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Via Email – regs.comments@federalreserve.gov

Board of Governors of the Federal Reserve System
Attention: Ann E. Misback, Secretary
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996; FRB Docket No. R-1576 and RIN 7100 AE-74

Ladies and Gentlemen:

We are writing to offer our comments on the notice of proposed rulemaking related to the Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, FRB Docket No. R-1576 and RIN 7100 AE-74, issued by the Board of Governors of the Federal Reserve System (the "**Board**") and published in the October 27, 2017 edition of the Federal Register (the "**Proposed Rule**").[1] Comerica Incorporated is a bank holding company, headquartered in Dallas, Texas, with offices in various states including Arizona, California, Florida, Michigan, and Texas. Comerica Bank, a subsidiary of Comerica Incorporated, is a state member bank that, in addition to other business lines, is in the business of making commercial loans, some of which would be covered by the Proposed Rule. The modification of the existing capital rules, as presented in the Proposed Rule, will have an impact on Comerica Bank as a member bank and as a commercial real estate lender. Accordingly and on behalf of Comerica Incorporated, Comerica Bank (collectively, "**Comerica**") appreciates the opportunity to comment on the Proposed Rule.

The Proposed Rule includes revisions to the treatment of acquisition, development, and construction ("**ADC**") exposures under the standardized approach that would apply for all firms. The revisions relating to the treatment of ADC exposures are designed to address concerns regarding the existing definition of high volatility commercial real estate ("**HVCRE**") exposure. Accordingly, we have limited our comments to those ADC and HVCRE issues that we believe need more focus than may be noted in

1 82 FR 49,984 (October 27, 2017).

other letters you'll be receiving from the trade associations of which Comerica is a member.[2]

I. The same definitions should be used for purposes of standardized approach and advanced approaches calculations.

Although the question has been directed to the advanced approaches banking organizations, we want to observe that standardized approaches banks may face unintended competitive challenges if the existing HVCRE exposure definition is maintained as an alternative for advanced approaches organizations while the more expansive high volatility acquisition, development, or construction ("**HVADC**") exposure definition is adopted as the sole measure for standardized approach entities. Under the Proposed Rule, advanced approaches institutions remain subject to both the current HVCRE definition (which has higher risk weights but also offers broader exceptions) and the new HVADC definition, but that dual standard is applicable only while those institutions are subject to the parallel run requirements[3]. Advanced approaches banking institutions who have received approval to exit parallel run are no longer measured by the standard approaches requirements[4]. There are significant variances in risk weights and differing exceptions to the application of those risk weights between the two definitions. Variances in risk weights often affect loan pricing. Those differences, in particular the capital based exception found in the HVCRE definition but not in the HVADC part of the Proposed Rule, seem likely to create competitive advantages that will favor advanced approaches organizations who are not subject to parallel run and who are able to use the HVCRE definition alone.

If implemented, the HVADC exposure definition[5] of the Proposed Rule should completely replace the HVCRE exposure definition for both standard and advanced approaches banking organizations.

II. The agencies should revise the proposed definition of HVADC to retain the contributed capital exemption for commercial real estate loans that meet specified levels of contributed capital.

The proposed definition of HVADC exposure in the Proposed Rule will eliminate the current exception to inclusion in HVCRE exposures found in paragraph (4) of the existing HVCRE definition for ADC loans with a loan-to-value ratio at or below the

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2 Comerica has participated in various working groups sponsored by our trade associations and supports the comments reflected in those other letters. This comment letter of Comerica has been prepared to focus on a set of discrete issues that need greater focus.

3 *See* 12 CFR 217.121(c).

4 *See* 12 CFR 217.121(d).

5 *See* §217.2, 82 FR 50,016, of the Proposed Rule.

applicable maximum supervisory loan-to-value ratio, borrower contributed capital in the form of cash, unencumbered readily marketable assets or payment of out-of-pocket development expenses totaling at least 15% of the "as completed" appraised value of the project that has been contributed before the loan is made, and where no contributed or internally generated capital can be withdrawn before the loan is repaid or converted to permanent financing. In addition to creating the potential competitive issues with advanced approaches banks noted above, loss of this exception for HVADC exposures will remove the existing incentive for borrowers to capitalize their ADC loans sufficiently to meet this exception, as the amount of contributed capital will no longer allow a loan to avoid classification as HVCRE, reducing its risk weight and allowing a reduction in borrowing costs.

Consequently, removing the contributed capital exception seems likely to increase, not reduce, the overall risk of the affected ADC loans. In Comerica's experience with the existing HVCRE rule, this exception has been a powerful incentive for borrowers to provide at least the required 15% contributed capital needed to obtain the exception. Based on our experience, we anticipate removing this exception will have the unintended effect of incenting borrowers to prefer loan structures with lower capital contributions with a resulting increase in risk to the lender. The utility of this exception seems to be recognized by the drafters themselves, who have retained the definition of HVCRE exposures and its capital contribution exemption as an alternative for advanced approaches banking organizations.

In addition, the 15 percent contributed capital requirement should be evaluated against the total cost of the project, as it provides a more meaningful measurement than when it is measured against value. When comparing two projects of equal cost and equal contributed capital, the current methodology would imply that the project with the higher appraised value would carry more risk. The current methodology provides an incentive to lower the amount of the loan for properties with higher values (as compared to the cost of the project) and increase the amount of the loan for properties with lower values (as compared to the cost of the project).

If implemented, the final HVADC exposure definition[6] should include a borrower contributed capital exemption.

III. Contributed capital should recognize the greater of market value or cost for land contributed to the project rather than cost alone.

In addition to retaining the contributed capital exemption for HVADC for loans that have at least the required capital level and meet or exceed supervisory loan-to-value requirements, where the borrower contributes appreciated land to the project, the Proposed Rule should be clarified to ensure that the current market value of that land be considered when calculating the borrower's capital contributions. Since market value has

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[6] *Id.*

an obvious effect on the lender's likely recovery on its collateral should enforcement be necessary, increases in market value have a corresponding impact on reducing the lender's risk on the loan. Just as encouraging greater capital contributions reduces risk, providing an incentive for the contribution of appreciated land can be expected to have the same effect.

Recognizing market values when calculating the capital contribution amount will also remove a counterproductive element in the existing rule that places a disadvantage on borrowers who contribute appreciated assets. An appreciated asset has greater value because of increases in its market value that typically occur over time; this concept should be better reflected in the Proposed Rule. Moreover, during that holding period the borrower has borne both the out-of-pocket holding costs of the asset and the opportunity costs inherent in the commitment of its capital to the asset. An otherwise similarly situated borrower contributing a recently acquired parcel can be expected to have a higher cost basis in that land, but will have avoided those carrying and opportunity costs (which will have been borne by its seller, who will have realized that value in the sale price). In either case, the higher value of the land will contribute to reducing the lender's risk.

The Proposed Rule should recognize the functional equivalency of the value of a recently acquired parcel and a comparable appreciated parcel.

IV. Closing Comments

We value each and every opportunity to provide comments regarding regulatory proposals. We trust that you find the comments noted above useful in formulating the final rule. We hope that you will give our comments due consideration and consider them in your development of the final rule, as we believe that our comments and the recommendations contained therein will contribute to reduced systemic risk in ADC loans while avoiding unintended consequences.

If you have any questions, please do not hesitate to contact me at 214.462.4401 or by email at djculkar@comerica.com.

Very truly yours,

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