PERFORMANCE TRUST
CAPITAL PARTNERS

August 23, 2012

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

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

Re: Proposed Regulatory Capital Rules: Regulatory Capital, Implementation of BASEL III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (R-1442, Docket ID OCC-2012-0008, RIN 1557-AD46, RIN 3064-AD95)

Proposed Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements (R-1442, Docket ID OCC-2012-0009, RIN 1557-AD46, RIN 3064-AD96)

Ladies and Gentlemen,

Performance Trust Capital Partners, LLC (PTCP)[1] appreciates the opportunity to submit comments on the above-referenced notices of proposed rulemaking (NPRs). The NPRs were released on June 12, 2012 by the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), (together, the "Agencies") and are designed to incorporate the latest

[1] Founded in 1994, Performance Trust Capital Partners, LLC helps community financial institutions maximize profitability through strategic financial advisory services. By deploying a disciplined analytical approach to investing, the firm provides objective, transparent, and unbiased advice that allows clients to make confident and informed investment decisions. The company also has a strong educational focus, teaching decision makers how to make beneficial choices for their institutions with the aim of producing consistent, significant improvement in their long-term performance.

Performance Trust Capital Partners, LLC
500 W. Madison, Suite 450, Chicago, IL 60661
phone 312.521.1000, fax 312.521.1001
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revisions to the Basel III capital framework and to implement relevant provisions of the Dodd Frank Wall Street Reform and Recovery Act. The Agencies have stated their belief that the proposals will result in capital requirements that "better reflect banking organizations' risk profiles and enhance their ability to continue functioning as financial intermediaries, including during periods of financial stress, thereby improving the overall resiliency of the banking system."

PTCP fully supports the Agencies' efforts to address perceived weaknesses in the banking industry's capital framework. We also recognize the enormous challenges that the Agencies face in developing a system that accurately reflects risk across the broad and diverse universe of financial institutions that make up the United States banking system. Because of the scope of the exercise and the significant impact it will have on the industry, particularly on community and regional banking institutions, we appreciate the Agencies' willingness to extend the comment period through October 22, 2012. We believe this additional time will allow institutions to properly evaluate the impact of these changes and provide meaningful responses to assist the Agencies' in their ongoing effort to refine these rule changes.

Although the extended comment period provides more time for the industry to respond, it also results in less time for the Agencies to evaluate the submitted responses, particularly if the transition period for various aspects of the proposal will begin on January 1, 2013, as currently described. For this reason, PTCP is providing a prompt response on several key components of the NPRs that we believe could, in practice, run counter to the Agencies' objective of providing a better mechanism for reflecting capital risk within the banking system. The comments provided below reflect specific aspects of the proposals that, in our view, will have the most significant impact on our community and regional banking clients. We recognize, however, that other aspects of the NPRs that are not addressed herein could have a material impact on the operations of individual organizations. Our specific comments are listed below following our paraphrase of the relevant sections of each specific NPR.

Proposed Regulatory Capital Rules: Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (Basel III NPR)

» Proposed Rule: Accumulated Other Comprehensive income (AOCI) as a component of Tier 1 capital – The Agencies are proposing that AOCI, which includes all unrealized gains and losses on AFS securities, would flow through to common equity Tier 1 capital. This would include unrealized gains or losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate, as opposed to changes in credit risk (for example U.S. Treasuries and U.S. government agency debt obligations).

PTCP Comments: PTCP has a number of concerns about the inclusion of AOCI as a component of Tier 1 capital. The Agencies themselves have recognized that the inclusion of unrealized gains and losses on securities could "introduce substantial volatility in a banking organization's regulatory capital ratios." While we recognize the appropriateness for AOCI inclusion in a tangible capital ratio from a market valuation perspective, the introduction of a similar structure to the regulatory capital metric has the potential to create confusion over the adequacy of recorded ratios and could lead to flawed, uneconomic, and even unsound

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decisions regarding an institution's asset-liability management and investment options. Some of the more troubling aspects of this proposal include the following:

1. Inclusion of AOCI in the standardized regulatory capital ratios would force regulators and financial institution managers to calculate alternative ratios to determine an effective capital position, exclusive of AOCI. Capital ratios bolstered by market appreciation would most certainly be discounted to reflect the potential volatility that might exist in a rates-up environment. At the same time, market depreciation would be counted against capital, even though a rates-down scenario might significantly improve the institution's capital position. In the latter case, institutions would need to hold greater levels of common equity capital to comply with a ratio requirement that reflects a potentially temporary adjustment.
2. To avoid recognition of AOCI, institutions may be incentivized to hold more securities in the held-to-maturity (HTM) account. While the move to the HTM account would no longer require gains and losses on those securities to be recorded in Tier 1 capital, the operational restrictions imposed on the HTM account would greatly reduce management's ability to properly adjust its portfolio for liquidity and funds management purposes. Additionally, when different institutions place identical securities in AFS or HTM, it creates differing capital treatments even though the relative risks involving the securities are the same.
3. To avoid capital ratio volatility, institutions may also be inclined to make shorter-term investment decisions that reduce volatility and increase liquidity. This may help to reduce market risk, but it also could reduce the ability of the investment portfolio to produce income and generate capital appreciation. As a result, banks would be forced to pursue other options to generate yield, which could include diverting investment to other asset classes, with higher levels of credit risk and/or greater levels of unrecorded market volatility.
4. The AOCI inclusion for AFS securities applies mark-to-market treatment to only one set of assets on an institution's balance sheet. Other balance sheet components that are economically very similar do not receive the same treatment, such as loans, structured liabilities, and HTM securities. We find two difficulties in this inequivalent treatment. First, this appears to violate the basic accounting principle of consistency. Second, it would in effect weaken an institution's asset-liability management; specifically, it adds a potential capital penalty on using the securities portfolio, the most flexible tool at ALCO's disposal, to reduce overall asset sensitivity while leveling no such penalty on any other balance sheet component.
5. The negative impacts of these effects would fall disproportionately upon community banks, due to their limited access to capital markets for funding and temporary equity enhancements.

To illustrate the impact of this proposal, we have included a straightforward simulation in an Appendix. In this simulation, we have forecast the impact of rate changes on the capital of a $500 million dollar institution, with a typical AFS securities portfolio of $100 million, and a leverage ratio[2] of 8.00 percent. In order to model the institution's investments in a simple fashion, and to remove basis, credit and optionality variables, we will assume the bond portfolio consists entirely of a 3.5-year duration Treasury. Such a portfolio would presumably be less volatile and risky than that of the average real financial institution with that typical portfolio duration and the aforementioned additional risk components. Further, to remove the asymmetrical effects of the current near-zero level of interest rates, we will consider this institution in a different rate environment, specifically the environment in which the 3.75-year Treasury (3.50 year duration) with a 4.00 percent coupon is priced at par. Based on an instantaneous rate shock of plus or minus 300 basis points, application of AOIC causes the institution's leverage ratio to fluctuate between 9.98 percent and 6.17 percent. This is a difference of 381 basis points due solely to AFS market value changes caused by interest rate movements on a risk-free asset. While real institutions will certainly have the ability to make some adjustments to the AFS portfolio to reduce the size of this capital fluctuation, considerable questions persist as to how such institutions would be treated from a regulatory perspective when an instantaneous shock scenario shows such a dramatic impact.

PTCP Recommendation: PTCP recommends that the Agencies exclude any AOCI adjustments from the regulatory capital calculations and continue to include an addendum in the Call Report to reflect ongoing gains/losses in the AFS portfolio. In our view, the concerns addressed about market value appreciation/depreciation are best managed through a strong liquidity and funds management function. While the impact on capital should be considered, financial institution capital ratios cannot be effective measurements of risk when only one class of assets among many is required to recognize ongoing market value adjustments.

The Agencies have suggested a potential exclusion of the capital charges for debt obligations to U.S. government, U.S. agency, and U.S. Government Sponsored Entities. The Agencies have also suggested a similar exclusion on general obligations issued by states or other political subdivisions. PTCP supports these exclusions and agrees that they would help to minimize the impact of the proposed AOCI treatment. However, to minimize risk and properly diversify the investment portfolio and total balance sheet, institutions should also be able to make informed investments in securities that contain some level of credit risk without an inequitable capital volatility penalty. If there is a need to hold higher levels of capital against these investments, that need should be addressed through an appropriate adjustment to the standardized risk weight measurement, not through an ongoing fluctuation in the Tier 1 capital ratio.

» Proposed Rule: Minimum Capital Ratios, Capital Conservation Buffer, and Prompt Corrective Action Requirements – Under the Basel III NPR, the Agencies have introduced a new common equity Tier 1 capital ratio and have modified the capital components and ratios for the existing risk-based and leverage capital framework. The Agencies are also proposing limits on capital distributions and certain discretionary bonus payments if the banking organizations do not hold a specified "Capital Conservation Buffer" in addition to the established minimum risk-based capital requirements. The minimum risk-based capital

[2] The leverage ratio was used to demonstrate the relative impact of the AOCI charge on a singular capital measure. Risk-weighting would present more variables in a broader analysis, but it would not materially change the tangible and directional impact of the conclusion.

requirements correspond to the minimum thresholds for "adequately capitalized" status under the Prompt Corrective Action (PCA) framework, and the Capital Conservation Buffer is proposed to be 2.5 percent above these minimum requirements. The Agencies are proposing to continue the PCA framework, with existing requirements still in force for organizations that fall below the statutory definition of "well-capitalized", which is 2.0 percent above the minimum requirement.

PTCP Comments: PTCP does not object to the proposed minimum capital requirements, or to the addition of the new common equity Tier 1 capital ratio. However, it is unclear why the Agencies would create a capital conservation buffer that would exceed the minimum thresholds for "well-capitalized" under the PCA framework. In essence, the proposal suggests that an institution needs a 2.0 percent buffer to be "well-capitalized', but it would need a 2.5 percent buffer be "resilient" throughout different financial cycles. By establishing this framework, an institution could be "well-capitalized" and free from any restrictive covenants under the PCA framework, e.g., limitations on brokered deposits, but at the same time still have restrictions on capital distributions and discretionary bonuses if it did not exceed the requirements for the Capital Conservation Buffer. This staggered and somewhat parallel layer of restrictive covenants above the PCA "well-capitalized" framework will create a confusing and contradictory set of standards.

In reviewing the Agencies' justification for Capital Conservation Buffer, it was not clear how the Agencies empirically developed the specific 2.5 percent ratio or how that level, over and above a "well-capitalized" level, would help to "bolster the resilience of banking organizations throughout financial cycles." It was also unclear if the Agencies considered the impact of the proposed changes to risk-weighting requirements in their determination of the 2.5 percent buffer. If the proposed changes to the Standardized Approach NPR create a risk-weighting mechanism to better reflect balance-sheet risk, it would seem that the revised capital ratios would automatically be more resilient and better able to absorb cyclical risks at the "well-capitalized" level.

The proposal also did not appear to address the authority that currently exists within the Agencies' enforcement powers to restrict capital distributions when appropriate. If, through the examination process, an Agency determines that capital distributions need to be restricted because of the specific financial condition of the institution, the Agency has the power to restrict those distributions through existing enforcement authority. Codifying this type of restriction in a regulation over-simplifies this issue and could impact the ability to exercise appropriate regulatory flexibility.

PTCP Recommendation: To avoid confusion and to better link the proposed capital guidelines to the existing PCA framework, PTCP recommends that the Capital Conservation Buffer be adjusted to 2.0 percent. This would align the Capital Conservation Buffer with the buffers that already exist between "adequately-capitalized" status and "well-capitalized" status under the PCA framework. Banks that fall below "well- capitalized" could be subject to a variety of restrictions, including the proposed restrictions under the Capital Conservation Buffer. However, in the interests of clarity, flexibility and simplicity, we believe the Agencies may even wish to consider eliminating the Capital Conservation Buffer altogether in favor of instead

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applying existing enforcement authority to restrict capital distributions as circumstances warrant.

Proposed Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets (Standardized Approach NPR)

» Proposed Rule: Residential Mortgage Exposures – In light of the recent experiences of the U.S. residential mortgage market, the Agencies are proposing a wider range of risk weightings (between 35 percent and 200 percent) for residential mortgages. Mortgage loans would be subdivided into two risk categories based on underwriting criteria (traditional vs. nontraditional) and lien position. Within each category, risk-weights would then be assigned based on standard Loan-to-Value ratios. The current risk-based capital treatment would be maintained for residential mortgage exposures that are guaranteed by the U.S. government or a U.S. government agency.

PTCP Comments: PTCP agrees with the Agencies' assertion that inadequate loan underwriting and high-risk mortgage products have contributed to an increase in mortgage loan defaults and home foreclosures. In the NPR, the Agencies have tried to create a set of standardized criteria that segregate higher risk loan products from more traditional loan products. We concur with the intent, but it is unclear whether the criteria fully and fairly accomplish their intended result. Key questions about the Agencies' segmentation include the following:

1. Does the standardized approach treatment fairly align with the advance approach guidelines for similar assets? Specifically, do larger banks have an ability to offer similar or more innovative mortgage products with a lower capital charge than what would be allowed under the standardized approach used by community banks?
2. With regard to the specific criteria, questions remain about what constitutes a "balloon payment" and what are the specific regulatory requirements to demonstrate that the borrower's income has been sufficiently "documented and verified".
3. Will the inability to recognize private mortgage insurance for risk mitigation impact the cost and availability of mortgage products to credit-worthy borrowers, particularly first-time home buyers?
4. The NPR allows the primary federal regulator to make an independent determination that any particular loan may not qualify as Category 1 exposure, even if the loan meets the specified criteria. What will be the basis for that determination?

PTCP Recommendation: PTCP believes that the criteria for Category 1 loans need to be more clearly defined so that prudently underwritten loan products are not unfairly targeted. Specifically, we would redefine the Category 1 exclusion for loans that "result in a balloon payment" and only include loans that are not amortizing. A five-year amortizing adjustable rate mortgage does not have the same risk characteristics as a payment-option or negative amortization loan.

We would also recommend requiring the Agencies to adhere to established criteria in determining whether a loan is qualified as Category 1. In order to lend to credit-worthy borrowers, institutions need to have confidence that if they follow defined criteria, their actions will not be overturned by an arbitrary regulatory ruling.

» Proposed Rule: Past Due Exposures – The Agencies have proposed that banking organizations assign a risk weight of 150 percent to any exposure that is not guaranteed or not secured (and that is not a sovereign exposure or a residential mortgage exposure) if it is 90 days or more past due or on nonaccrual. A banking organization may assign a lower risk weight to the collateralized or guaranteed portion of the past due exposure if the collateral, guarantee, or credit derivative meets the proposed requirements for recognition.

PTCP Comments: During periods of economic stress, it is expected that banking organizations will have normal cyclical increases in past-due and nonaccrual loans. To account for the potential loss exposure of these problem loans, institutions will make periodic provisions to their respective allowances for loan and lease losses (ALLL). If the ALLL is calculated properly and reflective of the risk of loss in the loan portfolio, there should be no need to create an additional capital charge to reflect temporary and expected fluctuations in the economic cycles of different markets.

Assigning a higher risk weight to past due loans does not appear to be a proactive measurement of risk. Instead, it is a retroactive penalty that has the potential to lower institution capital ratios at a time when a bank would most need to sustain those ratios. In fact, this provision could discourage institutions from working with borrowers and from taking appropriate lending risk during times of economic stress.

PTCP Recommendation: Since loan loss exposures are already reflected in the ALLL, which is limited as a Tier 2 capital component to 1.25 percent of risk weighted assets, we do not believe there is a basis for an additional capital charge based solely on past-due status.

» Proposed Rule: Securitization Exposures – The proposed securitization framework is designed to address credit exposures that involve the tranching of the credit risk of one or more of the underlying financial exposures. Mortgage-backed pass-through securities (for example, those issued by FHLMC or FNMA) do not meet the proposed definition of a securitization exposure because they do not involve a tranching of credit risk. For securitizations of U.S. Government or Government Sponsored Entities (GSEs) there are no changes to the risk-based capital requirements. For privately-issued mortgage securities and for all other securitization exposures, financial institutions under $50 billion in assets would determine the risk-based capital requirement by applying either a simplified supervisory formula approach (SSFA), or a gross-up approach. A banking organization would be required to apply either the gross-up approach or the SSFA consistently across all of its securitization exposures. Alternatively, a banking organization may choose to apply a 1,250 percent risk weight to any of its securitization exposures. Also, if a banking organization is unable to demonstrate a comprehensive understanding of a particular securitization exposure to the satisfaction of its primary federal regulator, the banking organization would be required to assign a risk weight of 1,250 percent to the exposure. In all cases, the minimum risk weight for securitization exposures would be 20 percent.

PTCP Comments: By not relying exclusively on credit ratings and the "first dollar of loss methodology", securities would be judged on the characteristics of the underlying loan exposures, allowing for greater risk-weight alignment between securities and loans held on a portfolio basis. That said, both the gross-up approach and the SSFA overlook key structural features to securitizations that provide credit enhancement, including the purchase price or carrying value of a security. In our view, the discount generated between par and the carrying value of a security provides an additional buffer against potential loss and should receive appropriate consideration.

With regard to the requirement for understanding the securitization exposure, the proposal has set forth specific points of consideration to demonstrate and document for the regulators that an institution has a comprehensive understanding of a specific securitization's risk. We concur with these points of consideration, but have reservations about the consistent understanding and application of these points during the course of ongoing regulatory examinations. We question whether examiners will be able to apply these points consistently across and between all organizations. It is conceivable that two banks holding the exact same security could receive different capital treatments based solely on a perceived management deficiency, rather than the underlying risk of the asset. In such cases, the assignment of a 1,250 percent risk weight appears somewhat extreme, when the actual calculated risk weight could be much lower.

On a parallel issue, we have questions about the Agencies' 2004 Uniform Agreement on the Classification of Assets and the Appraisal of Securities by Banks and Thrifts. This agreement continues to place a great deal of reliance on Nationally Recognized Statistical Rating Organizations (NRSROs), which are now precluded from being a part of Agency regulation. If a bank complies with due diligence criteria and can demonstrate that a security does not meet the definition of a classified asset, will examiners no longer default to NRSROs ratings as the basis for classification treatment during the examination?

PTCP Recommendation: We believe a purchase discount is an important consideration when evaluating the credit risk of a securitization exposure, as it creates a tangible level of credit protection that would not exist in a comparable security purchased at par. For this reason, we believe the level of purchase discount should be factored into the risk-weight formula in some manner to differentiate the potential loss exposure among different instruments.

We also would suggest reconsidering the capital penalty of 1,250 percent for failing to demonstrate a comprehensive understanding of a particular credit exposure. The penalty should, at least, correspond to the actual risk weight of the asset and not create capital disparities that are grossly dissimilar for assets of equal risk.

We also believe that the due diligence points of consideration that are listed in the proposal should be included in examination guidelines for the classification of assets and the appraisal of securities. Financial institution managers should have a clear understanding of the due diligence guidelines and classification criteria that will be relied upon by examiners during the course of their regulatory scheduled examinations.

Performance Trust Capital Partners, LLC
500 W. Madison, Suite 450, Chicago, IL 60661
phone 312.521.1000, fax 312.521.1001
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Conclusion

PTCP supports the Agencies' effort to improve the quality and quantity of regulatory capital and to build additional capacity into the banking system to absorb losses in times of economic stress. We also support and acknowledge the Agencies' effort to formulate an appropriate transition period for various aspects of the proposal. The time frames granted were generous but appropriate given the magnitude of the changes contemplated. While the applicability of certain provisions to smaller banks was not expected, absent the AOCI charge, the NPRs do not appear to present an immediate compliance concern for most banks from a pure ratio perspective. As noted above, PTCP has attempted to provide feedback that will help improve and enhance the quality of the overall proposals. We have concentrated our comments on areas that have the greatest impact to our community and regional banking clients. In our view, there are several provisions that could create significant volatility and inconsistency in their reported capital ratios. We believe these provisions could impact the effectiveness of the proposal and have negative consequences for the banking system as a whole.

In summary, as it relates to the Basel III NPR, the AOCI provision is a matter of great concern, both in terms of creating significant volatility and inconsistency in reported ratios and in potentially introducing economically unsound decision-making constraints. As a result, we do not believe that AOCI should be included as a part of regulatory capital. We also believe that the Capital Conservation Buffer should be limited to 2.0 percent and incorporated as part of the existing PCA capital framework. Further, there are several provisions of the second proposal, the Standardized Approach NPR that, if left unadjusted, could also create inaccuracies and inconsistencies in the reported ratios, particularly the risk-based adjustments for mortgage exposures and past-due loans and the potential shortcomings in the securitization valuation approach.

PTCP appreciates the opportunity to comment on this proposal. If you have any questions or would like additional information, please do not hesitate to contact any of the undersigned through Mr. Smith at 312-521-1643.

Sincerely,

W. Bartow Smith, Jr.	Richard S. Berg	Philip M. Nussbaum
Managing Director	Chief Executive Officer	Chairman

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500 W. Madison, Suite 450, Chicago, IL 60661
phone 312.521.1000, fax 312.521.1001
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Appendix to Performance Trust Capital Partners, LLC Letter of August 23, 2012

The below is a simulation of a financial institution's balance sheet and the consequent capital effects of applying the proposed AOCI provision under rate shocks ranging from down 300 bps through up 300 bps.

The institution is modeled with average total assets of $500MM, a securities portfolio of $100MM (20% of assets), leverage capital of $40 MM (and therefore a leverage ratio of 8.00%), and a securities portfolio duration of about 3.50 years, which is reasonably typical.

To remove any asymmetrical peculiarities due to current rates being less than 300 bps from zero, the case is modeled in an environment in which the 3.75-year Treasury rate is 4.00%. This maturity was selected because at a 4.00% yield, this Treasury would have a 3.49-year duration.

To simplify the illustration and to remove any potential additional capital volatility due to security credit, structure, optionality or basis risk, the portfolio is modeled to consist entirely of this 3.75-year Treasury with a 4.00% coupon and currently priced at par.

Initaial Condition (,000s)

Assets		**Liabilities & Equity**	
Loans & Other Assets	$400,000	Liabilities	$460,000
AFS Securities	$100,000	Equity	$40,000
Total	**$500,000**	**Total**	**$500,000**

Rate Shock Impact on Capital

Rate Shock in bps	**-300**	**-200**	**-100**	**0**	**100**	**200**	**300**
Yield[1]	1.00%	2.00%	3.00%	4.00%	5.00%	6.00%	7.00%
Price[2]	111.01	107.18	103.52	100.00	96.61	93.37	90.25
AOCI (,000s)	$11,005	$7,183	$3,516	-	($3,385)	($6,631)	($9,749)
Capital (,000s)	$51,005	$47,183	$43,516	$40,000	$36,615	$33,369	$30,251
Assets (,000s)	$511,005	$507,183	$503,516	$500,000	$496,615	$493,369	$490,251
Leverage Ratio[3]	**9.98%**	**9.30%**	**8.64%**	**8.00%**	**7.37%**	**6.76%**	**6.17%**

[1]Market yield on a 3.75-year Treasury given the rate shock, assuming initial yield is 4.00%

[2]Price of a 4.00% coupon, 3.75-year Treasury, given the shocked market yield

[3](After-shock capital/After-shock assets); assume go-forward average assets = after-shock assets