STATE OF ALABAMA
STATE BANKING DEPARTMENT

Robert Bentley
Governor

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Superintendent of Banks

October 4, 2012

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

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

Subject: Federal Reserve Docket No. R-1430 and Docket No. R-1442
FDIC RIN 3064-AD95 and FDIC RIN 3064-AD96

Dear Ms. Johnson and Mr. Feldman,

The Alabama Banking Department regulates 115 banks, with assets totaling $217 billion. As one of the largest State banking supervisory authorities in the United States, it is incumbent upon us to ensure that our opinions and the opinions of our regulated institutions regarding major proposed laws, rules, and regulations are made known. To that end, we respectfully submit the following comments regarding the Basel III notices of proposed rulemaking (NPRs) regarding revisions to the regulatory capital rules.

The basic premise of Basel III, to enhance the capital requirements for banks, is laudable. The recent extreme stresses in the world economies, in general, and the banking industry, in particular, underscore the paramount importance of capital. Further, we recognize the massive effort that has been expended in the creation of the Basel III proposals. However, we feel that certain aspects of the Basel III NPRs should be revised in order to better risk focus the requirements.

While we applaud the efforts to strengthen the quality of capital, some recurring themes seem to surface whenever we discuss Basel III among ourselves, with our regulated institutions, or with other regulatory bodies. Primary concerns relate to the overall complexity of the proposed regulations and the changes to both the definition of capital, itself, and the risk-weightings of bank assets for calculation purposes. These areas are addressed in detail below.

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Ratio Requirements

While the risk-weighted capital ratios are useful, we tend to focus more on the Tier 1 Leverage Capital Ratio (T1L Ratio) when analyzing capital. Under the proposed Basel III rules, the T1L Ratio criteria for Prompt Corrective Action (PCA) purposes would remain largely static. This means, for example, that the minimum T1L Ratio required to achieve the "Well Capitalized" designation would remain at five percent (5%). We contend that, even in the best of economic times, a five percent (5%) T1L Ratio would be considered marginal. In Alabama, the current average, non-weighted T1L Ratio for all of our State-regulated banks is 11.31 percent. We feel that the regulatory minimums for this critical ratio should be increased to bring them more into line with actual levels and expectations. To this end, we propose the following requirements for the T1L Ratio for PCA purposes, with all other minimum PCA ratios remaining as proposed.

Prompt Corrective Action Category	Tier 1 Leverage Ratio
Well Capitalized[1]	≥ 8%
Adequately Capitalized	≥ 6%
Undercapitalized	< 6%
Significantly Undercapitalized	< 4%

The proposed Capital Conservation Buffer (CCB) is a topic that is receiving a significant amount of attention. The CCB provision establishes additional capital ratio parameters governing whether or not a bank would be allowed to make certain payments. We feel that, for simplicity's sake, if a capital buffer is necessary, it should simply be incorporated into the base capital ratios. However, it should also be noted that regulatory bodies often impose restrictions on dividends and discretionary payments, such as bonuses, in both formal and informal enforcement actions. By making such restrictions automatic based upon defined capital parameters, the proposed rules are assuming what has traditionally been a discretionary decision of regulatory supervisors. Further, a number of our regulated institutions, particularly those operating as S corporations, have strong reservations about having automatic dividend restrictions based upon these CCB parameters.

Capital Composition

The inclusion of Accumulated Other Comprehensive Income (AOCI), more particularly Net Unrealized Holding Gains/Losses on Available-for-Sale Securities (NUHGL), in Tier 1 Capital seems to be troubling to most regulators and bankers. The inclusion of these gains/losses in capital would appear to introduce additional volatility into the bank's reported capital, based upon an incomplete picture of the true, aggregate ongoing value changes in a bank's balance sheet.

[1] While we realize that Congressional action would be required, we believe the term "well-capitalized" to be inappropriate. We find it confusing to investors regarding the true strength of banks' capital positions, and we do not believe that it reflects our and other regulators' recent experiences that, once a bank goes below well-capitalized, it has limited chances of survival. We believe that the PCA capital guidelines should be increased and the term "well capitalized" be done away with.

A bank's bond portfolio accounts for simply one portion of one side of a bank's balance sheet. All of the assets and liabilities of a bank are constantly changing in value owing to market interest rate movements and a host of other factors. By recognizing NUHGL in a vacuum, while ignoring the valuation changes on the full liability side of the balance sheet and, in most cases, the majority of the asset side of the balance sheet, it is quite possible that we are producing a less accurate calculation of true bank capital.

It should also be noted that most banks are long-term bond investors. This means that most investment appreciation (as the majority of banks now have, with market interest rates at historic lows) or depreciation will never be realized through sales, despite the fact that the bulk of bank bond portfolios are often designated "Available-for-Sale." This fact further bolsters the argument for continuing to exclude these gains and losses from capital calculations.

The argument has been advanced that recognizing changes in investment portfolio values could actually stabilize a bank's capital position due to their counter-cyclicality. That is, as market interest rates declined in a weakening economic environment, investment portfolio values would rise, offsetting decreasing earnings, and, as market interest rates increased in a strengthening economic environment, rising earnings would offset declining investment portfolio values. In reality, investment portfolio value increases in a declining interest rate environment would be unlikely to be taken, given the increased liquidity requirements and limited reinvestment opportunities in such a situation. The recognition of such an illusory capital increase is counter to the basic premise of PCA. Conversely, recognizing investment portfolio value declines in capital as an economy begins to rebound could retard the ability of banks to assist in the burgeoning economic recovery.

Risk-Weighted Assets

Another common area of concern for both regulators and bankers alike are the dramatic revisions to the risk weightings of bank assets in the Standardized Approach. In some instances, these changes appear to be reactive, based upon the recent market turbulence. Further, it is quite possible that the revisions could have significant unintended consequences for both banks and their customers and for the economy as a whole.

The proposed changes to the risk weightings for residential mortgage lending and commercial real estate lending are of concern to us, our regulated institutions, and the other regulatory bodies to whom we have spoken. More specifically, the following examples of risk weighting changes have elicited a great deal of angst.

Credit Product	Current Risk Weight	Proposed Risk Weight
Res. Mtg., 5Yr. Balloon, LTV≤80%	50%	100%
Res. Mtg., 5Yr. Balloon, LTV>80%.≤90%	50%	150%
Res. Mtg., Stand-alone Jr. Lien LTV>90%	100%	200%
ADC Loan, Non-1to4 Family, LTV≥90%	100%	150%

For many of our regulated institutions, these weighting changes would cause significant declines in their risk-weighted capital ratios, up to hundreds of basis points in certain instances, according to proforma ratio runs. Interestingly, under the proposed rules, non-real estate commercial and industrial lending and unsecured consumer lending would both generally be risk-weighted at one-hundred percent (100%). That is, in some instances, loans with less tangible or no collateral would receive lower risk weightings than the residential and commercial real estate loan types listed above.

It should also be noted that borrower repayment capacity does not appear to be a weighting criterion until a loan actually goes in default. This would mean that a highly credit-worthy loan customer and a marginal borrower would require the same capital allocation, based simply upon the type of loan and loan-to-value (LTV) ratio that they have. This emphasis on collateral, versus borrower repayment capacity, is something that we have discouraged in our regulated institutions and a point of significant concern in the proposed capital regulations.

In response to the proposed weighting changes, our institutions are discussing the potential necessity of shifting away from certain loan products and/or increasing pricing for consumers to offset the increased capital costs. This situation has the potential to result in a "lose-lose" for both financial institutions and their customer bases, with banks moving toward emphasizing loan products outside of their core competence and consumers having fewer choices, higher costs, or both.

Appropriately risk-pricing credit products is not only desirable, it is something that we, as regulators, expect our institutions to do as a matter of course. To be consistently successful, they must do it routinely, considering all factors of their customer relationships, but with a keen focus on borrower repayment capacity. Basing loan pricing more upon the type of credit product selected and loan-to-value parameters rather than upon demonstrated creditworthiness would generally not be prudent.

Compliance Costs

The expected costs of complying with the proposed Basel III regulations appear to be an almost universal concern among the bankers to whom we have spoken. Beyond the potential opportunity costs detailed above, most institutions expect data system modification costs and increased personnel expenses to be significant. It is important to note that such costs are expected to be incurred by all banks regardless of size.

Transition Period

The extended transition period outlined in the Basel III proposals could be extremely useful to banks as they seek to comply with the new regulations. However, it is probable that smaller institutions, with significant limitations on their customer bases, geographic reach, and access to capital markets, will find it difficult to make wholesale changes to their business models, even with the lengthy transition period. Given that reality, many of our institutions have asked about the possibility of having a size exemption, with smaller institutions remaining under the current capital regulations and only larger institutions being subject to Basel III. We feel that different capital requirements for different institutions within the Standardized Approach category would be problematic. We also feel that the implementation of our recommended changes to the NPRs would be extremely helpful in facilitating their general acceptance.

Other Matters

The following additional matters, although not eliciting as strong a response as the topics addressed above, are also worthy of attention.

- Asset concentrations, which have led to significant problems in a number of financial institutions, are not specifically addressed in the two notices of proposed rulemaking. If the approach of employing "buffers" is pursued, concentrations could be addressed through that avenue.

- The continued limitation of the allowance for loan and lease losses to one and one-quarter percent (1.25%) of risk-weighted assets for inclusion in Tier 2 Capital understates total capital.

- A limited number of our smaller institutions feel that the elimination of trust-preferred securities as qualifying Tier 1 Capital further restricts their already limited access to the established capital markets. We, however, believe that this measure to strengthen the quality of bank capital is prudent.

In conclusion, we thank you for the opportunity to comment on these important proposed regulations. As we have already stated, we understand the well-meaning intent of these proposals and acknowledge the extensive efforts that have been expended in their production. Further, we feel that our recommended revisions would significantly improve the proposed rules, with minimal additional work being required. Please do not hesitate to contact us with any questions or comments.

Sincerely,

John D. Harrison
Superintendent of Banks
Alabama Banking Department

cc: Senator Richard Shelby
Representative Spencer Bachus
Conference of State Bank Supervisors