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September 6, 2012

The Honorable Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
Docket ID OCC-2012-0008

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Docket R-1442

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
comments@FDIC.gov
RIN 3064-AD95

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action

Heads of the Agencies:

On behalf of Sandler O'Neill + Partners, L.P., in this first of two letters we are commenting on one of the Agencies' three joint notices of proposed rulemaking ("NPRs") to implement agreements reached by the Basel Committee on Banking Supervision in *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, December 2010 ("Basel III Accord"), consistent with provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1]

This letter comments on a single provision of the Basel III NPR: the proposal to recognize (include) in common equity tier 1 capital unrealized gains and losses on all available-for-sale ("AFS") securities, both debt and equity, pursuant to a phased transition period from calendar years 2013 to 2018. We will shortly submit a companion letter commenting on other matters, including Dodd-Frank issues specific to U.S. banks.[2]

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[1] The three NPRs are together titled *Regulatory Capital Rules* and individually subtitled *Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (Basel III NPR), 77 FR 52792 (August 30, 2012); *Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements* (Standardized Approach NPR), 77 FR 52888 (August 30, 2012); and *Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule* (Advanced Approaches and Market Risk NPR), 77 FR 52978 (August 30, 2012). Comments are due October 22, 2012.

[2] The companion letter will further comment on AFS securities, particularly in relation to cash flow hedges,

Although this letter is addressed to the Agencies as setters of regulatory accounting principles implementing capital requirements for U.S. banks, it is equally addressed to the U.S. Department of the Treasury, the European Central Bank, the Financial Services Authority, the Securities and Exchange Commission, the Basel Committee on Banking Supervision, the Financial Accounting Standards Board, and the International Accounting Standards Board by virtue of their responsibilities for systemic, prudential, accounting, and disclosure requirements for banking organizations, both U.S. and foreign.

Sandler O'Neill is a market-leading, full-service investment banking firm and broker-dealer focused on the financial services sector.[3] We address the Agencies as a firm of financial professionals who work closely with a wide variety of financial firms nationwide and, increasingly, around the globe. Our clients include almost a thousand banks and thrifts (together, "banks") and their holding companies.

Overview

As described above, the Agencies propose to recognize (include) in common equity tier 1 capital unrealized gains and losses on all available-for-sale ("AFS") securities, both debt and equity, pursuant to a phased transition period from calendar years 2013 to 2018.[4]

While asserting that such treatment "would better reflect an institution's actual risk," the Agencies acknowledge that temporary changes in the market values of certain lower-risk debt securities could introduce substantial volatility to regulatory capital ratios, in some cases triggering prompt corrective action ("PCA") enforcement. Because of such volatility and its disincentive to holding highly liquid instruments with relatively low credit risk, the Agencies specifically request comment on alternative treatments.[5]

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as well as the following subjects: residential mortgage market; non-reliance on credit ratings; capital stress testing; corresponding deductions from capital; recognition of minority interests; REIT preferred consent dividend; trust preferred securities, including the M&A growth penalty; capital requirements for small SLHCs; and pension assets and liabilities.

[3] For further information on Sandler O'Neill, see http://www.sandleroneill.com/.

[4] Under current U.S. capital rules unrealized gains and losses on AFS debt securities are excluded from regulatory capital, while net unrealized losses on AFS equity securities are included in tier 1 capital and net unrealized gains on AFS equity securities are partially included in tier 2 capital. The Agencies' proposal implements the capital treatment agreed to in Basel III: "There is no adjustment applied to remove from Common Equity Tier 1 unrealised gains or losses recognised on the balance sheet." Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (December 2010), ¶ 52 at p. 13 & n. 10.

[5] Under U.S. GAAP, unrealized losses on AFS debt securities are unrelated to credit losses, which are recognized in earnings as other-than-temporary impairments. See FASB Staff Position No. FAS 115-2 & FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, April 9, 2009.

We concur in the Agencies' concerns, but not in the view that the proposed fair value treatment "would better reflect an institution's actual risk." To the contrary, we believe the financial statements and disclosures of U.S. banking organizations already adequately reflect the risks arising from unrealized temporary losses on investment securities, including AFS securities, and that better reflection of risk provides no justification for including such losses (or gains) in regulatory capital.[6]

Rather than implement – in whole or in part – the Basel III inclusion in regulatory capital of unrealized gains and losses on AFS securities, the Agencies should reject it in toto because:

- the Agencies' fears of substantially increased capital volatility for U.S. banks and perverse incentives for securities portfolio management are justified,
- accounting developments subsequent to the Basel III Accord would exacerbate these negative consequences for all banks, both U.S. and foreign,
- the underlying accounting treatment arose from the misdiagnosis of another financial crisis two decades ago, and it should not be propagated,
- the capital treatment Basel III endorses reflects bad accounting that would coerce unsafe and unsound changes in the banking business model and operate as a pro-cyclical accelerant in any future financial crisis, and
- gratuitous capital volatility would raise the cost of capital for banks and harm investors by increasing the risks of investing in banks.

The Origins of Fair Value Accounting for Banks

No discussion of the fair value accounting subscribed to in Basel III would be complete without observing that it originated in the regulatory misdiagnosis of another financial crisis – the thrift crisis in the United States two decades ago. Scrutiny of the commonly accepted justification of fair value accounting for banks reveals it to be a supervisory myth that over the years has morphed into accounting orthodoxy.[7]

Although the Financial Accounting Standards Board had formally committed itself to serving "external users who lack the authority to prescribe the financial information they

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[6] "General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders, and other creditors to estimate the value of the reporting entity." FASB, Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting* (September 2010), ¶ OB7. We question the consistency of much fair value accounting with this core concept of generally accepted accounting principles, or GAAP. If fair value accounting is often inappropriate for earnings, how can it be appropriate for equity? Other comprehensive income, or OCI, strikes us as a conceptually illegitimate sundering of equity from earnings.

[7] Nowhere in this letter do we intend to impugn the good faith of the FASB or IASB. Rather, we think the boards believe too deeply in fair value orthodoxy to see beyond it to what investors really want, and we hope this letter may help them to do so.

want from an enterprise"[8] (investors rather than regulators), the FASB explained the genesis of Statement of Financial Accounting Standards ("SFAS") No. 115 as follows:

> This Statement was undertaken mainly in response to concerns expressed by regulators and others about the recognition and measurement of investments in debt securities, particularly those held by financial institutions. They questioned the appropriateness of using the amortized cost method for certain investments in debt securities in light of certain trading and sales practices.[9]

In point of fact, however, the accounting culprit-in-chief of the 1980s thrift crisis was not amortized cost or the gains trading it enabled but, rather, the recognition by generally accepted accounting principles ("GAAP") and the federal thrift regulator of goodwill as an asset, and by the federal thrift regulator of supervisory goodwill.[10]

From 1981 to 1984 the net worth of FSLIC-insured[11] thrifts as a percentage of assets declined from 4.3% to 3.7% on a RAP basis and from 4.2% to 2.6% on a GAAP basis, while on a tangible basis it plummeted from 3.9% to 0.3%. By 1984 goodwill and supervisory goodwill, not historical cost accounting, largely enabled one-fifth of the thrift industry – with over one-third of its assets – to avoid reporting insolvency.[12]

To have suggested that the lack of fair value accounting prevented policymakers, examiners, accountants, or investors in stock thrifts from detecting or assessing financial

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[8] Statement of Financial Accounting Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises* (November 1978), ¶ 28. In its concepts statements, the FASB remains committed to investors as its primary constituent, a commitment the IASB has embraced. See FASB, Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting* (September 2010), ¶ OB2; IASB, *Conceptual Framework for Financial Reporting: Project Summary and Feedback Statement* (September 2010), p. 4.

[9] Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (May 1993), ¶ 2. A subsequent study by the research manager and a board member of the FASB documented that the Securities and Exchange Commission was the regulator most responsible for the FASB's adoption of SFAS 115. See L. Todd Johnson & Robert J. Swieringa, "Anatomy of an Agenda Decision: Statement No. 115," *Accounting Horizons*, vol. 10, no. 2 (Sarasota: June 1996), p. 145.

[10] Whereas goodwill represents the acquisition premium paid in excess of the fair value of assets of a solvent firm, supervisory goodwill represented the fair value excess of liabilities over assets in the acquisition of an insolvent thrift recognized not by GAAP but by regulatory accounting principles ("RAP") applied by the Federal Home Loan Bank Board, predecessor agency to the Office of Thrift Supervision, itself recently abolished by the Dodd-Frank Act.

[11] Federal Savings and Loan Insurance Corporation, the former federal insurer of thrift deposits.

[12] See Lawrence J. White, *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation* (Oxford U. Press, 1991), pp. 86-87, Table 5-10 in particular. White advocates fair value accounting as a preventative of "gains trading," or selling appreciated assets while holding depreciated ones (pp. 225-229). Gains trading, however, is a minor irritant in the annals of historical cost accounting.

ruin of this magnitude was nonsense. There were many failures during the thrift crisis, but historical cost accounting was not among them.

The enormous irony here is that during its two-decade crusade for fair value as *the* accounting cure-all, the FASB has not addressed GAAP's recognition of goodwill as an asset except to replace amortization with indefinite duration on the balance sheet, limited only by impairment. By contrast, the Agencies long ago uniformly banished goodwill from regulatory capital. Magnifying this irony, the Agencies responded to the equity volatility inherent in SFAS 115 by excluding from regulatory capital the fair value adjustment to equity required for AFS debt securities.

This brief review of the origins of fair value accounting in supervisory myth is no mere academic exercise, and for two reasons.

First, in its capital rules Basel III piggybacks on unrealized gains and losses recognized on the balance sheet by GAAP and International Financial Reporting Standards ("IFRS"). Thus, to oppose fair value in the capital rules requires addressing its legitimacy in accounting literature, and it is unjustified from the very beginning.

Second, what was mistakenly thought to be an empirical accounting response to the U.S. thrift crisis has achieved over two decades – through lack of correction in the face of erroneous reiteration – the status of orthodoxy. To oppose fair value orthodoxy requires that it be recognized as such and countered by arguments grounded in facts, empiricism, and responsible supervisory prerogatives.

Fair Value: A Large and Growing Problem for U.S. & Foreign Banks

Two recent decisions by the FASB and IASB in their ongoing joint deliberations on the classification and measurement of financial assets have exacerbated the risks to all banks and financial systems of the Basel III requirement that securities gains and losses recognized on the balance sheet be included in common equity tier 1 capital.[13]

First, the IASB has tentatively agreed to incorporate into IFRS 9 an AFS category in addition to the held-to-maturity ("HTM") and trading categories.[14] IFRS 9 as currently in effect is closer to U.S. GAAP before SFAS 115, when securities were either held for investment and carried at amortized cost or held for sale and carried at the lower of cost or market ("LOCOM"), with the difference that under IFRS 9 unrealized gains as well as losses on trading securities are recognized in net income.

Second, the FASB has tentatively agreed to adopt the IASB's instruments-characteristics criterion for determining eligibility for the AFS or HTM categories.

[13] See the minutes of the February 28, 2012 and May 21, 2012 joint board meetings titled "Accounting for Financial Instruments: Classification and Measurement," available on the FASB website at www.fasb.org.

[14] International Financial Reporting Standards 9, *Financial Instruments* (October 2010).

Pursuant to this criterion, for financial assets to be eligible for the AFS (fair value through OCI) or the HTM (amortized cost) category, their contractual cash flows must represent "solely payments of principal and interest." Otherwise, a financial asset would have to be held in a trading account (fair value through net income).

For foreign banks, the addition to IFRS 9 of a fair value through OCI (AFS) category would make it more difficult for them to exclude from common equity tier 1 capital unrealized gains and losses by carrying securities at amortized cost (HTM). In other words, the addition of an AFS category would intercept securities that otherwise could have been carried at amortized cost, expanding the regulatory capital recognition of unrealized gains and losses far beyond what foreign banks had anticipated.

For U.S. banks, the adoption of the instruments-characteristics criterion would further amplify the volatility of earnings as well as equity and regulatory capital. For example, the criterion would appear to require all perpetual equity securities and convertible debt instruments to be held in a trading account, with unrealized gains and losses recognized in net income. Derivatives, including fixed-income derivatives, would also appear to be trading securities, and the status of structured asset-backed securities seems unclear because of their redirection of cash flows and creation of residual, equity-like tranches.

Because of these accounting developments, the stakes for all banks – both domestic and foreign – are not only large but larger than they appeared when the final Basel III Accord was issued in December 2010. For this reason alone, all bank supervisors should be concerned enough to revisit the Basel III fair valuing of investment securities, as the Agencies clearly are.

How Big a Problem for U.S. Banks?

To assess how large a problem fair valuing the AFS portfolios of U.S. banks could be, we modeled the impact on consolidated leverage capital of a positive 300 basis point parallel shock to market interest rates using second-quarter 2012 SNL Securities data. Many banks and examiners are themselves currently using this scenario because it seems reasonable in the context of the historically low current interest rate environment. We assumed an effective duration for the securities portfolio of 3.5 years and performed our analysis twice, assuming a zero percent tax rate and a 35% tax rate to generate both nominal and tax-effected impacts.

Having elsewhere analyzed the impact of such a shock on common equity tier 1 capital, we chose the leverage capital ratio for this letter because it provides an additional capital metric. We constructed our ratio to reflect the Agencies' proposal. The numerator consists of tier 1 capital, including common equity, noncumulative perpetual preferred stock, and grandfathered cumulative perpetual preferred stock issued to the U.S. Treasury. The denominator consists of the book value of total assets.

The results of our analysis for leverage capital are presented in Appendix A to this letter, stratified into five cohorts of banks by asset size. Suffice it to note here that the nominal reductions in leverage ratios are generally on the order of some 200 basis points, while the tax-effected reduction is on the order of over 100 basis points, with banks of less than $15 billion in assets exhibiting the most sensitivity. Note, however, that the cohort of banks larger than $50 billion has the lowest post-shock ratios, with both nominal and tax-effected ratios less than 100 basis points above the proposed 5% PCA well-capitalized threshold.

In short, the Agencies are right to be concerned about substantial capital volatility arising from the Basel III fair valuing of investment securities, and the accounting developments we have discussed, if adopted, would exacerbate that volatility.

They are also right to be concerned about the disincentive to holding highly liquid instruments with relatively low credit risk. However, a partial exemption for such securities would leave in place perverse incentives to avoid capital volatility at the expense of flexibility in managing other securities by holding them in the HTM rather than AFS portfolio.[15] For these reasons and others discussed in this letter and its companion letter, we urge the Agencies not to address the Basel III fair value problem by halves.

The Nexus Between Good Accounting, Business Models & Investors

During the depths of the recent crisis, former FASB Chairman Robert Herz defended fair value accounting for securities held by banks in Congressional testimony. He reasoned that a FASB staff analysis revealing that 52% of all U.S.-listed commercial banks were trading below tangible book value at November 3, 2008 suggested that investors "viewed bank net assets as overstated, not understated, as would be the case if fair value adjustments were causing excessive write-downs of bank assets."[16]

The fundamental flaw in this line of reasoning is that banks are not mutual funds, and investors in banks do not look to accounting principles applied to them for daily net asset values for purposes of redemptions. Rather, in normal markets investors typically focus on expected future earnings instead of book value in the knowledge that banks manage not to total return but to the spread relationships between earning assets and funding liabilities. As Chairman Herz acknowledged, "loans held for investment, which make up

[15] The OCC regards the loss of management flexibility from transferring securities from AFS to HTM to be problematic enough that its guidance instructs national banks to obtain prior approval from the board of directors. OCC Bulletin 2004-29, *Embedded Options and Long-Term Interest Rate Risk*, July 2, 2004, p. 5.

[16] Testimony of Robert H. Herz, Chairman, Financial Accounting Standards Board, before the U.S. House of Representatives Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Entities, March 12, 2009 (full text of testimony), pp. 11-12.

the bulk of financial assets for many banks, are carried at amortized cost subject to loan loss allowances that are not based on fair value."[17]

What Chairman Herz failed to acknowledge is that banks often own large portfolios of securities that are also held for investment to generate recurring income, and that there is no principled basis in GAAP (or IFRS) for applying different guidance on fair value and impairment to such securities given the counterexample of loans. Debt securities are merely certificated loans, and thus easier targets for partisans of fair value who give short shrift to the common business reason for holding each.

To assess how consistently U.S.-regulated banks hold investment securities in the AFS portfolio to generate recurring income rather than to realize gains, we surveyed net unrealized gains and net realized gains on AFS securities as a percentage of total AFS securities from the year SFAS 115 was adopted in 1993 through 2011. Appendix B presents the results of this analysis, expressed as a median rather than a mean to minimize distortion that extreme outliers would otherwise cause.

The results are a compelling empirical validation of the banking business model in practice: while net unrealized gains are volatile, net realized gains are remarkably stable over time at a fractional amount of unrealized gains. What emerges from this analysis is a persuasive portrait of banks that do not trade securities in their AFS portfolios but, rather, generally hold them for the collection of contractual cash flows. Such sales as do occur likely reflect prudent management practices, including portfolio rebalancing and the defensive sale of rapidly prepaying mortgage-backed securities at a gain today rather than being repaid at par tomorrow (capturing cash flows that otherwise would be lost).

Regardless of the future direction of GAAP (or IFRS), in their capital rules the Agencies should not propagate accounting conventions that unnecessarily discourage the prudent management of securities held for investment by including temporary net unrealized gains in regulatory capital.

Sound Supervision Should Reject Bad Accounting

Just as banks are not mutual funds, so they are not hedge funds. In the United States the regime of capital requirements and supervision, including principles of regulatory accounting and reporting, has evolved to encourage them to remain what they are: financial intermediaries that pursue lower-risk lines of business in exchange for federal

[17] Testimony, p. 6. We note that as part of their financial instruments project, the FASB and IASB continue to deliberate a converged approach to the expected-loss recognition of credit impairments on loans and debt securities not fair valued through earnings. See FASB, Supplementary Document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment* (Jan. 31, 2011), as well as minutes of the boards' ongoing deliberations available at www.fasb.org. On August 22, 2012, the FASB made a number of key decisions that very constructively diverge from the unnecessary and inoperable complexity of the jointly deliberated impairment model.

deposit insurance and relatively modest, reliable returns. Recent history is replete with cautionary tales of institutional investors that mixed – to their great grief and sudden demise – the combustible ingredients of highly leveraged balance sheets, risky business strategies, and the pursuit of total return.

Much of Basel III is consistent with this tradition of U.S. bank supervision, but the requirement that unrealized securities gains and losses recognized on the balance sheet be included in regulatory capital is not. Indeed, the fact that this requirement has found its way into the Basel III Accord is symptomatic of the misguided fair value orthodoxy in current accounting thinking and literature discussed above.

Bank supervisors should reject the indiscriminate application of fair value accounting to bank capital required by Basel III. The more extensively banks are forced to apply fair value accounting to their core competence of credit intermediation, the greater will become the pressure to manage to total return rather than the spread relationships between earning assets and funding liabilities that traditionally have characterized the management of their balance sheets. Such a shift in thinking from spread management to a trading account mentality would be foreign to most bankers.[18]

In short, accounting conventions that do not respect business models will coerce them, as a result of which the fair value provision of Basel III would undermine safety and soundness in banking and could operate as a pro-cyclical accelerant in any future financial conflagration.

Going It Alone If Necessary

We hope that the Agencies can convince the Basel Committee on Banking Supervision to revisit and expunge the Basel III requirement to include unrealized gains and losses on AFS securities in regulatory capital. If they cannot, we urge the Agencies unilaterally to reject as unsafe and unsound this treatment for the capital accounts of U.S. banks, and to do so in toto.

Undoubtedly, going it alone would occasion criticism from some, but for others it would set an example to follow. If justification beyond doing the right thing were needed, it lies amply at hand in steps such as proposing a leverage capital requirement for U.S. banks that is two-thirds higher than that agreed to in Basel III and proposing to apply Basel III to all U.S. banks even though the vast majority of them are much smaller than the largest banks to which the Basel III Accord is addressed.[19]

[18] Fair value accounting should clearly apply to the trading activities of large banks.

[19] Some 5,925 U.S. banks have less than $500 million in assets, or 81% of all U.S. banks, per SNL Securities data as of 06/30/12.

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The simple but important point here is that the Agencies have the moral authority as well as the duty to reject bad accounting that would compromise safety and soundness in the U.S. banking and financial systems.

A final point concerning investors deserves mention. At the very moment that Basel III is significantly enhancing the quality and quantity of capital that banks are required to hold, its supervisory subservience to fair value orthodoxy would counterproductively increase the cost of capital by gratuitously exacerbating its volatility to the detriment of investors, who generally have never supported an accounting standard that is fundamentally at odds with the business models of the banks in which they invest. Where the accounting boards have failed investors, the Agencies should vindicate them because safety and soundness require no less.

Sincerely,

Fred D. Price
Managing Principal

Robert B. Albertson
Principal

Raymond E. Chandonnet
Principal

Thomas W. Killian
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Joseph Longino
Principal

Fred Price is a founding principal and member of Sandler O'Neill's Executive Committee, head of the Balance Sheet Group, and a senior member of the Capital Markets Group [fprice@sandleroneill.com; 212-466-7765].

Robert Albertson has led strategic research and client consulting for 10 years at Sandler O'Neill after having directed banking sector research for 26 years at Smith Barney and Goldman Sachs, and is a frequent media and industry commentator [ralbertson@sandleroneill.com; 212-466-7946].

Raymond Chandonnet has spent 26 years in the bank asset-liability management arena and is Sandler O'Neill's chief balance sheet strategist, working extensively with its clients on a range of tactical balance sheet issues related to earnings, capital, liquidity, investments, funding, and interest rate risk [rchandonnet@sandleroneill.com; 212-466-7816].

Thomas Killian has 33 years of capital markets and M&A transaction execution experience, with a long history at Sandler O'Neill of developing innovative capital instruments and representing the firm in conferences with the Fed, FDIC, and others to discuss capital structure, Basel III and DFA related issues [tkillian@sandleroneill.com; 212-466-7709].

Joseph Longino practiced business and finance law before becoming a senior federal supervisor during the 1980s thrift crisis, and for over 20 years has provided Sandler O'Neill and its clients with supervisory, regulatory, accounting, and analytical expertise [jlongino@sandleroneill.com; 212-466-7936].

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cc: The Honorable Cyrus Amir-Mokri
Assistant Secretary for Financial Institutions
U.S. Department of the Treasury
c/o Ms. Katheryn Rosen, Senior Advisor

The Honorable Mario Draghi, President
European Central Bank

The Honorable Adair Turner, Chairman
Financial Services Authority

The Honorable Mary L. Schapiro, Chairman
c/o Mr. Paul A. Beswick, Acting Chief Accountant
U.S. Securities and Exchange Commission

The Honorable Stefan Ingves, Chairman
Basel Committee on Banking Supervision

The Honorable Leslie F. Seidman, Chairman
Financial Accounting Standards Board

The Honorable Hans Hoogervorst, Chairman
International Accounting Standards Board

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Appendix A: AFS Tier 1 Impact

Nominal

Asset Size	Total Number Banks	Total Assets	Tier 1 Capital	Tier 1 Capital/ Total Assets	Total AFS Securities	Change in MV of Securities +300	+300 Tier 1 Capital	+300 Tier 1 Capital Ratio	Change in Tier 1 Capital Ratio	New Total Assets
> $50 billion	34	14,285,050,221	1,000,187,285	7.0%	2,353,874,494	(247,156,822)	753,030,463	5.4%	-1.6%	14,037,893,399
$15 billion - $50 billion	29	725,431,407	63,458,615	8.7%	121,569,188	(12,764,765)	50,693,850	7.1%	-1.6%	712,666,642
$10 billion - $15 billion	21	261,119,351	28,012,800	10.7%	57,100,266	(5,995,528)	22,017,272	8.6%	-2.1%	255,123,823
$500 million - $10 billion	1,070	1,607,869,301	155,285,599	9.7%	320,349,076	(33,636,653)	121,648,946	7.7%	-1.9%	1,574,232,648
< $500 million	5,542	861,190,152	88,530,531	10.3%	176,454,083	(18,527,679)	70,002,852	8.3%	-2.0%	842,662,473
TOTAL	**6,696**	**17,740,660,432**	**1,335,474,830**	**7.5%**	**3,029,347,107**	**(318,081,446)**	**1,017,393,384**	5.8%	-1.7%	17,422,578,986

Tax Rate	0.0%
Effective Duration	3.5
Risk Weighting of Assets	100.0%

Tier 1 Capital is defined as Total Tier 1 Common Capital + Total Perpetual Preferred & Surplus - Cumulative Perpetual + Capital Repurchase Program Perpetual Preferred

Tax-Effected

Asset Size	Total Number Banks	Total Assets	Tier 1 Capital	Tier 1 Capital/ Total Assets	Total AFS Securities	Change in MV of Securities +300	+300 Tier 1 Capital	+300 Tier 1 Capital Ratio	Change in Tier 1 Capital Ratio	New Total Assets
> $50 billion	34	14,285,050,221	1,000,187,285	7.0%	2,353,874,494	(247,156,822)	839,535,351	5.9%	-1.1%	14,124,398,287
$15 billion - $50 billion	29	725,431,407	63,458,615	8.7%	121,569,188	(12,764,765)	55,161,518	7.7%	-1.1%	717,134,310
$10 billion - $15 billion	21	261,119,351	28,012,800	10.7%	57,100,266	(5,995,528)	24,115,707	9.4%	-1.4%	257,222,258
$500 million - $10 billion	1,070	1,607,869,301	155,285,599	9.7%	320,349,076	(33,636,653)	133,421,775	8.4%	-1.2%	1,586,005,477
< $500 million	5,542	861,190,152	88,530,531	10.3%	176,454,083	(18,527,679)	76,487,540	9.0%	-1.3%	849,147,161
TOTAL	**6,696**	**17,740,660,432**	**1,335,474,830**	**7.5%**	**3,029,347,107**	**(318,081,446)**	**1,128,721,890**	6.4%	-1.1%	17,533,907,492

Tax Rate	35.0%
Effective Duration	3.5
Risk Weighting of Assets	100.0%

Tier 1 Capital is defined as Total Tier 1 Common Capital + Total Perpetual Preferred & Surplus - Cumulative Perpetual + Capital Repurchase Program Perpetual Preferred

Source: SNL Financial

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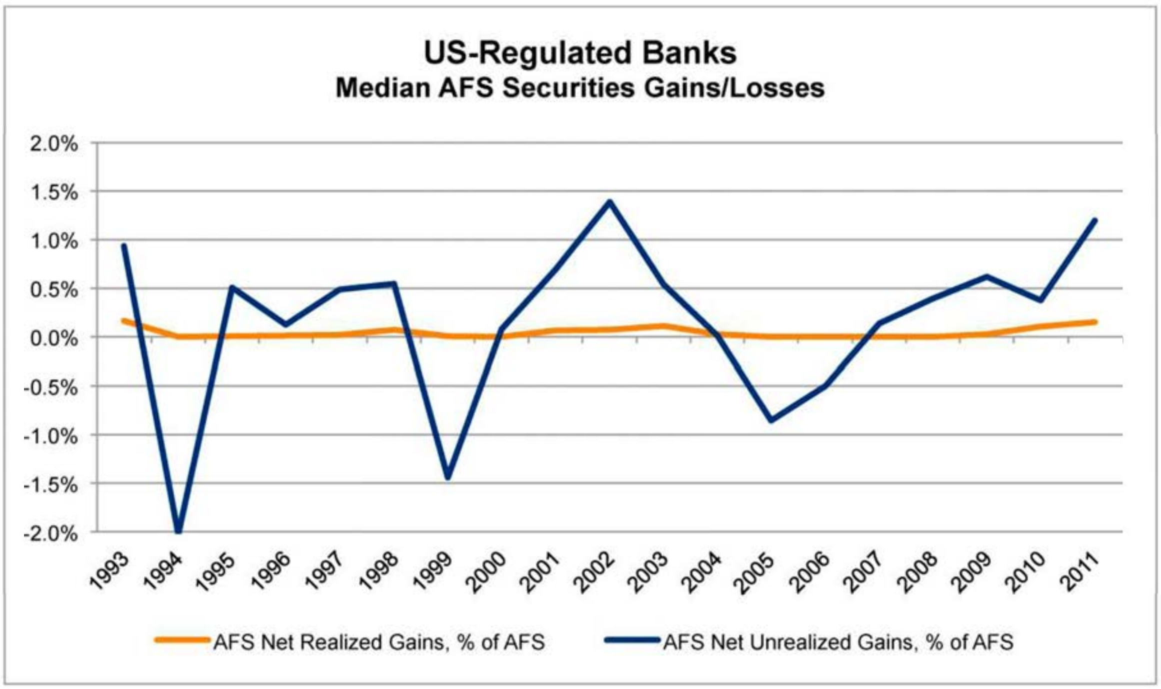
Appendix B: AFS Net Gains, Realized & Unrealized

US-Regulated Banks	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Median AFS Net Unrealized Gains, % of AFS	0.9%	-2.0%	0.5%	0.1%	0.5%	0.5%	-1.4%	0.1%	0.7%	1.4%	0.5%	0.0%	-0.9%	-0.5%	0.1%	0.4%	0.6%	0.4%	1.2%
Median AFS Net Realized Gains, % of AFS	0.2%	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%



Source: SNL Financial