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October 22, 2012

Board of Governors of the Federal Reserve System
Attention: Jennifer J. Johnson, Secretary
regs.comments@federalreserve.gov

Re: Notice of Proposed Rulemaking Implementing Basel III Regulatory Capital Rules (the "NPR")

Ladies and Gentlemen:

We are writing to express our opposition to the proposed accelerated Tier 1 capital phase out of trust preferred securities ("TPS") for depository institution holding companies ("DIHCs") with consolidated total assets of less than $15 billion ("Smaller Institutions") under the subject NPR promulgated 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"), collectively referred to as the "Banking Agencies." Our opposition is based on our beliefs that (A) it is unnecessary and unwise to accelerate the current Tier 1 capital phase out inherent in all TPS for Smaller Institutions, as permitted by current law and regulations, and (B) the NPR goes beyond current law applicable to Smaller Institutions[1] and should be revised to conform to current law.

A. Current Law and Regulations Adequately Address Smaller Institutions TPS Tier 1 Capital Phase Outs, and TPS Merit Continued Inclusion as Additional Tier 1 Capital for Such Institutions

TPS have been a Tier 1 capital component for many DIHCs since the FRB's 1996 decision approving these securities as eligible Tier 1 capital.[2] Their use increased significantly for smaller bank holding companies with the introduction of pooled TPS offerings a few years later.[3] The FRB incorporated its recognition of TPS as DIHC Tier 1 capital in the Code of Federal Regulations in 2005, and adopted the following additional quantitative limits and qualitative standards to the capital treatment of TPS, ***including capital phase out provisions*** [emphasis added]:[4]

1. Calculation of TPS' 25% limit as Tier 1 capital is net of goodwill;
2. TPS, subordinated debt, and limited-life preferred stock cannot exceed 50% of Tier 1 capital; and
3. TPS do not qualify as Tier 1 capital during the last 5 years of their related subordinated debt lives (which is generally 30 years). Thus, at year 25 TPS no longer qualify as Tier 1 capital, and are further amortized out of Tier 2 capital during their last 5 years at a rate of 20% per year, and are fully excluded from Tier 2 capital when their remaining maturity is less than one year.

As discussed below, we believe there are strong reasons not to adopt the NPR's proposed acceleration for Smaller Institutions of the FRB's existing structured phase outs of TPS from Tier 1 capital treatment during the last years of their lives.

First, the accelerated universal TPS Tier 1 capital phase out embodied in the NPR unnecessarily and unduly penalizes the vast majority of Smaller Institutions that have prudently and successfully used TPS to

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1 The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

2 Press Release, Federal Reserve Board, *Approval of the Use of Certain Cumulative Preferred Stock Instruments* (October 21, 1996), http://www.federalreserve.gov/boarddocs/press/bcreg/1996/19961021/default.htm; Kaiser, Kathy R., *FDIC San Francisco Regional Outlook – Financial Markets* (Fourth Quarter 1997).

3 Jordan, Paul, *Pooled Trust Preferred Stock – A New Twist on an Older Product*, Federal Reserve Bank of Chicago (March 2000); Eveson, Todd H., *Financial and Bank Holding Company Issuance of Trust Preferred Securities,* fn. 8, 6 N.C. Banking Inst, (2002).

4 Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital, Final Rule, 70 Fed. Reg. 11827-11838 (March 10, 2005), codified at 12 CFR Part 225, App. A.

support and grow their lending and investment activities in accordance with established regulations, and it is inconsistent with the NPR's proposal to continue Tier 1 capital treatment for certain other instruments:

> The agencies are also proposing to allow banking organizations to include in additional tier 1 capital instruments that were (i) issued under the Small Business Jobs Act of 2010 ["SBLF" – issuance of instruments under this Act was limited to Smaller Institutions whose assets were less than $10 billion] or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008 ["TARP"], and (ii) included in tier 1 capital under the agencies' current general risk-based capital rules. These instruments would be included in tier 1 capital whether or not they meet the proposed qualifying criteria for common equity tier 1 or additional tier 1 capital instruments. ***The agencies believe that continued tier 1 capital treatment of these instruments is important to promote financial recovery and stability following the recent financial crisis*** [footnotes omitted; emphasis added].

The rationale highlighted above is equally compelling for continuing to allow Smaller Institutions TPS Tier 1 capital treatment in accordance with current law and regulations, as the successful lending and investment activities of such institutions can likewise promote economic recovery and stability in the banking system.

TPS also have financial advantages as Tier 1 capital over the SBLF and TARP securities the NPR has proposed to continue to treat as Tier 1 capital. Tax-advantaged TPS are generally much lower cost capital instruments as compared to SBLF and TARP securities, and in the low interest rate environment that currently prevails and is projected by the Federal Open Market Committee to continue for the next several years, this TPS cost advantage is particularly valuable, especially in view of the dividend step-up terms of SBLF and TARP securities.

In addition, an accelerated TPS Tier 1 capital phase out for Smaller Institutions would be especially burdensome for many privately-owned DIHCs that already face greatly reduced capital raising alternatives and particularly limited choices in any efforts to refinance existing TPS.

Finally, the FRB has further authority to address capital requirements for individual DIHCs when warranted by the condition or conduct of a DIHC subsidiary. Under the prompt corrective action authority of section 38 of the Federal Deposit Insurance Act ("FDIA"),[5] the Banking Agencies have the power to downgrade an insured depository institution's capital status and require certain institutions to comply with mandatory or discretionary supervisory actions as if the institution were in the next lower capital category under certain circumstances.[6] FRB depository institution oversight authority is leveraged at the DIHC level by the FRB's source of strength doctrine first promulgated in Regulation Y,[7] and more recently elevated to statutory authority in section 38A added to the FDIA by section 616 of the Dodd-Frank Act,[8] as well as the related DIHC capital restoration plan performance guarantee requirements.[9] Given this expansive oversight authority, the FRB has more than adequate tools to address capital weakness in individual Smaller Institutions, whether resulting from inappropriate reliance on TPS or otherwise.

We believe the substantive points above strongly support revising the NPR to conform to section 171(b)(4)(C), of the Dodd-Frank Act. As discussed further below, we also believe such a revision is in fact required by that section.

B. The NPR Goes Beyond Current Law Applicable to Smaller Institutions

1. Language Used in the NPR and Other Documents

The language regarding the proposed phase out of TPS Tier 1 Capital treatment in (a) the June 4, 2012 staff memo to the FRB seeking approval of the draft notices of proposed rulemaking, (b) the Banking Agencies' Joint Press Release dated June 12, 2012, and (c) the NPR itself was incomplete and inaccurate with respect to the TPS provisions of the Dodd-Frank Act applicable to Smaller Institutions. Each of these

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5 12 U.S.C. § 1831o; 12 CFR §§ 6.6, 208.45, and 325.105.
6 12 CFR § 208.43(c) with respect to the FRB; the comparable OCC and the FDIC regulatory authority is set forth in 12 CFR §§ 6.4(d) and 325.103(d).
7 12 CFR § 225.4(a)(1)
8 12 U.S.C. § 1831o-1.
9 12 U.S.C. § 1831o(e)(2)(C)(ii)(I) and 12 CFR § 208.44(i).

documents stated that the proposed phase out of TPS Tier 1 Capital treatment for all institutions was "consistent with section 171" of the Dodd-Frank Act, but the FRB's recently launched website publication *Community Banking Connections* provided a more accurate statement in this regard:

> The exclusion of trust preferred securities from the tier 1 capital of bank holding companies and savings and loan holding companies is consistent with section 171 of the Dodd-Frank Act, which requires that such instruments issued by these organizations with $15 billion or more in total consolidated assets be phased out over a period of three years beginning in 2013. ***In addition,*** the agencies proposed that trust preferred securities issued by bank holding companies and savings and loan holding companies under $15 billion in total consolidated assets be phased out over a 10-year period beginning in 2013 [emphasis added].[10]

The second sentence in the above paragraph acknowledges that the Banking Agencies are seeking to implement a capital standard for Smaller Institutions that goes beyond the one provided in section 171 of the Dodd-Frank Act, but states no basis for seeking to modify by regulation a provision of current law.

2. *Relevant Provisions of the Dodd-Frank Act*

Section 171(b)(2) of the Dodd-Frank Act requires the Banking Agencies to establish minimum risk-based capital requirements on a consolidated basis for DIHCs and other institutions, and provides that such requirements shall not be less than the generally applicable risk-based capital requirements in effect for insured depository institutions as of July 21, 2010.[11] Were section 171(b) to have said nothing more on this issue, we would have understood it to preclude Tier 1 capital treatment for TPS, since the OCC and FDIC capital regulations have never approved TPS as a component of Tier 1 capital for an insured depository institution.[12] However, the fact that section 171(b) as finally adopted said much more than this is key to an evaluation of the NPR's TPS provisions for Smaller Institutions.

The original version of section 171(b) was submitted in the U.S. Senate by Senator Susan Collins of Maine on May 6, 2010 as an amendment to Senate bill S. 3712 (Restoring American Financial Stability Act of 2010).[13] On May 10, 2010 Senator Collins spoke on behalf of the amendment on the Senate floor and on May 12, 2010 she formally offered the amendment, which was adopted without debate by unanimous consent on May 13, 2010.[14] In addition to section 171(b), the only other provisions of what has come to be referred to as the *Collins Amendment* were what became section 171(a) (definitions of generally applicable leverage and risk-based capital requirements) and section 171(b)(7) (capital requirements to address activities that pose risks to the financial system).[15] On May 20, 2010 the Senate incorporated S. 3172 in H.R. 4173 – The Wall Street Reform and Consumer Protection Act of 2009 that the House of Representatives passed in December 2009 – and then passed H.R. 4173 in lieu of S. 3712.[16] The Senate and House each appointed representatives to a Conference Committee to reconcile the differences between their respective versions of the bill. Both houses subsequently agreed to the Conference Report for the re-named Dodd-Frank Act, which became law on July 21, 2010.[17] Without explanation or discussion in the Conference Report or its consideration in either the House or Senate,[18] the version of H.R. 4173 that became Dodd-Frank Act added several items to section 171, including the important subsection (b)(4)(C):

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10 *Community Banking Connections, Regulatory Capital Proposals: Frequently Asked Questions (Question 10),* Federal Reserve System (Third Quarter 2012).

11 12 U.S.C. § 5371(b)(2).

12 12 CFR Parts 167 and 325.

13 111 Cong. Rec. S 3371 – 3372 (May 6, 2010).

14 111 Cong. Rec. S 3459 – 3460 (May 10, 2010); 111 Cong. Rec. S 3616 (May 12, 2010); 111 Cong. Rec. S 3704 (May 13, 2010).

15 On May 13, 2010 Senator Collins stated she did not intend her amendment to apply to holding companies covered by the FRB's Small Bank Holding Company Policy Statement or to Federal Home Loan Banks, and she wanted a 5-year effective date deferral for DIHC subsidiaries of foreign banking organizations (items ultimately addressed in Dodd-Frank Act sections 171(b)(4)(E) and (5)(B) and (C)), but she did not address the other section 171 limitations and exceptions ultimately enacted into law by Congress. 111 Cong. Rec. S 3710-3711 (May 13, 2010).

16 111 Cong. Rec. S 4077 – 4078 (May 20, 2010).

17 U.S. House. Dodd-Frank Wall Street Reform and Consumer Protection Act, Conference Report to Accompany H.R. 4173 (111 H. Rpt. 517). Government Printing Office, 2010).

18 111 Cong. Rec. H 5233 – 5261 (June 30, 2010) and S 5870 – 5933 (July 15, 2010).

(C) Debt or equity instruments of smaller institutions.

For debt or equity instruments issued before May 19, 2010, by depository institution holding companies with total consolidated assets of less than $15,000,000,000 as of December 31, 2009, and by organizations that were mutual holding companies on May 19, 2010, ***the capital deductions that would be required for other institutions under this section are not required as a result of this section*** [emphasis added].[19]

In addition to the risk-based capital requirements mandated by section 171(b)(2) and the directly related and clearly stated Smaller Institutions TPS relief in section 171(b)(4)(C), section 168 of the Dodd-Frank granted the FRB the authority to issue regulations to implement subtitles A and C of the Dodd-Frank Act (subtitle C including sections 161 through 176).[20] Section 616 of the Dodd-Frank Act also added supplementary language to Bank Holding Company Act ("BHCA")[21] section 5(b)[22] stating that the FRB's existing authority to issue regulations and orders under the BHCA included "regulations and orders relating to the capital requirements for bank holding companies . . .."

3. Standards for Federal Agency Rulemaking Authority and Related Statutory Interpretations

Congressional grants of rulemaking authority to federal agencies to implement and administer laws must be exercised within the limits of the law and is subject to judicial review under the Administrative Procedure Act ("APA").[23] APA § 706(2) requires that a reviewing court hold unlawful and set aside agency action "not in accordance with law" or "in excess of statutory jurisdiction, authority, or limitations."[24] Consistent with this primacy of legislative authority over rulemaking authority, the applicable standard for reviewing the NPR in the context of the Dodd-Frank Act is found in the U.S. Supreme Court's decision in the case of *Chevron, U.S.A., Inc, v. Natural Resources Defense Council, Inc*.[25] and the later cases applying it. What has come to be known as the *Chevron* doctrine or framework sets forth a two step process for reviewing federal agency interpretations of a statute that it administers:

> First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, ***as well as the agency***, must give effect to the unambiguously expressed intent of Congress [emphasis added].[26]
>
> The judiciary is the final authority on issues of statutory construction, and must reject administrative constructions which are contrary to clear congressional intent. If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law, and must be given effect [citations omitted].[27]

Chevron's second step – deference to an agency interpretation of a statute – is only appropriate when a statute is silent or ambiguous on the precise question at issue. We discuss below why we do not believe deference to the FRB / NPR with respect to TPS treatment for Smaller Institutions is warranted under the following applicable Supreme Court guidance [internal citations and quotation marks omitted]:

- In determining whether a challenged regulation is valid, a reviewing court must first determine if the regulation is consistent with the language of the statute.[28] We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there.[29] [N]o deference is due to agency interpretations at odds with the plain language of the statute itself.[30]

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19 12 U.S.C. § 5371(b)(4)(C), hereinafter the "Smaller Institutions TPS Grandfathering."
20 12 U.S.C. § 5368.
21 12 U.S.C. § 1841 et seq.
22 12. U.S.C. § 1844(b).
23 5 U.S.C. § 701 et seq.
24 5 U.S.C. § 706(2). *See also* 12 U.S.C. § 1848 (providing for review of FRB orders under the BHCA).
25 467 U.S. 837 (1984).
26 *Id.* at 842 – 843.
27 *Id.* at 843 fn. 9. *Accord* United States v. Home Concrete & Supply, LLC 566 U.S. ___ (2012) (slip op. at 10).
28 K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 291 (1988).
29 Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253 – 254 (1992).
30 Ohio Pub. Employees Retirement System v. Betts, 491 U.S. 158, 171 (1989).

- It is a basic principle of statutory construction that a specific statute . . . controls over a general provision . . ., particularly when the two are interrelated and closely positioned . . ..[31] Specific terms prevail over the general in the same or another statute which otherwise might be controlling.[32] [I]t is familiar law that a specific statute controls over a general one without regard to priority of enactment.[33]

One case is especially instructive for evaluating FRB rulemaking authority under *Chevron* and the other Supreme Court guidance above – *Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*[34] In seeking to close what had been characterized as the "nonbank bank loophole" in the BHCA, in 1984 the FRB amended its Regulation Y to make nonbank banks subject to the BHCA through revised definitions of "demand deposit" and "commercial loan." Several parties sought judicial review of the amended Regulation Y and the United States Court of Appeals for the Tenth Circuit found the FRB's changes invalid and set aside the amended regulation.[35] The Supreme Court agreed to review the case to decide if the FRB acted within its statutory authority. The FRB offered further arguments in the Supreme Court that its definitions fell within the "plain purpose" of the BHCA and that it had power to regulate nonbank banks under section 5(b) of the BHCA – 12 U.S.C. § 1844(b). The Supreme Court decided against the FRB on all points, beginning with the plain language of the BHCA (citing *Chevron's* step one), stating that "The traditional deference courts pay to agency interpretation is not to be applied to alter the clearly expressed intent of Congress,"[36] and concluding that the definitions the FRB had adopted through rulemaking were not accurate or reasonable interpretations of section 2(c) of the BHCA. The Supreme Court next rejected the FRB's further arguments.

The Supreme Court stated that ignoring the plain language and limits of a statute could not be justified by invoking the asserted "plain purpose" of the legislation at the expense of the terms of the statute itself, which it said reflected the process of Congressional compromise that must be respected.

> The statute may be imperfect, but the Board has no power to correct flaws that it perceives in the statute it is empowered to administer. ***<u>Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute</u>*** [emphasis added].[37]

The Supreme Court also dismissed the FRB's contention that it had the power to regulate nonbank banks under its general BHCA section 5(b) authority providing that the FRB may issue regulations "necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof."

> ***<u>But [BHCA section] 5 only permits the Board to police within the boundaries of the Act; it does not permit the Board to expand its jurisdiction beyond the boundaries established by Congress in 2(c)</u>*** [emphasis added].[38]

The bright line that the *Board of Governors* case drew between Congressional legislative authority and agency rulemaking authority delegated by Congress makes it clear that the FRB may not effect changes in the law through rulemaking. It is important to note that the change regarding nonbank banks that the Supreme Court said was beyond FRB rulemaking authority was only later made through legislation enacted by Congress.[39]

4. Interpreting the Dodd-Frank Act

As noted earlier, the *Collins Amendment* included in the Senate passed version of H.R. 4173 indeed would have eliminated TPS from Tier 1 capital if it alone had became law, but the final version of section 171 as enacted by the Congress added important limitations and exceptions to the *Collins Amendment*. Section 171(b)(4)(C) of the Dodd-Frank Act as passed into law is unequivocal in stating that capital deductions

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31 HCSC-Laundry v. United States, 450 U.S. 1, 6 (1981); *Accord* RadLAX Gateway Hotel, LLC. v. Amalgamated Bank, 566 U.S. (2012) (slip op. at 5 – 7).
32 Fourco Glass Co. v. Transmirra Corp., 353 U.S. 222, 229 (1957).
33 Bullova Watch Co., Inc. v. United States, 365 U.S. 753, 758 (1961).
34 474 U.S. 361 (1986)
35 Dimension Financial Corp. v. Board of Governors of the Federal Reserve System, 744 F.2d 1402 (10th Cir. 1984)
36 *Board of Governors, supra* fn. 39 at 368.
37 *Id.* at 373 – 374.
38 *Id.* at 373 fn. 6.
39 The Competitive Equality Banking Act of 1987 – Pub. L. No. 100-86.

required under section 171 for other institutions are not required for Smaller Institutions. There was no contemporaneous lack of understanding of this plainly expressed intent of Congress. CCH, a leading provider of business and corporate law information, published a 1600-plus page book in July 2010 written by its editorial staff of banking and securities attorneys that correctly reflected section 171(b)(4)(C) by stating that "capital deductions are not required for debt or equity instruments issued before May 19, 2010 by bank holding companies with total consolidated assets of less than $15 billion."[40] Similarly, an article from the Indiana Bankers Association shortly after the passage of the Dodd-Frank Act accurately described the genesis of section 171 and the final form in which it was adopted:

> The Collins Amendment, as originally adopted, had no grandfather provisions or transition rules. It was adopted without debate and without dissenting vote. The senators seemed oblivious that the amendment, as written, would have eliminated billions of dollars of existing tier 1 capital overnight, *including* the cumulative preferred stock issued to the U.S. Department of the Treasury pursuant to the TARP Capital Purchase Program. ***Fortunately the Conference Committee corrected the situation by adopting several mechanisms to ease the transition. . . . Holding companies with less than $15 billion in consolidated assets (as of Dec. 31, 2009) . . . are allowed to continue to include qualifying instruments issued before May 19, 2010 in tier 1 capital*** [emphasis added].[41]

The only reasonable interpretation of the plain language of Dodd-Frank Act section 171(b), as finally enacted by Congress, is that it expresses an unambiguous intent on the precise question of TPS treatment for Smaller Institutions, and that specificity controls over any general grant of rulemaking authority in the Dodd-Frank Act or BHCA, and hence must be given effect by the FRB in exercising its rulemaking power within the limits of the law.[42]

Accordingly, for all the reasons presented above, we join with others in strongly urging that the NPR be revised to incorporate the Smaller Institutions TPS Grandfathering currently provided for in the United States Code at 12 U.S.C. § 5371(b)(4)(C).[43]

Thank you for the opportunity to present our views on this important matter.

Sincerely,

Alan J. Lane
President

John M. Bonino
Senior Vice President

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[40] CCH Attorney Editor Staff, *Dodd-Frank Wall Street Reform and Consumer Protection Act – Law, Explanation and Analysis* (July 2010).

[41] Aguggia, Paul M. and Daly, Joseph P. (Kilpatrick Stockton LLP), *The Dodd-Frank Act: Continuing the Reign of King Capital*, Hoosier Banker (September 2010).

[42] *See Chevron, supra* fns. 28 and 29; cases cited in fns. 31 -33; and *Board of Governors, supra* fns. 36 – 38. For a very recent example of a court vacating an agency rulemaking see International Swaps and Derivatives Ass'n v. Commodity Futures Trading Commission, No. 11-cv-2416, Memorandum Opinion (D. D. C. September 28, 2012), denying *Chevron* deference to an agency interpretation at odds with unambiguous language in 7 U.S.C. § 6a(a)(1) , but separately finding language in other subsections ambiguous and requiring remand to the agency.

[43] We are aware of at least 69 other NPR comment letters submitted to one or more of the Banking Agencies that express views similar to those set forth herein.