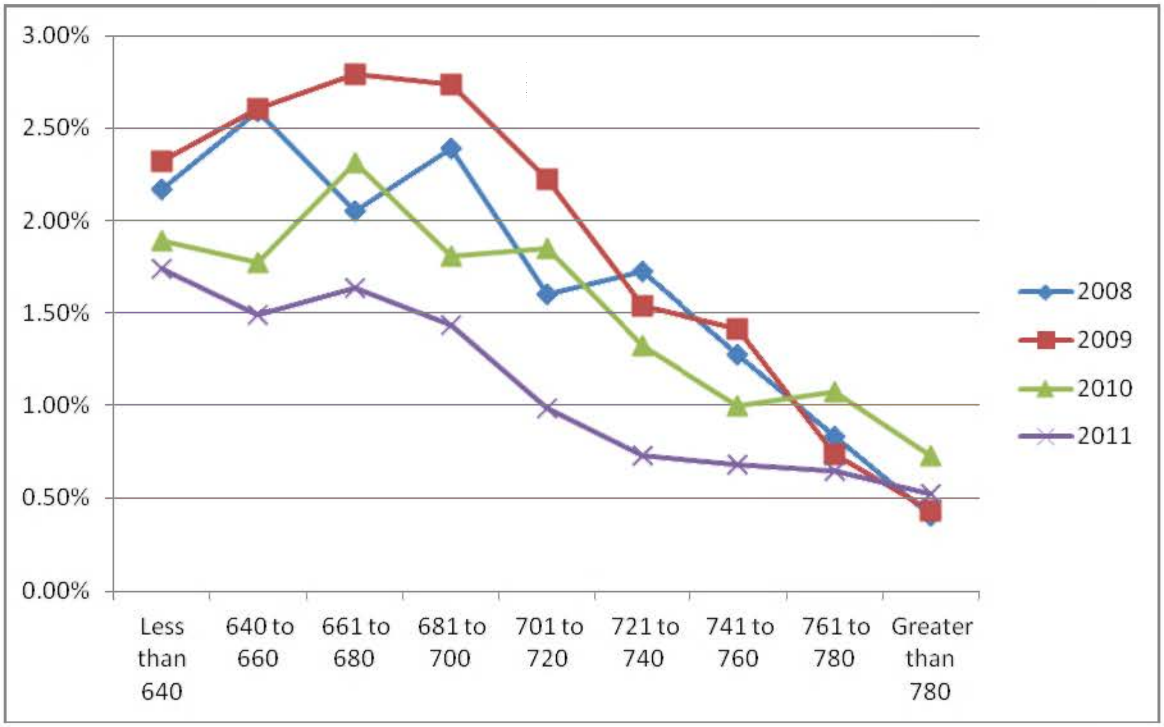
To illustrate the importance borrower-specific credit quality, SunTrust analyzed its own portfolio data. First, loans were divided loans into category 1 or category 2 on the basis of the Standardized Approach NPR, and then plotted against the total percentage of unpaid principal balance ("UPB") of loans that move to default under the Standardized Approach definition[9]. Results were annualized using an average of the quarter-over-quarter roll. These data were plotted against LTV band and against borrower-specific credit quality,[10] as shown below:

Category 1 Default Rates Based Solely on LTV



9 Defined as the movement of a loan from less than ninety days past due to more than ninety days past due.
10 A credit score derived from a Fair Isaac Corporation credit score and used by SunTrust in evaluating consumer credit ("FICO Score").

Category 1 Default Percentages Based Solely on FICO Score[11]

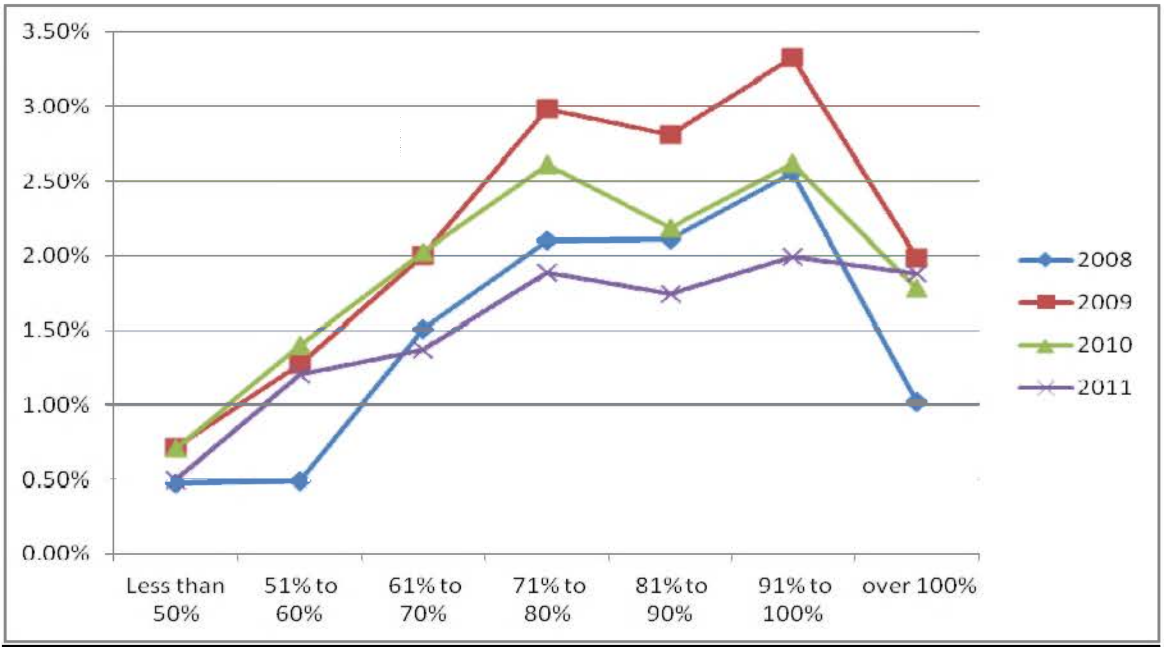


SunTrust notes the stark difference between the two charts: The chart based solely on LTV shows a meandering line without a conclusive slope, while the chart based on FICO Score demonstrates a more consistent relationship between FICO Score and default rate. SunTrust notes that the charts intentionally cover years that were part of the recent credit crisis and, consequently, numbers are likely to be greater than historical averages and show a gradual and continuing decline in default percentages.

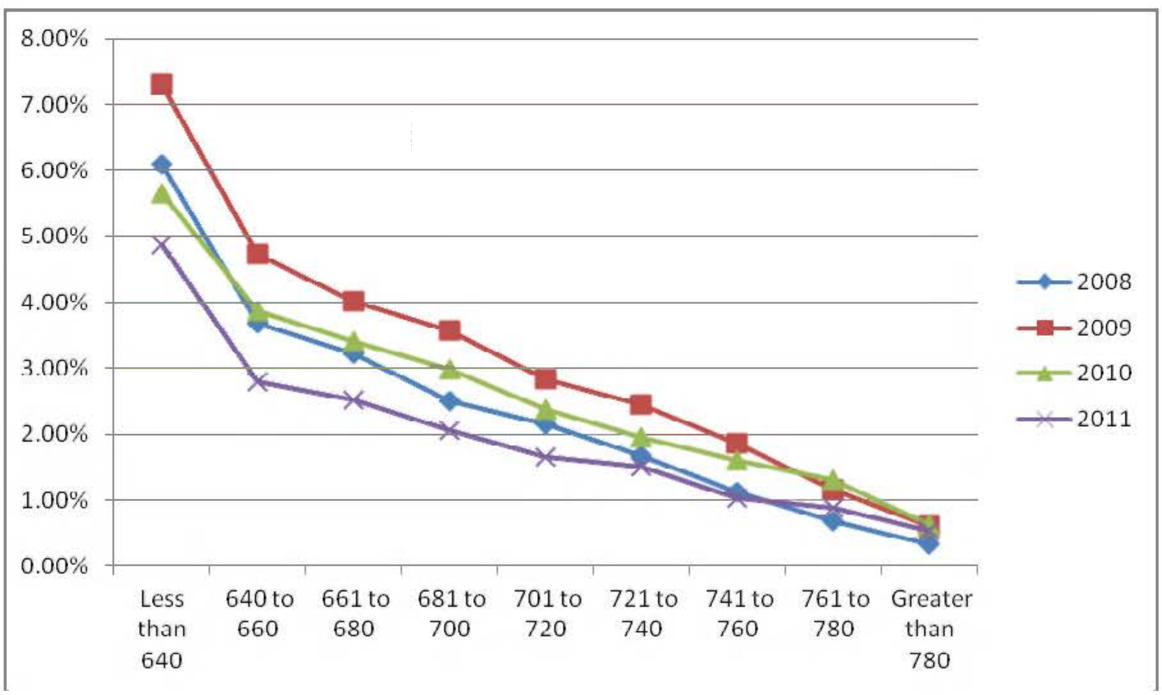
The same method has been employed to analyze loans that fall within category 2 under the Standardized Approach NPR, as presented below:

11 When FICO Scores were missing, they were included in the "Less than 640" category, which may explain slightly better performance there because not all borrowers in the "Less than 640" categories may have had actual scores less than 640. Also, for all years, more than half of all unpaid principal balances represented loans with LTVs between 60% and 90%, thus potentially skewing the representative nature of the sample.

Category 2 Loans Default Percentages Based Solely on LTV



Category 2 Loans Default Percentages Based Solely on FICO Score[12]



12 As in the preceding charts, un-scored credit is placed in the category of "Less than 640." One small difference between these charts and the previous charts, more than two-thirds (2/3) of the unpaid principal balance of category 2 loans in SunTrust's portfolio during this time have LTVs or combined LTVs between 70% and 90%.

With respect to category 2 loans, the default / LTV relationship reflects a modest upward bias; however, the default / FICO Score relationship is very clear, suggesting a much stronger linkage of default and FICO Score.

Based on our portfolio analysis, SunTrust recommends that the Board adopt an approach which specifically considers client credit quality in the Standardized capital rules for consumer mortgage products. One option would be to utilize an approach advanced by the FDIC in their rulemaking on high-risk consumer loans for purposes of large bank pricing assessment (the "FDIC Approach").[13] SunTrust sees several advantages to following this common approach. Under the FDIC Approach, a high risk consumer loan is defined to be:

> "all consumer loans where, as of origination, or, if the loan has been refinanced, as of refinance, the probability of default ("PD") within two years ("the two-year PD") was greater than 20 percent, excluding those consumer loans that meet the definition of a nontraditional mortgage loan."[14]

The particular benefit of the FDIC Approach is that it differentiates several facets of risk in uniform manner. From an administrative burden point of view, most banks are already working to comply with this particular rule and as a result of their implementation efforts either model PD's or digitally capture information that can be easily mapped into a PD. Extending the rule to smaller banks should not pose a tremendous issue because mapping tables are in the process of being produced for banks that currently do not model PD to ensure compliance with the FDIC Approach. It is SunTrust's recommendation that if the Board is looking to also differentiate risk among institutions with respect to residential mortgages, the Board should seek to follow a harmonized approach that both limits the administrative burden and captures more information about the true risk of the loan.

Past Practices should be Recognized

The risk weightings set forth in the Standardized Approach NPR are severe and, unrevised, will cause market dislocations. Under the current rules, the highest risk weight for an asset secured by one-to-four family residential property is 100%. All loans in our portfolio were originated on this prior basis; in fact most loans qualified for a 50% risk-weighting. Retroactively re-characterizing all past residential loans to higher risk weights will cause unwarranted strain on financial institutions with respect to loans that either (i) are performing and have been performing for some time, or (ii) for which some loss reserve has been taken. Application of the Standardized Approach NPR to the current portfolio does not incent any behavior because the underwriting activity occurred in the past. Consequently, SunTrust recommends that the risk-weights for loans originated prior to the effect of the Standardized Approach NPR not be changed.

13 Assessments, Large Bank Pricing, 77 FR 18109 (March 27, 2012), adopted by the FDIC in final form on October 9, 2012, but not yet posted in the Federal Register.
14 Id., 18113.

Inconsistent Incentives should be Reconsidered

Furthermore, SunTrust requests that the Board consider some of the inconsistent incentives created by category 2 mortgages. For example, all junior lien mortgages will receive a risk weight ranging from 100% to 200% dependent on LTV because they will be category 2 mortgages under the Standardized Approach NPR. The risk weight associated with credit card debt is 100%. Therefore, extensions of credit through unsecured credit card lending arrangements will likely be less expensive than credit extended with the support of home equity collateral. It is unclear why more favorable treatment of unsecured credit relative to secured credit is warranted given additional means for recourse, and presumably a greater likelihood of repayment, when a bank receives a promise to repay and collateral rather than simply a promise to repay.

Treatment of Modified and Restructured Loans should be Reconsidered

The Standardized Approach NPR proposes two different treatments for modified and restructured loans depending on whether a loan was modified solely pursuant to the U.S. Treasury's Home Affordable Mortgage Program ("HAMP"). Under this proposal, a HAMP modification would not be restructured or modified under the proposed requirements and receive the risk weight in Table 5 of the Standardized Approach NPR according to the loan's original LTV. Consequently, any loan modification done outside HAMP would be considered restructured or modified and receive a risk weight according to its updated LTV at the time of restructuring.

Similar to many financial institutions, SunTrust developed proprietary modification programs for its bank-owned portfolio during the recent crisis. As a result, of the $3.2 billion of modifications granted to assist borrowers with their financial burdens, only $20 million was completed solely pursuant to HAMP. However, SunTrust's proprietary modifications are very similar to HAMP in loan structure and seek to alleviate the financial burden on borrowers while reducing risk for the bank. To ensure the borrowers' ability to repay, the bank's loss mitigation program qualifies borrowers based on income surplus and affordability through maximum debt-to-income ("DTI") ratios. Affordable payments are found through reduction of note rates, extension of loan terms and principal forbearance. SunTrust's models show that these modifications often reduce SunTrust's potential loss that it might otherwise experience by foreclosing and liquidating the borrower's collateral.

As an example of the impact of the current Standardized Approach NPR, assume a Category 1 residential mortgage was originated at 80% LTV and receives a 50% risk weight. It subsequently defaults and becomes non-accrual, turning it into a Category 2 exposure, receiving a 100% risk weight. The lending institution finds an affordable modification with a loan term of 31 years. At the time of modification, the loan has a 95% LTV due to home price depreciation. The loan performs and returns to accrual status. Under the Standardized Approach NPR, since this loan is a non-HAMP modification, the risk weight increases to 200% (95% LTV, Category 2 due to 31 year term). While a modification would benefit both the borrower and lender, the financial institution would incur a capital charge to modify this loan – a significant disincentive.

In addition, SunTrust has launched a "cash-in" modification program for its performing interest-only ("IO") loans that has resulted in $173 million of modifications to current loans that would normally fall outside of HAMP. This specific program seeks to reduce IO risk, or otherwise the ability for a borrower to defer repayment of principal, by soliciting a cash contribution designed to lower the loan's current LTV and converting the IO exposure into a fully amortizing one. Since HAMP does not have a mechanism to address IO-specific risk, any modifications completed under this program would automatically be assigned a punitive risk weighting under the Standardized Approach NPR, even though the program increases both the financial position of the borrower and the bank. As an example of the impact of the Standardized Approach NPR in this case, assume a Category 2 IO mortgage was originated at 80% LTV and receives a 100% risk weight. It subsequently receives a proprietary modification to convert it into a fully amortizing Category 1 mortgage. At the time of modification, the loan has a 95% LTV due to home price depreciation. Under the Standardized Approach NPR, since this is considered a non-HAMP modification, the risk weight remains at 100% (95% LTV, Category 1). The financial institution receives no risk weight benefit under the Standardized Approach NPR, even though the fully amortizing modification curbs Category 2 exposure.

Due to these limitations, SunTrust believes that assigning an updated LTV exemption based solely upon HAMP would restrict and potentially de-incentivize financial institutions from addressing time-specific financial risks and assisting borrowers in future downturns. SunTrust recommends appropriate risk-weighting for all modifications that benefit both the borrower and financial institution. One way to do this would be to create a qualified modification that incorporated the following principles:

1. Proof of benefit to the borrower: The modification or restructuring should not have an adverse impact to the borrower. Payments should be qualified based on updated borrower financials and affordability should be determined based on industry-accepted ratios, e.g. maximum DTI used to qualify loans for HAMP.

2. Proof of benefit to the financial institution: The modification or restructuring should not have an adverse impact to the financial institution. Any reduction in cash-flow due to the restructuring should out-weigh the loss-event alternative such as foreclosure. A net present value should be consulted to provide the financial justification for modification.

Proposed Rules for High Volatility Commercial Real Estate ("HVCRE") Exposures

Attributing Value to Land as Equity Contributed in HVCRE Rule

The definition of HVCRE provides for an exception to the scope of the definition if a borrower contributes capital in the form of cash or unencumbered, readily marketable assets of at least fifteen percent (15%) of the real estate's appraised "as completed" value. The term "unencumbered, readily marketable asset" would appear to exclude land that may be contributed to a project. The value of land is always ascertainable and should not be discounted as valuable collateral in a loan. Consequently, SunTrust recommends that the Board permit land that is owned by a borrower to be counted as equity contributed to a loan or, at least, some portion of the value of land contributed and upon which a bank can take a lien.

<u>HVCRE Scope should be Refined to Target Risk</u>

The scope of the definition of HVCRE is broader than what is contemplated by the Basel II advanced approach, from which SunTrust has inferred this proposal is derived, and captures loans that the Basel committee notes are not highly volatile commercial real estate. The definition of HVCRE in the Standardized Approach NPR has exceptions only for (i) one- to four-family residential properties and (ii) commercial real estate projects that meet certain criteria around LTV ratios and capital contributed by the borrower. The scope of the proposed HVCRE rule would appear to include loans to many small businesses, and to businesses that will occupy the facilities being improved and whose source of repayment comes from the business ("Owner-Occupied"). SunTrust believes that this large scope of the HVCRE rule does not accurately capture risk.

The BIS Basel II final accord, paragraph 227 defines HVCRE to be commercial real estate loans that (i) are secured by properties that a supervisor concludes has higher default rates, (ii) finance land acquisition, development and construction ("ADC") phases of properties, <u>and</u> (iii) where the source of repayment at origination of exposure is either (a) the future uncertain sale of the property or (b) cash flows whose source of repayment is substantially uncertain. SunTrust agrees with this approach, but notes that it differs substantially from the definition in the Standardized Approach NPR. For example, Owner Occupied businesses have a source of repayment that is not substantially uncertain (e.g. profits from business), but would nevertheless be captured by this definition. Therefore, SunTrust recommends that the definition of HVCRE conform more closely to the Basel II requirements in this respect.

Another way to address the issue mentioned above and other issues is to add the "income-producing real estate" category from the Basel II advanced approach final accord, which was omitted when HVCRE was included in the Standardized Approach NPR. The BIS Basel II final accord paragraph 226 defined income producing real estate ("IPRE") as a method of providing funding to commercial real estate where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset. SunTrust believes this distinction is important to differentiate between ADC projects that are highly volatile and other projects that are not highly volatile. SunTrust recommends the inclusion of an IPRE category in the final rule.

SunTrust also notes that paragraph 70 of the BIS Basel II final accord, which discusses exposures to be included in the regulatory retail portfolio, includes exposures to "an individual person or persons or to a small business." SunTrust believes this inclusion of small business in retail is intentional and that, up to a certain amount, exposures to small businesses should be treated differently than those to larger projects, both from the aspect of risk and the significance to the economy generally. SunTrust notes that the Standardized Approach NPR does not include a separate categorization of retail claims under commercial real estate. To this end, SunTrust supports an exception that all commercial real estate loans of one million dollars ($1,000,000) or less should be risk-weighted at 100% because these loans would primarily benefit small business.

SunTrust also requests clarification on the duration of HVCRE risk-weighting on loans. The 150% risk weighting may be appropriate before the project becomes cash flow positive;

however, once it becomes cash flow positive, 150% seems excessive given the risk. The scope of the definition says that it would encompass "a facility that finances or has financed" projects, implying that if a loan is originated during the HVCRE phase, it would forever be risk-weighted as an HVCRE loan. SunTrust believes that once a real estate project becomes cash-flow positive, either through pre-leasing or other means, the risk-weight should accordingly be reduced to reflect the true risk of loan.

Proposed Capital Treatment of Accumulated and Other Comprehensive Income ("AOCI")

Under the Proposed Capital Rules, "...unrealized gains and losses on all available-for-sale ("AFS") securities would flow through to common equity tier 1 capital." The current risk-based capital rules, which have been in place since the advent of FAS No. 115 in 1993, generally exclude unrealized gains and losses on securities designated as AFS securities. The current capital rules implicitly recognize that the accounting treatment of the investment portfolio is substantially different than the accounting treatment of the remaining bank balance sheet, namely debt and deposits; an asymmetric view which could be misleading when considering the capital position of a banking organization. By excluding unrealized gains and losses associated with the AFS investment portfolio, the current rule allows for the appropriate management of bank interest rate and liquidity risks without injecting capital volatility, given the mismatch between accounting treatments for AFS securities and the debt and deposits that fund them.

Bank investment portfolios serve as a particularly critical tool for asset-liability management. To the extent bank deposits are non-rate sensitive (e.g. DDA, NOW balances), the appropriate hedge is a fixed rate asset, thereby stabilizing the contribution from the deposit and reducing income volatility. Ideally, the deposit would be matched off with a loan of similar tenor but that's not always possible through organic loan production, leaving investments as a more realistic hedging option.

The removal of the accumulated other comprehensive income ("AOCI") filter would, therefore, result in a one-sided capital impact – the change in value of the hedged item (the deposit) would not affect capital but the change in value of the hedge (the fixed rate AFS investment) would. A hedged bank would experience capital volatility that could be material in a changing rate environment. This proposal, therefore, would lead to a substantial change in bank risk management, ultimately impacting the number of products that banks are able to offer clients because they could not offset the interest rate risk.

Investment portfolios are also important sources of liquidity for future loan growth, potential contingent liquidity requirements, and collateral for municipal deposits. Regional banks like SunTrust fulfill an important role in the U.S. economy and seek to make more mortgage loans to consumers. However, continued sluggish recovery has muted loan demand and other factors have driven an increase in deposits. In the wake of dramatically reduced loan-to-deposit ratios as well as the substantially heightened liquidity requirements under the soon-to-be-proposed liquidity coverage ratio and section 165 of the Dodd-Frank Act rules, banks generally have had no choice but to increase holdings of fixed income securities. The elimination of the AOCI filter, however, will both exacerbate the cost of complying with new liquidity standards and reduce SunTrust's ability to rely on securities portfolios as safe and reliable sources of income.

As recognized by the Board, including unrealized gains and losses related to certain debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate could introduce substantial volatility in a banking organization's regulatory capital ratios. Should the rule be adopted as proposed, banks would generally be forced to reduce the size and duration of their portfolios, regardless of whether they currently provide a good economic match to their liabilities, because the volatility in capital ratios would be unacceptable. For example, if a bank is holding 15% of assets in its investment portfolio, and the duration of that portfolio is approximately two years, a 300 basis point change in market interest rates would result in a change in asset value of nearly 1%, which corresponds to approximately a 10% change in capital. This change in capital may be temporary as rates increase or decrease, thus causing unacceptable volatility within regulatory capital levels.

Furthermore, as banks would be less willing to add duration to balance sheets, the current widespread use of Mortgage Backed Securities (MBS) as a source of balance sheet duration offsetting natural liability (deposit) duration will be significantly curtailed, with consequences for overall market demand for mortgage and mortgage products. This change in behavior would clearly be in opposition to recent efforts by the Federal Reserve to support the real estate market through direct acquisition of mortgage-backed securities.

If the AOCI filter is not retained, SunTrust would support a carve-out for certain high-quality liquid assets as defined by the Board in its Section 165 proposal. As discussed above, these securities, composed largely of U.S. Treasuries, government agency and securities issued by government sponsored entities, have very little credit exposure. Such a carve-out would allow banks to maintain a substantial liquidity buffer and prudently manage interest rate risk without taking capital charges related to movements in underlying benchmark rates and wholly unrelated to changes in credit.

SunTrust also believes loss of principal associated with credit risk is already captured in the income statement as a result of quarterly Other Than Temporary Impairment ("OTTI") evaluation required by generally accepted accounting principles. Expected losses considering probability of default and severity of default due to credit deterioration for securities that are in an unrealized loss position must be realized in the income statement. There have been large changes in the fair value of non-agency securities, ranging from large losses at the height of the crisis to more recent gains. OTTI is reflects the impact of losses that are likely to be permanent rather than temporary. SunTrust believes that it is equally bad policy to hold capital against losses that are temporary as it is to be inadequately capitalized, but have such inadequate capital masked by temporary gains. Consequently, new regulation is unnecessary to capture this risk, particularly with respect to securities with no or limited credit risk, because the information is already available to the Board and investors.

Capital Conservation Buffer

As the Capital NPR is currently drafted, the capital conservation buffer acts more as an additional capital requirement above stated minimums rather than a true buffer. SunTrust believes a capital conservation buffer ("CCB") should act more as a true buffer against an economic downturn. Although characterized as "incentives" for banking organizations to hold sufficient capital, the consequences for breaching the CCB more closely resemble prompt corrective actions by limiting capital distributions and discretionary bonus payments. This is done with the stated intent of incentivizing capital improvement through additional retained earnings, incremental capital issuance, or risk-weighted asset reductions. Thus, during an economic downturn, when it would be most that likely financial institutions may experience losses that reduce capital, the CCB would serve as a pro-cyclical requirement to raise capital and, we believe, violate the intent of Section 616 of the Dodd-Frank Act.

In order to better align the proposed CCB with the intent of Section 616 of the Dodd-Frank Act, SunTrust recommends that the Board reserve the right to limit financial institution capital distributions and bonus payments during times of noted economic distress. While during non-recessionary periods a requirement to hold higher levels of capital is consistent with Section 616, during times of economic weakness strong banks may employ capital either through loss absorption or balance sheet growth, as market share is taken from failing banks. Under these circumstances, the CCB should act truly as a buffer to ensure the strength and continued proper function of the banking system throughout the economic cycle. Alternatively, rather than imposing strict economic consequences for breaching the CCB, particularly during times of widespread economic distress, the Board could require that institutions submit a capital recovery plan that details projected usage of the CCB and timelines for recovering the CCB. In both alternatives, the CCB would be a true buffer rather than a *de facto* capital requirement.

Timing and Scope of NPRs

SunTrust strongly believes in the approach taken by the Board in applying the NPRs to all U.S. banks with less than $250 billion in assets. The Standardized Approach NPR should serve as a floor for larger banks. All banks should consistently hold capital for risks in order to prevent an uneven distribution of risks across the financial system. The threat of concentrating risks in certain sectors of the banking industry is sufficient to require consistent application of capital rules throughout the industry. While SunTrust has noted several items within the NPRs that deserve further consideration and refinement, SunTrust would like to commend the Board on its prudent approach in applying the rule to all regulated financial institutions.

SunTrust believes, however, that the implementation timetable for the NPRs should not be set to firm dates, but rather permit longer consideration of certain aspects of the NPRs, particularly in light of potential data gaps and administrative burdens that will be faced by many banks. SunTrust recommends that the NPRs be implemented simultaneously because some elements of the Standardized Approach NPR affect implementation of the Capital NPR. SunTrust also recommends that rather than setting specific dates, the Board would best be served by setting implementation to be eight (8) quarters after publication of the final rule, unless a QIS suggests a longer period is necessary. By setting implementation dates at a period after publication of a final rule, financial institutions can better manage the timing on projects that may be necessitated by adoption of the final rule. Financial institutions are generally reluctant to begin projects to implement proposed rules when the details may change substantially between proposed and final rules. Changes in relatively minor aspects of a rule can cause large cost and time overruns. Setting an implementation date which allows for an appropriate amount of time after the adoption of a final rule is a reasonable solution which would allow financial institutions to plan for and implement required system and process changes from the certainty of a final rule.

Conclusion

SunTrust strongly recommends that a quantitative impact study be performed in order to fully understand the macro- and micro-financial impacts resulting from implementation of the NPRs. A QIS would inform changes that would make the rules more effective and efficient. Ideally, a QIS exercise would incorporate all current and soon-to-be proposed rules, such as those covering liquidity risk management, in order to fully understand the interaction of all current and anticipated regulatory changes.

Absent a QIS, there are several areas of the NPRs that should be changed to make the proposed rules more effective, such as the risk weights assigned to residential mortgages and commercial real estate loans. There are also changes that need to be made to the NPRs in order to allow them to deliver more meaningful results to the Board and public, such as changes to the capital calculation, particularly related to the treatment of AOCI and its volatile and misleading elements, and changes to the Capital Conservation Buffer. For the NPRs to effectively work, they must be applied to all financial institutions, and the ability for unregulated entities to compete with products that are not subject to these capital rules must be curtailed. SunTrust notes that many of the leading residential mortgage producers prior to this most recent financial stress were not subject to the same capital charges as those experienced by regulated financial institutions, and would not be subject to the current NPRs. The NPRs will fail to achieve a global regulatory framework for more resilient banks and banking systems if the issue of unregulated competition is not addressed or the scope of the NPRs is unevenly applied.

Please do not hesitate to contact me directly with any questions or comments you may have about this letter.

Regards,

Paul Burdiss