State of North Carolina

OFFICE OF THE COMMISSIONER OF BANKS

BEVERLY E. PERDUE
GOVERNOR

JOSEPH A. SMITH, JR.
COMMISSIONER OF BANKS

October 18, 2012

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
RIN 3064-AD96

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. R-1442
RIN No. 7100-AD87

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, D.C. 20219
Docket ID OCC-2012-0009

Dear Sir or Madam:

The North Carolina Office of the Commissioner of Banks appreciates the opportunity to comment on the joint Notice of Proposed Rulemaking ("NPR") issued by the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency entitled "Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements."

Clearly intended to respond to the recent economic crisis centered in housing and commercial real estate, the proposed rule seeks to revise the risk weights for risk-based capital ("RBC"). While this agency is a strong supporter of robust and high-quality capital standards, we are opposed to the revisions to RBC set forth in this NPR. First, we believe that RBC is an inherently flawed concept, in that it assumes bank regulators are possessed of a prescience and precision unsubstantiated by its history.

In that regard, the recent housing crisis is instructive. Long thought to be among the least risky of bank assets, 1-4 family residential first-mortgage loans have for years been accorded a weight of 50%. As the result of a number of factors, including sales and securitization, the introduction of some novel approaches to mortgage lending, and most notably the advent and subsequent bursting of the "housing bubble," these assets "suddenly" became very risky. The lesson here should not be limited to just residential mortgage loans. The risk inherent in any category of assets is subject to variation between different geographies (e.g., home loans in Nevada vs. home loans in Iowa, in the current cycle), between different banks, owing their differing qualities of underwriting, supervision and risk mitigation, and even, perhaps especially, differences that develop over time. In hindsight, did it make any sense to assign an arbitrary risk-weighting to 1-4 family residential first mortgage loans and then allow it to remain unchanged for a period of years?

While it may seem as though merely recalibrating the current regime of risk-weighting will be sufficient to correct the problems, we think the concept is subject to entirely too many variables, known and unknown, current and future, intrinsic and exogenous, to form the basis of a sound capital management approach or reliable capital adequacy metric. The complexity of such a scheme is a bit like efforts to predict climate change. Many variables are known, but so many more are not.

Finally, the proposal will impose a level of complexity and confusion on community banks that is not only ill-conceived but also very poorly timed. Two years into Dodd-Frank, nearly two-thirds of its required rules are yet to be developed or implemented, and its full implications are as yet far from understood. To layer up these new proposed capital rules at a time when many banks are still struggling to cope with the effects of the recession, will likely prompt many smaller banks to throw in the towel and look for exit strategies. The loss of more community banks will operate to the detriment of the North Carolina communities they serve.

In summary, we do not believe that risk-weighting of assets provides a sound methodology for establishing or assessing capital adequacy. Overly complex rules and laws, like overly complex machines, are prone to failure. We believe this proposal, or indeed any rule reliant upon the assignment of fixed risk weights, is particularly so.

At the very least, the proposals under this NPR would create yet another administrative and regulatory burden opon community banks that neither benefitted from nor contributed to the recent economic downturn. If the rule must go forward as essentially proposed, we would urge that an exemption be carved out for small, noncomplex community banks.

Much preferable, however, would be a return to a simpler system relying upon a robust and easily comprehensible capital structure based largely upon the Tier 1 Leverage Ratio, with due regard for concerns regarding the potential for banks to attain a realistic return on equity. Such a scheme would necessarily be dependent upon a supervisory regimen with capital adequacy determinations made on the basis of careful monitoring and examination of each bank in the context of its own unique market, business plan, management acumen, and circumstances. This certainly places a burden on both federal and state regulators, but we believe we bear that burden in any event.

Sincerely,

Ray Grace
Acting Commissioner of Banks

cc: The Honorable Ben Bernanke, Chairman, The Federal Reserve System
Thomas Curry, Comptroller, Office of the Comptroller of the Currency
Martin Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation
North Carolina State Banking Commission
Thad Woodard, President & CEO, North Carolina Bankers Association