IBAT

INDEPENDENT BANKERS ASSOCIATION OF TEXAS

1700 RIO GRANDE STREET
SUITE 100
AUSTIN, TEXAS 78701
P: 512.474.6889
F: 512.322.9004
WWW.IBAT.ORG

February 3, 2012

Via E-Rulemaking Portal: http://www.regulations.gov

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

Re: FDIC; RIN 3064-AD70
Risk-Based Capital Guidelines: Market Risk; Alternatives to Credit Ratings for Debt and Securitization Positions

Dear Mr. Feldman:

The following comments are submitted on behalf of the Independent Bankers Association of Texas (IBAT), a trade association representing approximately 500 independent community banks domiciled in Texas. IBAT's members range in size from approximately \$50 million in assets to over \$14 billion. Most community banks are \$250 million or less in assets. These banks will be significantly adversely affected by the change in the law as implemented in this proposal. While we recognize that the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") itself mandates eliminating the reference to credit rating agencies in certain rules, we urge you to mitigate the costs and complexity to community institutions. The following are our observations.

Overview

The FDIC and other Federal bank agencies are seeking comment on an amendment to the notice of proposed rulemaking ("NPR") to modify the agencies' market risk capital rules, published in the Federal Register on January 11, 2011. The January 2011 NPR did not include the methodologies adopted by the Basel Committee on Banking Supervision ("Basel Committee") in 2009 for calculating the standard specific risk capital requirements for certain debt and securitization positions, because the Basel Committee methodologies generally rely on credit ratings. In particular, the Basel Committee finalized its "Revisions to the Basel II Market Risk Framework." The Basel Committee revised the framework, in part, to eliminate arbitrage between the banking book and trading book. Generally, the Basel revisions apply the banking book capital treatment, a ratings-based approach, to securitizations held in the trading book.

However, under Section 939A of Dodd-Frank, all federal agencies must remove references to and requirements of reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness. In the Proposal, the agencies are proposing to incorporate into the proposed market risk capital rules various alternative and complex methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings. The Proposal offers alternatives to the ratings-based approach for securitizations in the trading book, not the banking book. The Federal bank agencies have not yet removed references to credit ratings in the existing banking book capital rules. While most community banks do not have a trading book, IBAT is commenting on the NPR because it is concerned that alternative methodologies for calculating risk capital requirements for the trading book will ultimately be applied to the banking book, which concern is heightened by the Basel revisions applying the banking book capital treatment, a ratings-based approach, to the securities held in the trading book.

The stated objectives of the Proposal's amendments are that any alternative creditworthiness standard should, to the extent possible:

- Appropriately distinguish the credit risk associated with a particular exposure within an asset class;
- Be sufficiently transparent, unbiased, replicable, and defined to allow banking organizations of varying size and complexity to arrive at the same assessment of creditworthiness for similar exposures and to allow for appropriate supervisory review;
- Provide for the timely and accurate measurement of negative and positive changes in creditworthiness;
- Minimize opportunities for regulatory capital arbitrage;
- *Be reasonably simple to implement and not add undue burden on banking organizations* [Emphasis added]; and,
- Foster prudent risk management.

IBAT's member banks do not hold sovereign debt, but as to corporate debt, the FDIC and other Federal bank agencies are considering various options including whether to permit banks to determine a specific risk-weighting factor for corporate debt positions based on whether the position is "investment grade," as that term is defined in the OCC's regulations at 12 C.F.R. Section 1.2(d). For example, under such an approach, an investment grade exposure might be assigned a risk-weighting factor of 6.0 percent and a non-investment grade exposure might be assigned a risk-weighting factor of 12.0 percent. This proposed analytical method is discussed more fully in part A. of the "Alternatives" section of this letter.

Undue Burden on Community Banks

In the Proposal, the FDIC and the other Federal bank agencies expressly request comment regarding whether the proposed revisions strike an appropriate balance between measurement of risk and implementation burden in considering alternative measures to creditworthiness and what operational challenges, if any, banks would face in implementing alternative methodology to measuring creditworthiness. We appreciate how difficult it will be for the Federal bank agencies to develop "reasonably simple" substitutes for credit agency ratings as mandated by Dodd-Frank. However, we believe that, in practice, the Proposal's requirements will be impossible to reconcile with the stated objective that the regulation's risk-based capital requirements be reasonable and practical to implement and not unduly burdensome on community or regional banks. Community and regional banking organizations do not have the financial resources to develop internal systems capable of analyzing the gambit of securities products. Community and regional banks will be required to rely on outside, third party service providers to perform the analysis, which will be tantamount to, but more expensive, than a credit rating agency service. These are costs that will not add one penny to the primary business of banking—making sound loans. One likely consequence is that these banking organizations may, as a result, exit all but the most conservative asset classes. This will have the unintended consequence of further restraining lending and damaging this country's fragile economic recovery.

Inconsistent with Basel III Implementation

The elimination of credit ratings will complicate U.S. adoption and implementation of Basel III, and make it difficult to achieve consistent global implementation. We believe that the agencies should consider consistency with international capital standards as a goal of the new creditworthiness standards, and permit the United States to implement the changes to risk-based capital rules required by the revisions to Basel II and Basel III. The Basel II market risk rules and proposed Basel III are already tackling the issue of undue reliance on external credit ratings by requiring banking organizations to supplement regulatory capital requirements based on externally rated securitizations with their own credit analysis and capital estimates of the exposure. Without a broadly consistent global approach to creditworthiness standards for securities, including securitizations, the agencies run the risk of encouraging regulatory arbitrage and of accentuating systemic risk. Indeed, from a narrow U.S perspective, existing banking book and trading book rules still need to be made consistent to avoid regulatory arbitrage. As previously noted, the Proposal offers alternatives to the ratings-based approach for securitizations in the trading book, not the banking book

Alternatives

A. Alternative Based on Proposed Revised "Investment Grade" Definition for National Banks.

In the Proposal, the FDIC and the other Federal bank agencies expressly request comment regarding whether to permit banks to determine a specific risk-weighting factor for corporate debt positions based on whether the position is "investment grade," as that term is defined in the OCC's regulations at 12 C.F.R. Section 1.2(d). For example, under such an approach, an investment grade exposure might be assigned a risk-weighting factor of 6.0 percent and a non-investment grade exposure might be assigned a risk-weighting factor of 12.0 percent. The OCC's investment securities regulations generally require a bank to determine whether or not a security is "investment grade" in order to determine whether purchasing the security is permissible. Under the OCC's recently proposed revisions, a security would be "investment grade" if the issuer has an adequate capacity to meet financial commitments under the security for the projected life of the security. To meet this new standard, banks would have to determine that the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected and could consider a number of factors, as appropriate such as internal analyses, third-party research and analytics including external credit ratings, and internal risk ratings, default statistics, and other sources of information as appropriate for the particular security. Under the proposed OCC revisions, national banks would have to supplement the credit ratings with increased due diligence processes and analyses that are appropriate for the bank's risk profile and for the amount and complexity of the debt instrument, including, incredibly, Type I securities issued or backed by the U.S. Government which are inherently less risky than other types of securities. If there is some fair and equitable manner to implement a specific risk-weighting factor for corporate debt positions based on whether the position is "investment grade," as that term is defined in the OCC's regulations, we would support such an approach so long as unreasonable and burdensome due diligence requirements are not imposed on community and regional banks. Otherwise, we believe the Proposal will create an undue burden and lead to significantly increased costs for community and regional banks and will leave too much discretion in the hands of examiners and regulators to criticize a bank's practices.

These comprehensive analyses will apply to local government securities, like bonds issued by municipalities, counties, and school districts. Community banks have been a significant source of funding for these critical governmental functions. The additional costs imposed on banks to acquire and maintain these in their investment portfolios could either reduce the market for such investments or potentially drive the price up. Either consequence will harm the ability of local government to prudently invest in needed infrastructure.

Furthermore, community banks may have difficulty accessing timely and reliable data from the issuers of municipal bonds. Sometimes those issuers provide financial data only with long and variable time lags.

B. Community Bank Alternative

In the Proposal, the FDIC and the other Federal bank agencies expressly request comment regarding whether there are other alternatives permissible under section 939A of Dodd-Frank that strike a more appropriate balance between measurement of risk and implementation burden in considering alternative measures to creditworthiness. We believe a far better method to alternative methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings is to require community and regional banks to obtain sufficient ratings from two third-party sources and to provide greater oversight of the existing rating agencies. The widely publicized instances where the reliance on credit ratings at large complex banking organizations has exposed the financial institutions to undue risk should not be used to taint the established investment management programs of community banks that do not present such undue risk and have not had negative safety and soundness examination findings. Rather than presenting undue risk, the investment management programs of community and regional banks are generally straightforward. In any event, bank regulators are already authorized to prohibit any undue risk or problematic investment programs identified during an examination. As support for a two-tier approach for the measurement of risk, in a January 12, 2012, ICBA meeting with the new CFPB Director, Richard Cordray, Mr. Cordray indicated that he would be open to having certain future regulations be two-tier or have one or more exemption thresholds in the regulation that would permit community banks to have less burdensome regulatory requirements imposed on them.

Transition Period

We strongly urge the FDIC and the other Federal bank agencies to provide a reasonable transition period for compliance with the Proposal's requirements when it is issued in final form. This is necessary, we believe, because of the complexity of the Proposal and its far reaching effect on banks. Banks of all sizes will very likely be required to establish or upgrade in-house systems, analytical capabilities and/or management capabilities. As a result, we recommend that any final rule provide a transition period of at least one year before compliance is required with the requirements of the Proposal when issued in final form.

Thank you for this opportunity to comment.

Sincerely,

Christopher L. Williston

Christopher L. Williston, CAE
President and CEO