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October 22, 2012

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219
Docket IDs OCC–2012–0008, –009

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Docket Nos. R–1430, R–1442; RIN No. 7100–AD87

√ Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
FDIC 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; Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements

Ladies and Gentlemen:

On behalf of TCF Financial Corporation and its affiliates ("TCF"), I am writing to provide TCF's comments on the above-referenced joint notices of proposed rulemaking published by the Office of the Comptroller of the Currency, the Board of Governors of the

Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, "the agencies") in the Federal Register on August 30, 2012.[1]

TCF is a Wayzata, Minnesota-based national bank holding company with $17.9 billion in total assets at June 30, 2012. The company has over 430 branches in Minnesota, Illinois, Michigan, Colorado, Wisconsin, Indiana, Arizona and South Dakota, providing retail and commercial banking services. TCF, through its subsidiaries, also conducts commercial leasing and equipment finance business and leverage lending in all 50 states, commercial inventory finance business in the U.S. and Canada, and indirect auto finance business in over 40 states.

TCF appreciates the agencies' efforts to implement the risk-based and leverage capital requirements agreed to by the Basel Committee on Banking Supervision in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems," as well as the capital requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[2] However, we agree with the Conference of State Bank Supervisors that "[m]any of the issues the agencies are trying to address are best managed through risk management and the supervisory process" rather than on a transaction-by-transaction basis that leads to a "capital framework that is more complex and more prone to volatility."[3] The Federal Deposit Insurance Corporation Director Thomas M. Hoenig agrees with these positions.[4] He believes that the proposed rules place too much reliance on highly complex modeling tools and on central planners making determinations of risks rather than the markets.[5] In his speech, Mr. Hoenig summarizes a good capital rule as follows:

> Experience suggests that to be useful, a capital rule must be simple, understandable and enforceable. It should reflect the firm's ability to absorb loss in good times *and* in crisis. It should be one that the public and shareholders can understand, that directors can monitor, that management cannot easily game, and that bank supervisor can enforce.[6]

Regulatory agencies have for years indicated that disclosures should be simple and understandable. The same is true for capital rules. The current proposed rules are not simple and understandable but rather contain thousands of pages of instructions that would impact almost all of a bank's operations. There is not sufficient understanding of the impact of the proposed rules on bank's, the impact on credit availability, and potential changes to business

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1 *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action,* 77 FR 52792 (Aug. 30, 2012); *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements,* 77 FR 52888 (Aug. 30, 2012).

2 Pub. L. No. 111-203, 124 Stat. 1376-2223 (2010).

3 Statement on Federal Banking Agencies' Proposed Capital Rules, October 3, 2012 available at http://www.csbs.org/news/press-releases/pr2012/Pages/pr-100312.aspx.

4 Back to Basics: A Better Alternative to Basel Capital Rules; Thomas M. Hoenig, Director, Federal Deposit Insurance Corporation, delivered to The American Banker Regulatory Symposium; Washington, D.C. September 14, 2012 available at http://fdic.gov/news/news/speeches/chairman/spsep1412_2.html.

5 *Id.*

6 *Id.*

practices. The proposed rules are overly complex and will curtail lending in many traditional loan products. This complexity will lead to adverse incentives for banks to make asset choices based on the rules rather than choices that ensure their communities and borrowers are well served. One example will be the risk-weighted assets proposal for mortgage lending. The definition for a Category 1 mortgage loan is very narrow and the Category 2 mortgage loan risk weights are very punitive. The likely impact of this will be less home equity lending, which is an important source of credit to both consumers and small businesses, and the elimination of some traditional mortgage products. This will occur when the housing market is still on poor footing. These types of adverse incentives are contained in a number of areas of the proposed rules and will misalign risk and returns. The end result will be the loss of some important products and services.

We understand and appreciate how much time and energy was put into drafting the proposals and where we are at in the rulemaking process. However, like the Conference of State Bank Supervisors[7] and FDIC Director Thomas M. Hoenig, we respectfully ask you not to advance the proposed rules.[8] Rather, we believe the agencies should step back, reassess and revisit the overall intent of the proposals, the effect of changing risk weights from "five to thousands," and the impact the proposals will have on the financial system.[9]

If the agencies choose to move forward with the proposed rules, certain aspects of the agencies' proposed rules should be revised to reflect their implementation burdens on banks, their competitive impact for mid-size and community banks, and their likely consequences for the availability of credit and national financial stability. We address those aspects of the proposed rules in which we believe revision is most critical below.

I. Treatment of Residential Mortgages

A. Risk-weighting of Residential Mortgages

1. Junior Liens

The proposed risk-weighting rule classifies all junior liens, such as home equity loans and lines of credit, as Category 2 exposures with risk weights ranging from 100-200 percent. In addition, a bank that holds two or more mortgages on the same property would be required to treat *all* the mortgages on the property, even the first lien, as Category 2 exposures subject to a very narrow exception that requires both loans to fully comply with the Category 1 requirements. Most junior liens will not meet all the proposed Category 1 requirements. Thus, if one bank makes an $80,000 (80% LTV) first lien and also makes a $10,000 (90% CLTV) junior lien, then the junior lien may "taint" the first lien into a Category 2

[7] Statement on Federal Banking Agencies' Proposed Capital Rules, October 3, 2012 available at http://www.csbs.org/news/press-releases/pr2012/Pages/pr-100312.aspx.
[8] Back to Basics: A Better Alternative to Basel Capital Rules; Thomas M. Hoenig, Director, Federal Deposit Insurance Corporation, delivered to The American Banker Regulatory Symposium; Washington, D.C. September 14, 2012 available at http://fdic.gov/news/news/speeches/chairman/spsep1412_2.html.
[9] *Id.*

mortgage which results in a higher risk weight for the first lien mortgage. By contrast, if one bank makes the first lien and a second bank makes the junior lien, then the junior lien does not change the risk weight of the first lien. The net result is that more capital is required depending on who holds the first lien (the same creditor or a different one).

Given one of the primary purposes of the capital rules (to protect the safety and soundness of the entire system and not just one institution); this defies logic and our experience. Our experience has been that where we hold both liens, the junior lien performs better than when we only hold the junior lien. Even if our experience is unique, it stands to reason that the risk presented by the first lien mortgage loan in the example above is no different whether the second lien was made by the same bank or a different one. Who holds the first lien should not determine the need for "additional" capital.

Another, hopefully unintended, result of the proposed rule on this point is that junior liens and "tainted" first liens will be treated as riskier and therefore require more capital than unsecured loans. Unsecured loans receive a 100% risk-weight under the proposed rules and therefore unsecured loans are treated as safer than loans secured by collateral. Again, this defies logic. Why should a secured loan require more capital than an unsecured loan? If the final rule retains the Category 1 and Category 2 distinctions based on lien position, then any final rule should not require a higher-risk weight for a first mortgage just because the lender also holds a junior mortgage, and in fact, if differential treatment is made, the junior mortgage should get a risk-weight reduction.

Junior liens are an important source of credit for consumers and small businesses. The highly punitive risk-weights for Category 2 mortgages will discourage bank's from making such loans. This will lead to the a reduction in an important source of credit for consumers and small businesses.

2. Characteristics for Riskier Residential Loans

The proposed capital rules do not address the entities that created the economic debacle. The misuse of subprime and Alt A residential loans were made primarily outside the banking system and securitized by large investment banks and lenders like Countrywide. According to a white paper issued by the Department of Treasury, approximately 94 percent of such loans were made outside the banking system.[10] The proposed capital rules do not reach those entities and actually punish the entities that acted responsibly.

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[10] Department of the Treasury, Financial Regulatory Reform A New Foundation: Rebuilding Financial Supervision and Regulation, Jun. 17, 2009, at 69-70 ("Moreover, the Federal Reserve has reported that only six percent of all the higher-priced loans were extended by the CRA-covered lenders to lower income borrowers or neighborhoods in the local areas that are the focus of CRA evaluations.").

The proposed rules also do not take into account any impact for private mortgage insurance whatsoever and place too much reliance on the term of the loan and LTV. Mortgages are therefore subject to high risk weights and require more capital even where private mortgage insurance reduces the risk of loss on such loans. Mortgage loans of more than 30 years are treated as riskier than loans of 30 years or less, and mortgage loans with higher LTVs are treated as riskier than mortgage loans with lower LTVs. Our experience shows that residential mortgage loans with terms of more than 30 years present no more risk than residential mortgage loans with terms of 30 years or less. In addition, if 30 years is considered a threshold for whether a residential mortgage loan is riskier or not, loans with a remaining term of 30 years or less, regardless of their original term, should pose no more risk than a new loan with a 30 year term. All of the factors from the proposed capital rule appear to have been included without any consideration of any other underwriting standards related to the loan and is based on assumptions made in isolation regarding those factors.

A letter submitted recently by several community groups[11] for the Qualified Residential Mortgage rulemaking cites a study which concludes that low down payment loans are not the same as subprime loans. The letter discusses a number of communities that will be impacted by higher down payment (lower LTV) requirements for mortgage lending. The study looked at a large sample of mortgages originated between 2000 and 2008 and found that the reduction in the default rate for the lower LTV was not as meaningful as had been suggested and had increased down payments been required would have shut out a number of communities of color from owning homes. It further found that some of the other practices ("no doc" or "low doc" loans, not underwriting to fully-indexed rates and other items already addressed by other Dodd-Frank Act provisions) were more likely to reduce default rates than LTV.

The proposed rulemaking has taken a very narrow view of the underwriting criteria utilized in making a residential mortgage by using primarily just LTV, term and lien position. Looking only at lien position, LTV, loan term and a few other characteristics for certain loan types is contrary to the experience of the industry. That experience has found that well underwritten first or junior mortgage loans to higher FICO customers perform well, and that FICO along with the debt-to-income ratio ("DTI") and certain other underwriting criteria are a better predictor of risk and the probability of default. As indicated in the letter cited above, the focus on just LTV and lien position in the past would have led to a number of loans not being made and will further stifle mortgage lending by traditional depository institutions at a time when a long-term solution to housing finance has not been put in place.

[11] Letter dated August 30, 2012 from the Center for Responsible Lending, the National Coalition for Asian Pacific American Community Development, the William C. Velasquez institute, the National Urban League, the National Association for the Advancement of Colored People, and the National Fair Housing Association.

We recommend using the FDIC final rule related to mortgages that are considered "higher risk consumer loans" for the calculations used for the large bank adjustment for the deposit insurance assessment to determine higher risk residential mortgage loans that require more capital rather than lien position, term, LTV or the other items in the proposed capital rule. The FDIC final rule looks at the probability of default to determine which mortgage loans are riskier. The probability of default is then determined by a FICO score or some other criteria that meets the threshold. This will more accurately apply higher risk weights to riskier mortgage loans. In addition, the regulatory burden to make this determination and track it will be substantially less than under the proposed capital rules. If the final capital rules continue to have the types of characteristics set forth in the proposed capital rules, we recommend removing reference to the 30 year loan term requirement as a factor in determining whether a loan is Category 1 or Category 2. If the 30 year loan term requirement remains, we recommend clarifying that any loan with a remaining term of 30 years or less, regardless of the original term, is allowed to be treated as Category 1 or Category 2 depending on the other factors.

3. Grandfathering Existing Loans

In addition, we strongly believe that mortgages which were originated under the existing regulations and capital rules should be grandfathered under the proposed capital rules. The proposed mortgage categories did not exist at the time these mortgages were originated and banks can adjust their lending practices on a going forward basis to avoid some of the more punitive risk weights, but cannot do so with respect to mortgages already made. Many banks might not have and might find it difficult, if not impossible to obtain the data needed to classify the existing loans. Even where they can find the data, bank staff will be required to go through decades-old loan files to obtain the information and this will be extremely burdensome.

The substantial increase in the capital that would be required for these loans, which may constitute a substantial amount of assets on an institution's balance sheet, and the retroactive impact of the proposed treatment would be especially harsh. Given that the proposed capital rules already substantially increase the required minimum capital, the need for retroactive application of the new standards is significantly attenuated. In addition, to the extent that loans originated under the existing regulation and capital rules truly do reflect more risk to a bank that holds those loans, additional capital should already exist on those portfolios through the Allowance for Loans and Lease Losses ("ALLL"). Providing additional capital for those loans on top of what is already in the ALLL would be a mistake in our view. We believe any final rule should grandfather all existing mortgage exposures by assigning them risk weights as required under the current general risk-based capital requirements (i.e., 50% risk weight).

4. Allowance for Loan and Lease Losses

As stated above, the ALLL already takes into account a number of risk factors and provides the necessary additional capital for loans that present more risk to the system. The additional risk-weights represent unnecessary and redundant sources of capital allocation that will drive up the cost of credit to the consumer and restrict the availability of consumer credit. In addition, the limitation of 1.25 percent of risk-assets in loan loss reserve does not make sense. Why would limitations be placed on an allocation of capital that serves as a "capital conservation buffer?" Banks should be encouraged to build loan loss reserves with pre-tax dollars during good times and additions to loan loss reserves should be encouraged, not discouraged. The ALLL analysis already takes into account the risks associated with loans.

5. Administrative Burden

In addition to the effect on a bank's ability to lend, the change from assigning "risk-weightings to asset classes" to a "risk-weightings to individual loans" will create an administrative nightmare. The scope and granularity of the proposed capital rules will require the collection and reporting of new information in order to calculate the risk weights of assets. New software and systems may be required. Additional staff or outsourcing to a third party will be required just to assign and maintain risk weightings on the classes of loans that are identified in the proposed rules. Either way, the proposed capital rules will lead to new costs and regulatory burden. Also, you will not be able to just assign a risk-weighting when you book the loan, you will have to continually re-evaluate the risk-weightings based on changes in collateral values, past due status and other risk factors. The processes, systems and staffing for both the institutions and the examination staff to ensure data integrity will lead to increased overall regulatory burden. For loans, this makes no sense given that the ALLL analysis already accounts for any additional risk.

II. Minority Interests

The proposed rules would limit the amount of minority interest in consolidated subsidiaries that could be included in the regulatory capital of the parent company. Specifically, if a consolidated subsidiary has regulatory capital in excess of the sum of its minimum capital requirement plus the required capital conservation buffer, the minority interest that contributes to the excess would not be includable in the parent company's regulatory capital.

Not all minority interest amounts within banks are the same. They differ in the value they provide to the holders. As a result, the capital rules should not treat all minority interests the same. The capital rules should not apply the same standards to minority interests that include commitments by all the shareholders for additional equity compared to minority interests where the initial equity is all that is required. In addition, minority interests in joint ventures, such as ones related to equipment financing, that are supported by guarantees or other credit enhancements related to the underlying financing transactions, should not be treated the same as

those without these items. The capital rules should not apply the same approach to such minority interests where there is a material credit enhancement from the other shareholders. A material credit enhancement could be defined as one in excess of 25% of the average trailing 12-month minority interest (investment). In both of these cases, any future additional equity or credit support does not just come from the bank shareholder, but from all shareholders. In the case where either commitment exists, the total amount of the minority interest should be included in the parent's common equity tier 1, additional tier 1 or tier 2 capital elements, as appropriate.

III. Mortgage Servicing Assets

Under the proposed rules, mortgage servicing assets would be subject to a 10% limit and a 15% limit. Specifically, if the amount of mortgage servicing assets exceeds 10% of a banking organization's common equity tier 1 capital, the banking organization would have to deduct the excess from its common equity tier 1 capital. Two other types of assets – deferred tax assets and significant investments in the capital of unconsolidated financial institutions in the form of common stock – would each be subject to such a 10% limit. If the aggregate amount of these three types of assets, after deductions required by the application of the 10% limit to each of them, exceeds 15% of a banking organization's common equity tier 1 capital, the banking organization would have to further deduct this excess from its common equity tier 1 capital.

In addition, the amount not deducted from capital under the proposed rules would receive a 100% risk weight (and eventually a punitive 250% beginning 2018). A mortgage servicing asset is the right by a bank to service mortgage loans owned by others and in many cases represents servicing the loans originated by the servicing bank and sold to other third parties like Freddie Mac and Fannie Mae. The combination of excluding the assets that exceed the 10% and 15% limits with the 100% (and eventually 250%) risk weighting could severely impact some banks, perhaps even lowering capital levels below well capitalized status.

As a result, banks would be inclined to sell mortgage loans on a servicing-released basis. This would prevent a bank that originates a mortgage loan from maintaining a long-term relationship with the borrower by continuing to service the loan after selling it. It would also deprive the bank of an important source of fee income. Furthermore, the proposed limits would disproportionately affect banks with a sizable portfolio of mortgage servicing assets that have been retained or acquired in reliance on current regulatory capital rules. These new limits might ultimately lead to further consolidation in the mortgage servicing industry to very large non-bank servicers that are not subjected to the same rules and standards as regulated financial institutions. Bank customers would be relegated to being a number to a large non-bank entity rather than interacting with the local community bank that knows them well. Therefore, we believe that mortgage servicing assets should not be subject to the 10% and 15% limits, and if any limits are put in place, existing mortgage servicing assets should be grandfathered.

IV. High Volatility Commercial Real Estate

Under the proposed capital rules "High Volatility Commercial Real Estate" ("HVCRE") loans will be increased from a current risk-weight of 100 percent to a risk-weight of 150 percent. HVCRE loans are defined in the proposed rules to include acquisition, development and construction ("ADC") commercial real estate loans subject to limited exceptions. Unless one of

the exceptions is met, ADC loans would be included as HVCRE loans even if they were to borrowers with debt service coverage well above 1.0 and income earning loans. The proposed rules fail to account for a bank's experience and expertise in this type of lending, and the proposed 150% risk-weighting discourages banks from making these types of loans. Sovereign debt that is in default even receives the same risk-weighting as ADC loans.

Like Riskier Residential Mortgages, the proposed capital rules for HVCRE loans will require continual monitoring, new systems, processes and staffing and increase the overall regulatory burden for banks. Also, like Riskier Residential Mortgages, to the extent that HVCRE loans truly do reflect more risk to a bank that holds those loans, additional capital would already exist on those portfolios through the Allowance for Loans and Lease Losses ("ALLL"). Providing additional capital for those loans on top of what is already in the ALLL would be a mistake in our view. The ALLL analysis already takes into account the risks associated with HVCRE loans and the increased risk-weighting represents unnecessary and redundant sources of capital allocation that will drive up the cost of credit. In this case, requiring 50% more capital for construction and other ADC loans makes them more expensive, discourages this type of lending and will be bad for the economy.

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The proposed capital rules provide an important opportunity for the industry and policy makers to discuss how the rules should apply to a variety of institutions. We believe it is important to fully understand the potential impact of the rules on banks and how the changes in the rules will impact bank's origination of credit before issuing final rules. We ask that the agencies step back, reassess and revisit the overall intent and impact of the proposals, and then issue new proposed rules prior to issuing any final rules.

TCF appreciates the opportunity to express our concerns and suggestions on the proposed capital rules.

Very truly yours,

Michael S. Jones