

October 22, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, D.C. 20551  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)  
Re: Docket No.

**VIA ELECTRONIC MAIL**

Office of the Comptroller of the Currency  
250 E Street, S.W.  
Mail Stop 2-3  
Washington, D.C. 20219  
E-mail: [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)  
Re: OCC Docket ID OCC-2012-0008 and OCC Docket ID OCC-2012-0009

**VIA ELECTRONIC MAIL**

Robert E. Feldman, Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street, N.W.  
Washington, D.C. 20429  
E-mail: [comments@FDIC.gov](mailto:comments@FDIC.gov)  
Re: FDIC RIN

**VIA ELECTRONIC MAIL**

Re: Regulatory Capital Rules

Ladies and Gentlemen:

We are writing to comment on the Agencies' proposals, published in the Federal Register on August 30, 2012, entitled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action" (the "Capital Proposal"), "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements" (the "Standardized Proposal") and "Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule" (the "Advanced Proposal") (collectively, the three proposals are referred to herein as the "Basel III Proposals").

## Introduction

Compass Bank (“BBVA Compass”) is a Sunbelt-based financial institution that operates more than 700 branches in Alabama, Arizona, California, Colorado, Florida, New Mexico and Texas. BBVA Compass ranks among the top 20 largest U.S. commercial banks based on deposit market share and ranks among the largest banks in Alabama (3rd), Arizona (5th) and Texas (4th). BBVA Compass is a subsidiary of BBVA Compass Bancshares, Inc., a wholly-owned subsidiary of BBVA (NYSE: BBVA) (MAD: BBVA). BBVA is a financial services group with approximately \$740 billion in total assets, 47 million clients, 7,400 branches and approximately 107,000 employees in more than 30 countries.

We appreciate the opportunity to comment, as the Basel III Proposals are likely to have a significant impact on the nature of financial services in the United States and are also likely to have a significant impact on BBVA Compass and its affiliates.

BBVA Compass supports the idea of a risk-based capital system that is more risk sensitive. We also support the efforts of the Agencies to improve the risk sensitivity of the regulatory capital framework while addressing shortcomings in regulatory capital requirements that surfaced during the recent financial crisis. Like the Agencies, we are of the view that risk-sensitive regulatory capital requirements are integral to ensuring that banks and the financial system have adequate capital strength to absorb financial losses.

However, we are concerned about the impact and market consequences of the Basel III Proposals and we believe that significant changes need to be made to the Basel III Proposals. Our concerns can be addressed through solutions proposed by our comments below and by comments provided by the industry through a joint comment letter from the American Bankers Association, the Financial Services Roundtable and Securities Industry and Financial Markets Association (the “Joint Trades Letter”).

## Executive Summary

We believe that there should be incentives for banking organizations not otherwise required to apply the methodology in the Advanced Proposal to elect such methodology. We recommend the Agencies make clear that, for organizations using the advanced approaches methodology, the Collins Amendment does not apply to capital buffers, well capitalized requirements and capital surcharges. We also suggest a phase-in option for advanced approaches methods.

Currently, unrealized gains and losses on available-for-sale debt securities generally are not included in regulatory capital. We do not believe the Agencies should change how unrealized gains and losses on available-for-sale debt securities are treated for regulatory capital purposes. This letter discusses the anticipated impact on BBVA Compass of treating accumulated other comprehensive income as an adjustment to regulatory capital.

We believe that empirical analysis of risks in the residential mortgage market is needed before fundamental changes are made to the risk weighting used for determining the denominator of the risk-based capital ratios. Based on performance of many of our product portfolios, we believe that many of the proposed higher risk weights are unwarranted.

To address these broad issues, we offer the following recommendations and comments:

## **I. Voluntary Use of Advanced Approaches**

Notwithstanding the theoretical increase in risk sensitivity of the Standardized Proposal, there are still significant differences between this approach and using advanced risk measurement models that more closely align with internal risk management systems and the goal of continuously improving such systems. To that end, there should be further incentives to apply more sophisticated and risk-sensitive models, policies and procedures. In other words, the Agencies should ensure that there are sufficient incentives for banking organizations not otherwise required to apply the Advanced Proposal to elect such methodology.

We believe that both the agreements reached by the Basel Committee on Banking Supervision in “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems” (“Basel III”) and the Agencies’ Basel III Proposals are intended to establish risk sensitive regulatory capital systems that represent different points along a continuum of sophistication in risk management practices while also providing commensurate safety and soundness enhancements.

However, it is our view that the Basel III Proposals will not do enough to truly increase the risk-sensitivity of regulatory capital measures and, when read in connection with Section 171 of the Dodd-Frank Act (the “Collins Amendment”), will create a disincentive for banking organizations that are not otherwise required to use the Advanced Approaches rules to make necessary investments to develop and implement a more granular and more sophisticated system for measurement of risk and capital planning. Conversely, institutions that have already invested in some (or maybe a significant amount of) sophisticated risk measurement and management tools are likely to find that such investment was a waste of significant resources if the Standardized Proposal (whether as the primary capital approach or as the floor) requires less sophisticated and less exact calculations than that used for internal risk management purposes.

We, therefore, write to encourage the Agencies to ensure sufficient incentives for non-core banking organizations to direct significant resources into developing systems that inherently have a greater degree of risk sensitivity (and thus improve their management of capital and risk), while at the same time providing overall system-wide enhancements to safety and soundness.

We acknowledge the Agencies are not writing on a blank slate and are subject to constraints on their authority. Thus, implementing a system that truly aligns capital and risk may not be entirely within the authority of the Agencies due to the requirement that they impose a capital floor pursuant to the Collins Amendment. The Collins Amendment independently discourages investment in advanced systems, as it prevents banking organizations from receiving the full potential benefit of a reduction in capital that might stem from voluntary adoption of the Advanced Approaches rules.

Accordingly, we urge the Agencies to avoid minimizing or eliminating potential mechanisms that might provide benefits for banking organizations evaluating whether to move toward voluntary election of the Advanced Approaches risk-based capital rules. Stated another way, we

urge the Agencies to avoid taking a more restrictive approach to the proposed regulatory capital framework than is required by the Collins Amendment.

The Collins Amendment applies to a narrow set of measurements in the capital framework and requires only that the “minimum” leverage and risk-based capital requirements not be less than the generally applicable requirements.<sup>1</sup> This means that other requirements imposed on top of those minimum ratios or in addition to the minimum ratios, would not be subject to the requirements of the Collins Amendment.

Consistent with this conceptual framework, below we describe certain areas that may incentivize development of more sophisticated tools for measuring and predicting risk, and we recommend a phase-in method by which non-core banking organizations may choose to adopt voluntarily the Advanced Approaches methodology.

### Capital Conservation Buffer and Countercyclical Capital Buffer

The Agencies have already validated the appropriate reading of the Collins Amendment by determining, in the Capital Proposal, that compliance with the Capital Conservation Buffer is calculated by applying the Advanced Approaches only.<sup>2</sup>

We agree with the Agencies that calculation of the buffers using a floor calculation is not required by the Collins Amendment. The Collins Amendment addresses minimum amounts of required capital, not whether limitations on capital distributions or other sanctions apply at different capital levels above the minimum.

The Capital Proposal remains slightly unclear, however, with regard to the Countercyclical Capital Buffer, as the same language inserted into footnotes to the Capital Conservation Buffer section does not appear in the discussion of the Countercyclical Capital Buffer. We respectfully recommend that, for avoidance of doubt, the Agencies clarify, for the same reasons, that compliance with the Countercyclical Capital Buffer is to be determined in the same manner as the Capital Conservation Buffer.

### Well-Capitalized Requirements

Similar to the buffers, the determination of well-capitalized status for holding companies would be focused on amounts above the minimum adequately capitalized requirements. Compliance with the well-capitalized definition, for both insured depository institutions as well as for bank holding companies, should be determined using only the Advanced Approaches, for those

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<sup>1</sup> We recognize that the Collins Amendment also requires that the capital requirements not be quantitatively lower than those in effect for insured depository institutions as of July 2010. We understand that the Agencies believe that the Basel III Proposals, and other increased capital requirements, generally meet that test. We are not proposing anything in this letter that would be inconsistent with that finding.

<sup>2</sup> Footnote 33 of the Capital Proposal states: “For purposes of the capital conservation buffer calculations, a banking organization would be required to use standardized total risk weighted assets if it is a standardized approach banking organization and it would be required to use advanced total risk weighted assets if it is an advanced approaches banking organization.”

banking organizations that are subject to the Advanced Approaches or that elect to use the Advanced Approaches. The Advanced Approaches are a more appropriate measure for determining whether an Advanced Approaches banking organization is well capitalized because this methodology is more risk sensitive than the Standardized Approach and will therefore provide a more accurate measure of the banking organization's risk profile.

The definition of well-capitalized for bank holding companies has assumed more importance since enactment of the Dodd-Frank Act. The Bank Holding Company Act provides that a bank holding company may become a financial holding company if it (and its depository institution(s)) meet certain capital and management standards, including the requirement under 12 U.S.C. 1843(i)(1), as amended by Section 606 of the Dodd-Frank Act, for the bank holding company itself to meet well capitalized standards.

The Bank Holding Company Act allows the Federal Reserve Board to define what is meant by well capitalized for bank holding companies. One way for the Federal Reserve Board to avoid creating a disincentive for bank holding companies to begin investments to develop advanced modeling methods necessary to move to the Advanced Approaches rules would be to make clear that the definition of well capitalized that is applicable to financial holding companies is not affected by the Collins Amendment. Specifically, neither the Bank Holding Company Act nor the Collins Amendment require a banking organization that may be subject to the Advanced Approaches rules to use the lower of its minimum ratios as calculated under the general risk-based capital rules and the Advanced Approaches rules to determine well-capitalized status.

Therefore, we respectfully request that the Agencies clarify that the Collins Amendment's impact does not stretch to the determination of well-capitalized status for either insured depository institutions or bank holding companies. In particular, we respectfully request that the Federal Reserve Board clarify that the Collins Amendment floor will not apply to financial holding company determinations and the maintenance of financial holding company status. This would remove one more potential reason for banking organizations not to opt in to the Advanced Approaches method.

### Capital Surcharges

We note that both the Agencies and international regulators (through the Basel Committee or the Financial Stability Board, among others) are contemplating a number of different surcharges to be applied to various types of banking organizations, often based on their systemic significance. It is not clear yet from various regulatory pronouncements exactly which entities (or which parents or subsidiaries) will be subject to the myriad proposals for surcharges. The international regulatory community has proposed so-called "G-SIB" surcharges on the largest most systemically important institutions. However, the Federal Reserve, in its proposal for enhanced prudential requirements under Sections 165 and 166 of the Dodd-Frank Act indicated that there may be surcharges applied to all or a subset of the \$50 billion and over bank holding companies. Furthermore, the Basel Committee has finalized its proposal for a so-called "D-SIB" framework that may apply further capital surcharges on those institutions deemed to be "domestically important" depending upon criteria and rules that would be developed at the national level. In

addition, the Basel III Proposals stated that the OCC was considering surcharges on national banks that exhibited systemic importance.

Similar to the buffers described above, all of these surcharges would be above the minimum capital ratio criteria established in the Basel III Proposals and, therefore, would not be subject to calculation based on the Collins Amendment. Although none of the specific proposals for these surcharges has been the subject of a notice from the Agencies yet, it would be appropriate to signal now to banking organizations that have to, or elect to, apply the Advanced Approaches that these surcharges would be calculated under the Advanced Approaches only. In this way, banking organizations would be aware of the potential incentives to develop advanced systems, and apply more rigorous risk measurement and management, without having to wait for such proposals to be published.

#### Voluntary Opt-in, Phase-in and Transition

Above, we have described certain situations that we believe foster adoption of the Advanced Approaches and investment in critical advanced risk management infrastructure. We encourage the Agencies to search for other ways (provided they are not inconsistent with the Collins Amendment) to incent banking organizations to improve risk management models, systems and tools and to make attractive the idea of electing or continuing the Advanced Approaches methodologies.

However, for banking organizations that are not core banks, there may be certain burdens or resource constraints to implementing all of the requirements of the Advanced Proposal at once. To further encourage such institutions to adopt more sophisticated risk management systems, we believe that an appropriate phase-in and transition structure should be included in the Basel III Proposals.

BBVA Compass is of the view that risk-sensitive regulatory capital requirements play a key role in ensuring that banking organizations and the financial system have an adequate capital cushion to absorb financial losses. We understand that the Agencies have a similar view. Accordingly, we urge the Agencies to consider modifying current proposals to allow banking organizations to opt-in to the Advanced Approaches for one or more of a banking organization's portfolios or business segments.

Such an approach is not inconsistent with existing rules. As an appropriate analogy, current and proposed regulatory capital rules authorize a banking organization to choose not to apply a provision of the Advanced Approaches method to one or more exposures but only if the banking organization can demonstrate on an ongoing basis to the satisfaction of its primary federal supervisor that not applying the provision would, in all circumstances, unambiguously generate a risk-based capital requirement for each exposure greater than that which would otherwise be required, that the banking organization appropriately manages the risk of those exposures, and that exposures to which the banking organization applies this principle are not, in the aggregate, material.

We encourage the Agencies to provide for flexibility around transitioning from the Standardized Approach to the Advanced Approach for those institutions that wish to voluntarily opt-in. We believe a transition opt-in approach permitting phase-in of Advanced Approaches to business segments of the banking organization over time, when adopted in close coordination with the Agencies, would encourage innovation and could prompt banking organizations to begin transitioning to a more granular and sensitive system while at the same time making the overall financial system more resilient. Incremental implementation would also allow banking organizations to make appropriate and scaled investments over time, or in the case of banking organizations like BBVA Compass, to take advantage of systems being developed by parent organizations.

In connection with this proposal, we offer the following as conditions to implementation of such a transition opt-in approach:

First, although this opt-in approach would permit application of Advanced Approaches to certain portfolios and not others, this would not be an attempt to arbitrage or “cherry-pick” – a banking organization opting for such transition should be required to provide a plan to its primary supervisor detailing how, and over what timeframe, it will fully transition to the Advanced Approaches. Under current regulatory capital rules and under the Basel III Proposals, banking organizations are allowed to opt-in to the Advanced Approaches method. However, to do so, a banking entity must calculate its risk-based capital requirements for all credit exposures using the Advanced Approaches, except for exposures in portfolios that, in the aggregate, are immaterial to the organization. We understand that this “all or nothing” approach is to avoid regulatory capital arbitrage. However, we believe that banking organizations developing more sophisticated internal ratings-based systems should be allowed, and encouraged, to work with appropriate regulatory agencies toward development and implementation of an increasingly risk-sensitive approach to managing risk and capital when a banking organization can show that application of the advanced approaches method, at an individual portfolio level, would be appropriate.

Second, the opt-in would be permitted only with express supervisory approval. Concerns about regulatory capital arbitrage, or other concerns, could be sufficiently dealt with through general supervisory oversight or a formal application and approval process. Each portfolio to which the Advanced Approaches would apply, and the model that would be used, would be subject to approval or non-objection from the primary supervisory authorities of the banking organization. While a banking organization must bear primary responsibility for creating appropriate management and measurement systems and models, the process of incremental implementation could also promote further understanding and collaboration between regulators and banking organizations. Furthermore, under current and proposed rules, the Agencies reserve the authority to require a banking entity to hold capital greater than would otherwise be required if an organization’s primary federal regulator determines that an organization’s risk-based capital is not commensurate with the risks to which an organization is subject. This same authority could be used in connection with the transition to the Advanced Approaches method to avoid regulatory capital arbitrage. Similarly, the Agencies would still have the authority to require use of a different risk-weighted asset amount for the exposures or to use different risk parameters or model assumptions for the selected exposures.

Third, we recognize that the Advanced Approaches also include an operational risk component, whereas the Standardized Approach does not. We suggest phasing in the operational risk component of the Advanced Approaches. One method would be to apply some of the earlier Basel II proposals for operational risk that have been applied in other countries, such as the basic indicator approach or the standardized approach to operational risk. Such measures would be applied on an interim basis until the banking organization fully transitions to the Advanced Approaches and its operational risk requirements.

## **II. Greater Challenges to Interest Rate Management, Impact on Hedging Risk and Increased Volatility of Regulatory Capital**

Presently, unrealized gains and losses on available-for-sale (“AFS”) debt securities are deducted from, or filtered out of regulatory capital. Under the Capital Proposal, unrealized gains and losses on a banking organization’s AFS debt securities would be included in regulatory capital. We disagree with this approach and do not think it is required by either Basel III or the Dodd-Frank Act.

Removing the so-called accumulated other comprehensive income (“AOCI”) filter would create an asymmetric and inappropriate impact on a banking organization’s ability to manage risk by incentivizing banking organizations to (1) significantly reduce AFS debt securities holdings which are routinely used for liquidity purposes and to hedge against interest rate risk or (2) significantly shorten the tenor of the instruments held, thus skewing the liquidity and interest rate risk profile of the organization.

BBVA Compass routinely holds high-quality AFS debt securities to hedge against the interest rate risk associated with deposit liabilities. Removing the AOCI filter would likely negatively impact our ability to manage risk because we would likely be compelled to limit the duration of AFS debt securities to avoid increased and unmanageable volatility in regulatory capital ratios as the valuation of such assets can change frequently.

We are particularly concerned about removal of the AOCI filter at the same time interest rates are likely to be rising from historically low levels. As rates rise, banks will need to recalculate regulatory capital to recognize unrealized paper losses even though such unrealized losses are unlikely to create any real risk to banks.

To test our assertion, we constructed a hypothetical portfolio based on public information for banks roughly comparable in size to BBVA Compass. Our analysis made certain assumptions including an assumed 250 basis point increase in rates with a portfolio duration of three years. By removing the AOCI filter, banks in our peer group with the hypothetical portfolio could be expected to see an approximate one percent reduction in capital upon the occurrence of a 250 basis point increase in interest rates.

For the reasons discussed above, we believe that the AOCI filter should not to be removed.



### **III. Changes to Risk Weightings in the Standardized Proposal do not Reflect Actual Risk**

The Standardized Proposal, if adopted, would make fundamental changes to the general risk-based capital requirements for determining risk-weighted assets in the denominator of the risk-based capital ratios. For example, significantly higher risk weights would be imposed on some types of secured mortgages. However, the Standardized Proposal offers little or no empirical data or analysis to support these changes and such changes were not required by Basel III. We believe that it is important for banking organizations to understand how the proposed risk weights were determined and, whether there are quantitative studies supporting the relative risk weights proposed because many of the proposed risk weights do not comport with our experiences. For example, our professional residential mortgage program has some high loan-to-value ("LTV") mortgages but, as discussed below, we have experienced very low losses. We also have concerns about the Agencies' conclusion that higher risk weights should be applied to some types of secured mortgage loans than would be applied to unsecured loans.

The Standardized Proposal assigns different risk weights to residential mortgage exposures based on whether a mortgage is a "traditional" mortgage as re-defined by the proposal (category 1) or not (category 2); and on the LTV ratio of the mortgage. Category 1 mortgages vary from 35 to 100 percent, with higher risk weights associated with higher LTV ratios. Category 2 mortgages range from 100 to 200 percent, with higher risk weights likewise depending on higher LTV ratios.

We question risk weightings for mortgage loans focusing exclusively on collateral without factoring in ability to repay as determined by objective criteria such as credit scores. We agree with the general concept put forward by the Agencies that, all other facts being equal, mortgages with higher LTV ratios are riskier than ones with lower ratios. However, all other borrower characteristics are not always equal. As an example, our bank's professional residential mortgage program, which by design targets high quality borrowers as determined by their credit scores and terms of employment, deems LTVs of more than 80% to be appropriate for applicants with demonstrated ability to repay and a strong credit history. Using this standard, our professional residential mortgage program has had very few losses. Nevertheless, under the Standardized Proposed, such low risk/high LTV loans would be treated less favorably for capital purposes than loans with significantly lower credit scores and lower LTVs. In our view, a regulatory capital structure which might encourage lower LTV loans without accounting for the potential higher risk of the obligor is bad policy. We believe that risk weightings need to account for repayment risk in addition to LTVs. Focusing solely on collateral rather than ability to repay does not strike us as an appropriate alignment of capital and risk.

We also question the treatment of certain adjustable rate mortgage ("ARM") loans. The Standardized Proposal would exclude many of our lower-risk, prudently underwritten ARMs from category 1 and thus require higher risk weights even though the type of ARM we have generally provided – referred to as 5/2/5 (an ARM on which the interest rate may increase up to 5 percent in the first adjustment year and up to 2 percent in any subsequent year, but in no event may the increase be more than 5 percent over the life of the loan) – has not proven to be high risk. If adopted, this approach would penalize us for ARMs currently on our books even though

they have not proven to be high risk and they were prudently underwritten when made. We encourage the Agencies to reconsider treatment of this standard, and low risk, mortgage product. If, however, the Agencies do not change the proposed treatment of such ARMs, we urge the Agencies to grandfather existing ARMs because the retroactive impact of the proposed treatment would be especially harsh due to the substantial increase in capital that would be required for existing category 2 mortgages.

Similarly, many of our standard home equity lines of credit (“HELOCs”) would be deemed category 2 loans. For the same reasons mentioned in the preceding paragraph, category 2 treatment is unwarranted, in our view, based on performance of our HELOC portfolio.

#### **IV. Joint Trades Letter**

Finally, we note that BBVA Compass supports the views expressed by the American Bankers Association, the Financial Services Roundtable and the Securities Industry and Financial Markets Association in the Joint Trades Letter referenced above on page two.

\* \* \*

We thank you for considering the comments and recommendations in this letter. If you have any questions, please contact us.

Very Truly Yours,



Manolo Sánchez  
President and CEO  
BBVA U.S. Country Manager



Lawrence R. Uhlick  
Chairman of the Board  
BBVA Compass Bancshares, Inc.