THE RISK MANAGEMENT ASSOCIATION
Serving the Financial Services Industry

June 30, 2005

Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room, Mailstop 1-5
Washington, DC 20219
Attention: Docket No. 05-08
Via e-mail: regs.comments@occ.treas.gov

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
Washington, DC 20551
Attention: Docket No. OP-1227
Via e-mail:
regs.comments@federalreserve.gov

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments
Via e-mail: comments@fdic.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No.2005-14
Via e-mail:
Regs.comments@ots.treas.gov

RE: Comments on the Interagency Proposal on the Classification of Commercial Credit Exposures

Dear Sirs and Madams:

The Risk Management Association (RMA) appreciates the opportunity to comment on the Interagency Proposal on the Classification of Commercial Credit Exposures released by the agencies on March 28, 2005.

RMA has long argued that robust internal risk-rating systems are critical to sound risk management practices at financial institutions. Indeed, in 1994, RMA published a model risk-rating system that expanded on the regulatory classifications and included weighting for facility structure as well. To this end, RMA believes that the current regulatory classification does merit improvement and that the proposed changes as outlined in the interagency proposal are directionally correct.

However, we do have a number of concerns with the timing of the proposed changes and with the proposal itself. With regard to timing, the industry is currently almost overwhelmed by the intensity of regulatory compliance-rated issues, from Sarbanes-Oxley requirements and the Bank Secrecy Act to Basel II implementation. Institutions of all sizes report that valuable time and resources are being consumed by compliance-related activities at the expense of business development and, perhaps, ongoing risk management practices.

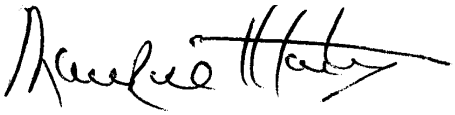
Community banking institutions in particular are concerned that the costs associated with training personnel to use the revised classifications could outweigh any benefit derived from improved risk management. And, while current accounting requirements, such as FASB 114, require collateral evaluation much as the proposed classification envisions, significant systems changes would be necessary at some institutions to align internal rating systems to the proposed regulatory classifications.

Larger institutions, particularly those planning to be AIRB Basel II compliant, believe that any proposed changes to the regulatory classifications should be implemented only after Basel II reporting systems are fully operational. Moreover, many believe that the proposed classifications do not offer sufficient granularity. As with the proposed Shared National Credit (SNC) Program Modernization proposal, these institutions were also concerned with the costs of maintaining dual reporting systems.

Outlined in Appendix A are the views of large institutions represented in RMA's Capital Working Group. RMA surveyed its community bank membership (institutions under $5 billion in assets) in addition to the membership of America's Community Banks to solicit commentary from small banks regarding the impact of the proposed classification changes. The results of that survey are included as Appendix B.

Again, RMA appreciates greatly the opportunity to comment on the interagency proposal and would be pleased to provide further information.

Sincerely,



Maurice H. Hartigan II
President and CEO

Enclosures

APPENDIX A

The RMA Capital Working Group Comments on the Interagency Proposal on the Classification of Commercial Credit Exposures[1]

The RMA Capital Working Group supports a move to a two-dimensional regulatory classification system, but believes that such a system should be developed and implemented only after Basel II compliant reporting systems are fully operational. Moreover, the Interagency Proposal in its present form must be refined significantly before it can truly differentiate risk in a uniform manner across the industry. Without further clarification, the Interagency Proposal would be difficult, if not impossible, to implement and would provide little or no value to internal risk management procedures.

RMA supports the goal of achieving greater consistency among the agencies in assessing the credit risk in an institution's commercial loan portfolio. However, we believe that this goal can be achieved through increased coordination between the agencies themselves.

Use Expected Loss (EL) Framework for Regulatory Classifications

Large complex banking organizations (LCBOs) have well-established, comprehensive dual-rating systems in place that measure probability of default (PD) and loss given default (LGD) for individual exposures and portfolios. These systems employ an expected loss (EL) methodology that could be used for regulatory classification purposes. Regulatory classification of credits based on calculated EL would be consistent with existing PD/LGD frameworks employed by LCBOs. Moreover, an EL system could be easily adaptable to a single- or dual-rating system. RMA recommends that the agencies replace the Borrower/Facility matrix with an EL vector.

Default Definition

The definition of default used in the Interagency Proposal is not entirely consistent with that contained in the Basel II framework as the Basel II definition is broader. While a narrower definition of default is preferable, a consistent definition of default within existing regulatory frameworks must be adopted and implemented as a first step toward achieving risk-rating consistency across the regulatory agencies and the industry as a whole.

Borrower Dimensions

Basel II requires borrower ratings to be correlated with PD. The regulatory classifications must align with PD as well to ensure risk-rating consistency and to prevent the

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[1] The RMA Capital Working Group consists of senior officers at the leading banking institutions in the U.S. and Canada who are responsible for the measurement of risk and the determination of economic capital. The names of the institutions represented on the Capital Working Group, along with staff members contributing to the preparation of this response, are shown at the end of Appendix A. Individual banking organizations that are members of the Group may be responding separately to the Interagency Proposal and may hold opinions regarding the proposal that differ from those expressed here.

burdensome and unnecessary expense of maintaining separate rating systems for Basel II purposes and U.S. regulatory classifications. The proposed borrower dimensions do not appear to be significantly divergent from the current definitions (Marginal = Special Mention, Weak = Substandard, and Default = Doubtful), so why change the terminology? The costs associated with making the systems, reporting, policy/procedures, and training and communications changes necessary to simply comply with a shift in terminology hardly seem justified. Moreover, without additional buckets to increase granularity or established ranges of PD to correlate to the borrower dimensions, the Interagency Proposal offers little improvement over the current classification system.

Facility Dimensions

The introduction of a facility rating is an improvement over the current system. However, the "Remote Risk of Loss" equal to zero chance of default is troubling. Again, as required by Basel II, facility ratings should be aligned with LGD. The loss severity benchmarks included in the Interagency Proposal (Remote = 0%, Low < = 5%, Moderate > 5 & < = 30%, and High > 30%) are not sufficiently granular.

An institution's historical loss data should be used to determine LGD, particularly if that institution is Basel II compliant and using such data for regulatory capital estimation purposes.

Asset-Based Lending

RMA supports the move to recognize asset-based lending with a distinct regulatory classification. However, we would note that other specialized and collateral-based lending activities should be included. Such activities must also be treated consistent with the Basel II Framework. Under the Interagency Proposal the treatment of asset-based lending would be difficult to implement and inconsistent with the Basel II Framework.

Conclusion

RMA suggests that the agencies postpone further work on the Interagency Proposal until Basel II Implementation is complete. We believe that much will be gained through the use of Basel II compliant reporting systems. The revised regulatory classification system could benefit greatly from what the industry and regulators alike learn in the coming years as Basel II becomes a reality.

APPENDIX A
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Institutions in the RMA Capital Working Group:

ABN AMRO North American	Bank of America
Bank of Montreal	Bank of New York
Capital One	CIBC
Citigroup	Comerica
HSBC/North American Holdings	JPMorganChase
KeyCorp	MBNA
PNC Financial Services Group	RBC Financial
State Street	SunTrust
Union Bank of California	Wachovia
Washington Mutual Bank	Wells Fargo

Staff participating in preparation or review of this paper:
Bank of America: Jim Chipouras, Senior Vice President, Enterprise Credit Risk
HSBC/North America Holdings: John Zeller, Executive Vice President, Credit Risk Management; David Coleman, Senior Vice President, Credit Risk Management; David Morin, Senior Vice President, Credit Risk Management; John Roesgen, Senior Vice President, Finance; Stephen Mongulla, Director, Credit Policy
JPMorganChase & Co: Michel Araten, Managing Director
KeyCorp: Ashish K. Dev, Executive Vice President, Enterprise-Wide Risk Solutions
PNC Financial Services Group: Shaheen Dil, Senior Vice President & Director, Risk Analytics; Terry Jewell, Senior Vice President & Manager, Quantitative Modeling Group; Thomas Bogdewic, Vice President, Portfolio Management
RBC Financial: Michael Cussen, Basel Coordinator; Jason Smith, Senior Manager, Credit MIS
State Street: Wendy Phillis-Lavoie, Basel II Project Leader; F. Andrew Beise, Basel II Credit Risk Team Leader; William H. Schomburg III, Director, Economic Capital; Norman J. Greenfeld, Director of Counterparty Review; Joseph J. Barry, Vice President, Legal & Industry Affairs
SunTrust: Kenneth J. Ferrara, Group Vice President; Jennie Raymond, Group Vice President; David Fisher, Senior Vice President, Portfolio Risk
Union Bank of California: Paul C. Ross, Senior Vice President, Portfolio Risk Management; Desta G. Medhin-Huff, Vice President, Portfolio Risk Management
Wachovia: Gary Wilhite, Senior Vice President, Credit Risk Management; Ann Baker, Vice President, Credit Risk Review; David Gylfe, Vice President, Credit Risk Management.
Wells Fargo: Jouni Korhonen, Senior Vice President, Credit Risk Architecture; Dennis P. Jacovson, Vice President, Credit Reporting and Portfolio Strategies
The Risk Management Association: Pamela Martin, Director, Regulatory Relations & Communications; Mark A. Zmiewski, Director, Strategic Learning & Research; Suzanne I. Wharton, Project Manager, Strategic Learning & Research

APPENDIX B

Comments on the Interagency Proposal on the Classification of Commercial Credit Exposures by the Community Bank membership of RMA and the membership of America's Community Banks [2]

[2] RMA surveyed its member institutions with assets of less than $5 billion to solicit commentary from community banks regarding the Interagency Proposal. The survey was also distributed to the membership of America's Community Banks to gain additional input.

COMMERCIAL CREDIT CLASSIFICATION SURVEY, 2005

Acknowledgments

A total of 331 respondents took part in this survey during June 2005. Member organizations of both The Risk Management Association and America's Community Bankers were invited to submit their responses. The survey covered proposed regulatory changes to the current risk-rating system for commercial credit exposures. Participants were informed that the information collected in this survey will aid RMA in forming its response to the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the Federal Reserve System regarding the "Interagency Proposal on the Classification of Commercial Credit Exposures" released by the agencies on March 28, 2005.

In the interest of time, the final report's presentation style is oriented toward showing overall aggregate results emphasizing the communication of facts over analysis. RMA staff members contributing to the study were Pamela Martin, Mark Zmiewski, Suzanne Wharton, and Stephen Revucky. The writing of the final report was undertaken by RMA.

DISCLAIMER

All the information contained herein is obtained from sources believed to be accurate and reliable. All representations contained herein are believed by RMA to be as accurate as the data and methodologies will allow. However, because of the possibilities of human and mechanical error, as well as unforeseen factors beyond RMA's control, the information herein is provided "as is" without warranty of any kind. RMA makes no representations or warranties express or implied to participants in the study or any other person or entity as to the accuracy, timeliness, completeness, merchantability, or fitness for any particular purpose of any of the information contained herein. Furthermore, RMA disclaims any responsibility to continue to update the information. Moreover, information is provided without warranty on the understanding that any person or entity that acts upon it or otherwise changes position in reliance thereon does so entirely at such person's or entity's own risk.

From where did you receive the invitation to participate in this survey?

Response	Count	Percent
RMA — The Risk Management Association	298	90.0%
America's Community Bankers	33	10.0%

1. What were your institution's assets as of 12/31/2004?

Response	Count	Percent*
< $250 million	131	39.7%
$251 - $500 million	64	19.4%
$501 - $750 million	28	8.5%
$751 million - $1 billion	23	7.0%
$1 - $2.5 billion	40	12.1%
$2.5 - $5 billion	20	6.1%
> $5 billion	24	7.3%

*Total may not add up to 100% due to rounding.

2. Approximately what percentage of your institution's assets was related to C&I and Commercial Real Estate as of 12/31/04?

Response	Count	Percent*
0 - 10%	18	5.5%
11 - 20%	31	9.5%
21 - 30%	36	11.0%
31 - 40%	39	11.9%
41 - 50%	34	10.4%
51 - 60%	56	17.1%
61 - 70%	39	11.9%
71 - 80%	38	11.6%
81 - 90%	23	7.0%
> 90%	14	4.3%

*Total may not add up to 100% due to rounding.

3. Indicate the type of rating system your institution assigns to a typical C&I exposure.

Response	Count	Percent*
Borrower only (risk of loss driven by factors intrinsic to the borrower, industry, financial condition, etc.)	53	16.0%
Loan only (the structure of a credit: terms, support, etc.)	17	5.1%
Combination borrower **and** loan; one grade only	240	72.0%
Two separate grades; one for borrower and one for loan	12	3.6%
Other	9	3.2%

*Total may not add up to 100% due to rounding.

"Other" responses:

- Although our rating system is loan specific, the entire relationship is viewed at one time and EVERY loan rating would be affected by an adverse rating for one loan.
- Borrower is rated; split rating is assigned when there is a facility secured with liquid collateral.
- Borrower only - probability of default.
- Borrower only at the note level. Risk grades (except basket of consumer loans) are based on probability of default unless risk grade shows 'Special Mention," in which case collateral becomes a 30% factor.
- Certain products like project finance have "loan only" rating.
- Overall grade plus LGD on special mention and substandard grades.
- We do not use a rating system.

4. Is the risk rating different for commercial real estate exposures?

Response	Count	Percent*
Yes	37	11.2%
No	291	88.4%
Unsure	1	0.3%

*Total may not add up to 100% due to rounding.

5. How many risk-rating grades do you use?

# of Grades	Pass		Watch List		Not Pass - Criticized (includes OAEM) or Classified	
	Count	Percent*	Count	Percent*	Count	Percent*
0	4	1.3%	36	12.2%	11	3.7%
1	24	7.7%	165	56.1%	20	6.7%
2	14	4.5%	17	5.8%	32	10.7%
3	54	17.3%	19	6.5%	97	32.3%
4	97	31.0%	24	8.2%	107	35.7%
5	83	26.5%	19	6.5%	10	3.3%
6	20	6.4%	7	2.4%	4	1.3%
7	6	1.9%	0	0.0%	5	1.7%
8	5	1.6%	0	0.0%	5	1.7%
9	3	1.0%	6	2.0%	6	2.0%
10	1	0.3%	1	0.3%	1	0.3%
11	0	0.0%	0	0.0%	0	0.0%
12 or more	2	0.6%	0	0.0%	2	0.7%

*Total may not add up to 100% due to rounding.

6. How long has your institution's current rating system been in existence?

Response	Count	Percent*
Less than 1 year	24	7.3%
1 to 2 years	59	17.9%
3 to 5 years	95	28.9%
More than 5 years	144	43.8%
Unsure	7	2.1%

*Total may not add up to 100% due to rounding.

7. Were you planning within the next 12 months to increase the number of grades used or change your risk-rating system in any material way?

Response	Count	Percent*
Yes	53	16.0%
No	256	77.3%
Unsure	22	6.6%

*Total may not add up to 100% due to rounding.

If you answered Yes to question 7, please briefly explain:

- Increase the number of grades. (24)
- Two-dimensional system: borrower and facility rating. (13)
- Moving to PD/LGD/EL model. (3)
- We plan to add a trend rating of stable, improving, or declining to our existing pass grades. (2)
- We plan to change to the new classification system being proposed by the OCC. (2)
- Expansion of the number of risk criteria scored and weighting to force lower overall risk grade for weaknesses in certain specific risk criteria.
- Rewrite to add clarification and better stratification.
- We are updating our entire commercial loan policy.

8. What are risk-rating migration data primarily used for?

Response	Count	Percent*
Portfolio quality/performance measurement	269	81.3%
Reserves	259	77.9%
Capital	54	16.3%
Pricing	78	23.6%
Other	10	3.3%

*Total may not add up to 100% due to rounding.

"Other" responses:

- Not used. (4)
- Concentration analysis.
- Making the loan.
- We struggle with good migration data at the loan/borrower level.

9. What is the single earliest and most reliable indicator of a commercial loan becoming impaired? (Please select one.)

Response	Count	Percent*
Loan manager judgment (customer knowledge, review of financials, etc.)	184	55.6%
Overdraft	24	7.3%
Timeliness of financial information	9	2.7%
Payment history	80	24.2%
Atypical use of the facility (usage, purpose)	6	1.8%
Independent review of borrower by credit/loan review or credit analyst	19	5.8%
Atypical deposit account activity	5	1.5%
Other	3	1.1%

*Total may not add up to 100% due to rounding.

"Other" responses:

- Collateral shortfall.

10. Do you support the regulators' proposed changes to the classification of commercial credit exposures?

Response	Count	Percent*
Yes	122	36.9%
No	110	33.2%
Unsure	99	29.9%

*Total may not add up to 100% due to rounding.

For the 30% that indicated they were unsure of supporting the changes, the overwhelming reason was that they did not have time to review the proposal. Community bankers are being overwhelmed by regulatory burden and have difficulty finding time to analyze additional changes/proposals.

If you answered No or Unsure, please explain:

- It adds no value to the risk management process. (39)
- May be too complex for small banks. (11)
- Cost of implementation exceeds perceived benefit. (9)
- We are still evaluating the proposal as it relates to our operational philosophy. (9)
- Existing system will not currently support two grades and our existing single-rating system considers both the customer and the facility. (4)
- For a small financial institution in particular, the conversion would be extremely costly and time consuming. (4)
- Have not spent enough time to determine how it will affect our loan portfolio. (4)
- Very confusing, not well thought out, difficult to implement, unnecessary for community banks. (4)
- Do not see a particular need given current regulatory environment. (3)
- Seems redundant with FAS 114, particularly for smaller, less complex portfolios. (3)
- Should follow best practices within the credit industry in evaluating credit; should not create their own, separate, new framework just for regulatory ratings. (3)
- I believe they are further complicating an already murky process. Under the present process, borrower strength, the type of loan facility, and collateral coverage are already taken into consideration. (2)

- It is too broad and too general. It appears to contradict the guidance coming from the Basel Committee suggesting a value with having more risk-rating categories and not less. (2)
- Need further explanation as to methodology related to the facility dimension. (2)
- We are not that heavily involved with commercial lending. (2)
- Adds another layer of grading that is unnecessary if properly monitored initially.
- Ag and commercial are risk rated on the same system here. There seems to be some merit in distinguishing the loan from the borrower; however, a watch list borrower is still a watch list credit no matter the type of loan when things go wrong.
- Benefits would appear to be improved analysis/information, but I have not fully studied the regulation or heard the rationale for opposition to it.
- Default category is too broad to the extent that the determination has been made that potential impairment exists on the loan.
- Doesn't appear to be very different from what we are doing now. Our default analysis is more precise, figuring expected dollar loss.
- Ease and speed of collateral liquidation is very subjective.
- Further define the classification if need be, but I do not see a need to change the name of the classification.
- I don't think the basics of credit have changed. I would rather see them reinforce the use of good sound underwriting and monitoring instead of change due to perceived crisis.
- I will want the opportunity to overlay the scheme on our existing system that works well to see how it would grade our existing credits. Our loss record has been excellent and I would want to ensure that the regulatory framework recognized this.
- If the borrower ratings aren't really going to change, the facility dimension doesn't really add anything since forcing a rating up or down based on the collateral should be implicit in the substandard to doubtful rating.
- I'm not quite sure what changes are being proposed other than Basel II, which is still a moving target.
- In a small-town community bank, lack of borrower sophistication and lack of quality borrower financial information are a source of uncertainty.
- It is not a good plan. The use of "Default" will be very confusing to some as it is not the same as a default under the credit facility. The ranges are ad hoc in my view and run against FASB guidelines for properly estimating loss.
- It may be more confusing but at same time can acknowledge liquid collateral as no risk of loss.
- Not totally sure what the reserves would have to be.
- Risk classification can be different between industries and individual credits. I believe that the framework of determining if individual credits are impaired should be left up to the flexibility of bank management.
- The level of precision suggested in the proposal probabilities is too precise.
- The requirement of classifying facilities only after they are in default is too late. The split approach of borrower and facility ratings will cause system issues. The split classification of borrowers and facilities will cause more confusion.
- The system does not cover commercial mortgage loans.
- The systems effort to implement will divert resources away from more meaningful MIS. It will create a subjective rating that will result in meaningless time and effort for regulatory discussion.
- While the regulators are moving in the right direction, this doesn't provide the "total" answer for banks and leaves much to the decision of the regulators when they come in for an exam. (2)

In addition to the overall statistics, we are providing the response to question 10 grouped by assets. Banks with assets of less than $250 million are the least supportive of the proposed changes.

11. Do you support the regulators' proposed changes to the classification of commercial credit exposures? (Answers provided in asset classes.)

Respondents with assets of <u>less than $250 million</u>

Response	Count	Percent*
Yes	41	31.3%
No	40	30.5%
Unsure	50	38.2%

*Total may not add up to 100% due to rounding.

If you answered No or Unsure, please explain.

- Existing rating system effectively identifies credit risk. (20)
- We are evaluating the proposal as it directly relates to our operational philosophy. (13)
- Should follow best practices within the credit industry in evaluating credit. Regulatory burden and costs will be increased. (8)
- I need time to study the proposal. (6)
- It will likely cause confusion among loan officers and our Board Members. (2)
- In a small-town community bank, lack of borrower sophistication and lack of quality borrower financial information are a source of uncertainty. (2)
- May be required clarification for a large bank, but is overkill for a small community bank, of which most number of banks fall within.
- Risk classification can be different between industries and individual credits. I believe that the framework of determining if individual credits are impaired should be left up to the flexibility of bank management.
- The proposal indicates that this new method will reduce judgment differences on credit classification between the banks and examiners. As proposed, it will require more judgment to classify a loan and result in more differences between banks and examiners.
- There seems to be some merit in distinguishing the loan from the borrower; however, a watch list borrower is still a watch list credit no matter the type of loan when things go wrong.

Respondents with assets between <u>$251 million and $750 million</u>

Response	Count	Percent*
Yes	34	37.0%
No	32	34.8%
Unsure	26	28.3%

*Total may not add up to 100% due to rounding.

If you answered No or Unsure, please explain.

- I don't see this as adding any value to the risk management process. (23)
- Require more detailed guidance. (7)
- Existing system will not currently support two grades and our existing single-rating system considers both the customer and the facility. (3)
- Do not see a particular need given current regulatory environment. (2)
- I will want the opportunity to overlay the scheme on our existing system. Our loss record has been excellent and I want to ensure that the regulatory framework recognized this.

- I'm not quite sure what changes are being proposed other than Basel II, which is still a moving target.
- Whenever regulators propose a change, it is important to evaluate what other impacts it may have—i.e., is this the first step to change all risk-rating systems, not just loans in trouble?

Respondents with assets between $751 million and $2.5 billion

Response	Count	Percent*
Yes	27	42.9%
No	20	31.7%
Unsure	16	25.4%

*Total may not add up to 100% due to rounding.

If you answered No or Unsure, please explain.

- Need more information and details to make a decision. (8)
- The current system has served us well. The proposed system appears to have much more subjectivity to it, which can lead to more differences of opinion between the bank and the regulators. (6)
- Too complicated, marginal benefit vs. cost; too much regulatory burden already! (5)
- Would require massive increase in work. (2)
- Adds another layer of grading that is unnecessary if properly monitored initially.
- Default category is too broad to the extent that the determination has been made that potential impairment exists on the loan.
- Ease and speed of collateral liquidation is very subjective.
- Many loan systems do not support dual risk ratings
- Seems redundant with FAS 114, particularly for smaller, less complex portfolios.
- The change seems like more to read to me. Either a credit is impaired or not. Credit should be managed with the focus always on risk. Changing the name of classifications adds little.
- We have very few problems and we have not worked with the proposed system.

Respondents with assets greater than $2.5 billion

Response	Count	Percent*
Yes	19	43.2%
No	18	40.9%
Unsure	7	15.9%

*Total may not add up to 100% due to rounding.

If you answered No or Unsure, please explain.

- Need to further study implications. (4)
- While they are moving in the right direction, this doesn't provide the "total" answer and leaves much to the decision of the regulators when they come in for an exam. (3)
- The basics of credit have changed. I would rather see them reinforce the use of good, sound underwriting and monitoring instead of change due to perceived crisis. (2)
- It is too broad and general. It appears to contradict the guidance coming from the Basel Committee suggesting a value with having more risk-rating categories and not less. (2)
- The systems effort to implement will divert resources away from more meaningful MIS. It will create a subjective rating that will result in meaningless time and effort for regulatory discussion. (2)
- The level of precision suggested in the proposal probabilities is too precise.
- Would not be compatible with our grade system.

12. Do you plan on commenting to the regulators on this proposed change?

Response	Count	Percent*
Yes	60	18.2%
No	172	52.3%
Unsure	97	29.5%

*Total may not add up to 100% due to rounding.

13. Regardless of whether or not you support the proposed changes to the commercial loan classification system, please rate the degree of difficulty in implementing them within your current risk-rating framework. (The scale ranged from 1 ["easy to implement"] to 7 ["could not implement at all"].)

Response	Count	Percent*
1	8	2.4%
2	38	11.5%
3	75	22.7%
4	105	31.7%
5	63	19.0%
6	36	10.9%
7	6	1.8%

*Total may not add up to 100% due to rounding.

If you answered that it was difficult to implement (i.e., if you answered 5, 6, or 7 above), please explain the difficulty.

- The two hardest parts would be retraining the lenders and assigning new ratings on the existing portfolio. (21)
- Time and manpower to change policy and change current risk-rating system. (15)
- Loan accounting system/software issues and would require us to rewrite our complete extensive grading policy. Education of lenders. etc. (13)
- System automation and tracking of two ratings. (11)
- Ongoing monitoring. (8)
- Review the entire portfolio, credit by credit; implementing the new guidelines would be a very labor-intensive task. (4)
- Confusing; small banks will have difficulty due to lack of personnel and large number of small loans with incomplete borrower financial information. (2)
- Difficulty in estimating severity of loss % and keeping current information in this respect. (2)
- Loan officers generally have 30+ years of experience = resistant to change they don't see as helpful to the process; only change for change's sake. (2)
- Reclassification errors. (2)
- Additional non-pass grading structure will be necessary.
- Additional sub factors to consider with NO related benefit.
- Customer base.
- The system would not fit into our pricing model, our risk of loss given default model, and ALLL model.
- We will be undergoing a change to PD/LGD in the next year. At this point in time, I believe it will be difficult to "calibrate" our system to the regulators in a cost-wise fashion.
- Will conflict with FAS 114 evaluation; mapping proposed to current system will be complex.

14. Generally Accepted Accounting Principles (GAAP) currently require collateral evaluation when a loan reaches non-accrual. Given that the proposed regulation mirrors this accounting practice, how difficult do you see implementation from a process perspective? (The scale ranged from 1 ["not difficult at all"] to 7 ["extremely difficult"].)

Response	Count	Percent*
1	53	16.1%
2	108	32.8%
3	76	23.1%
4	64	19.5%
5	22	6.7%
6	5	1.5%
7	1	0.3%

*Total may not add up to 100% due to rounding.

If you answered that it was difficult to implement (i.e., if you answered 5, 6, or 7 above), please explain the difficulty.

- Collateral valuation issues – expense, timing, benefit. (9)
- IT systems to carry new classifications; reeducate workforce. (5)
- Overlapping systems to accomplish same effect always leads to confusion and complexity. (3)
- Any change causes time and effort considerations. (2)
- Impairment valuation is not the only issue. Aligning an economic and expected loss risk-rating system with the regulatory proposal will be difficult and expensive. (2)
- We only perform impairment analyses above a certain threshold; my reading is that one would be required for all non-accrual exposures. (2)

15. What impact do you foresee this proposal's implementation having on your credit risk management program?

Response	Count	Percent*
Greatly enhances its effectiveness	5	1.5%
Somewhat enhances its effectiveness	113	34.1%
Neither enhances nor hinders its effectiveness	172	52.0%
Somewhat hinders its effectiveness	18	5.4%
Severely hinders its effectiveness	5	1.5%
No opinion	18	5.4%

*Total may not add up to 100% due to rounding.

"Comment" responses:

- It will divert IT resources away from more meaningful enhancements to our risk management MIS to develop the ability to comply with the proposal. (4)
- Once a problem loan is identified, the credit is reviewed and collateral evaluated; then a write-down is taken to equal the "unsecured" portion of the loan. What is left on the books is considered collectable. How is the proposed system better? (3)
- Adds to an already difficult, cumbersome process. (2)
- As long as FAS 114 analysis is being done on all classified loans, this RR process seems a bit redundant.
- Could lead to a fine-tuning of the reserve calculation, allowing us to reduce reserves on well-secured non-performing loans and increase reserves if secondary sources of repayment are weak.

- Credit is not always black and white.
- Facility rating should help with newer examiners.
- It is more important to be approximately correct than precisely wrong.
- Maybe a more granular approach of a bifurcated grading system could simply be mapped over to the broader, more general framework proposed.
- We had discussed the rating of borrower and facility separately. This would help us implement this.

16. Generally speaking, if this proposal were in place now, what would you predict the impact to be on your commercial portfolio?

Response	Count	Percent*
Portfolio would experience a net moderate number of upgrades	21	6.4%
Portfolio would experience a net minimal number of upgrades	60	18.4%
No net change	220	67.5%
Portfolio would experience a net minimal number of downgrades	24	7.4%
Portfolio would experience a net moderate number of downgrades	1	0.3%

*Total may not add up to 100% due to rounding.

Other comments:

- Hard to say for sure, but since we use both borrower and loan characteristics now the impact should converge on zero. (3)
- The contemplated changes would, at best, be a slice and dice of existing information. There are no meaningful changes from our present practices. (3)
- No net change in borrower grades; we would be adding facility grades to doubtful (default) borrowers for each of the borrowers' loans.
- The reason we feel this is not necessary is that the premise for the proposed change is factually incorrect. The experience of our institution, over many years, demonstrates that examiners do in fact view collateral, guarantor strength, and other factors in determining loan ratings. While we may have differed with an examiner over the factual valuation of a specific guarantor or piece of collateral, we have never seen an examiner apply the same rating to two facilities to the same, inherently weak borrower, where one is unsecured and the other well collateralized or protected by a strong guarantor. The proposal states that "facility ratings would be required only for those borrowers rated default (i.e., borrowers with a facility placed on non-accrual or fully or partially charged off)." This definition, in effect, equates to impaired loans under FAS 114, and the required calculation of the applicable reserve is already far more specific than the 0% to >30% "loss severity estimate" range contained in this proposal.
- We believe grading the borrower is more conservative than grading both the borrower and the credit.