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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
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OCC Docket ID OCC-2017-0018

Ann E. Misback, Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1576; RIN 7100 AE-74

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AE59

RE: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996

Proposed Rules Concerning HVADC Exposures

Ladies and Gentlemen:

Texas Capital Bank appreciates the opportunity to respond to the Agencies' request for comments on the proposed Regulatory Capital Rule. Our focus has been on the HVADC related rules so we are providing our perspective on what the likely impacts would be if the HVADC rules were implemented as proposed as well as our recommendations on what should be revised in the rules to address issues identified therein.

The Agencies indicate that the intent of the proposed Regulatory Capital Rule is to reduce regulatory burden. Unfortunately, the proposal related to HVADC Exposures would instead increase the weight on banks as the new regulations and associated higher risk weighted capital requirements would significantly diminish banks' abilities to continue to make real estate loans that have been both safe and acceptably profitable.

We support the response on the proposed rules concerning HVADC Exposures provided by the American Bankers Association and offer below the following comments as well.

ADVERSE IMPACTS

The adverse impacts of the proposed HVADC Exposures and associated higher capital requirements, if implemented, would be as follows:

1. **The cost of real estate loans from regulated institutions would be artificially increased.**

   Although the 130% risk weighted capital requirement would reduce the cost for new ADC loans that under the current regulations would be HVCRE exposures, the cost for all other ADC loans would increase. This higher cost would be absorbed by banks either choosing to reduce their earnings or by charging borrowers higher interest rates. This higher cost would not be driven by market forces or even tied to the degree of risk in a transaction. It would simply be imposed, indiscriminately. Banks that structured ADC loans with high levels of borrower equity and that well exceeded the HCVRE minimum levels would now have this kind of business put in jeopardy, and not because of changes in the market or because of an increase in inherent risks but solely because of the rule's imposed cost increase. This cost would penalize safe transactions.

2. **Non-regulated providers of real estate loans that are not subject to this rule's imposed cost would increase their lending to the detriment of the banks.**

   The burden of this increased cost would reduce the ability of banks to compete for real estate loans. It would make it more difficult for banks to provide lower risk loans because the borrowers with the most risk attractive transactions would have strong price incentives to choose the lowest cost provider. This increased cost could potentially even induce some banks to do riskier transactions than they would have before the imposition of this increased cost in order to sustain their real estate lending businesses.

3. **The availability and usage of real estate loans from regulated institutions would be materially reduced because of the higher costs.**

   The reduction in real estate lending by banks would not be because of market forces. The ability of banks to serve their markets and to facilitate economic growth would unnecessarily decline.

4. **Banks' opportunities to continue to enhance their soundness by generating earnings from safe real estate loans would be materially reduced.**

   Reducing the ability of banks to realize earnings from real estate lending is counter to the fundamental regulatory concern that banks generate sufficient profits to sustain their soundness. Banks should not be burdened with the rule's punitive costs that would inhibit their ability to provide safe loans that generate reasonable profits.

PRIMARY ISSUES

The primary issues in the regulatory proposal related to HVADC exposures are broken out below:

1. **ADC loans are treated as generic commodities with no potential for differentiation reflective of the actual levels of risk.**

ADC loans vary greatly as they finance differing percentages of total costs for a wide range of borrowers and property types in a wide range of markets and have differing structures. It is unnecessarily simplistic and contrary to experience and industry knowledge to treat them as if there are no material risk differences between them.

2. **The amount of borrower equity and resultant key metrics such as loan to value and loan to cost are given no consideration or significance for risk weighting purposes.**

   These key factors deserve to be given paramount consideration. Transactions with high levels of borrower equity should not be indiscriminately treated as being of a higher level of risk. Regulations should not be punitive to transactions that inherently are of lower risk.

3. **The cost from the higher weighted risk categorization would be the same for all HVADC loans with absolutely no difference between loans of lower and higher risk.**

   Although there are some issues with respect to the current HVCRE exposure regulations, at least those regulations acknowledge that all ADC loans are not the same and that lower risk transactions do not warrant capital requirements greater than general corporate loans. Lower risk transactions should not have their capital requirements increased and particularly not to the level of the highest risk transactions.

4. **The statement about "a stabilization period" detracts from the already clear definition of "permanent loan" and generates confusion and uncertainty.**

   The definition of "permanent loan" is simple and reflects the wording of the Call Report instructions. It needs no other commentary other than the existing limited statement about loans for lots or units for sale that is consistent with the Call Report instructions.

   The term "stabilization period" in the paragraph in which "permanent loan" is defined is not as simple as it may appear on the surface because it can be interpreted to mean many different things depending on many factors. Consistent treatment would consequently not be attainable. The inclusion of the term "stabilization period" has therefore created considerable confusion and uncertainty among banks, which is contrary to the Agencies' intention that the proposed rule reduce regulatory burden and provide simplicity. The wording "a stabilization period" should be removed from the proposed rule.

5. **The Agencies' use of the term "bridge loan" in their supplemental comments about permanent loans has also generated confusion and uncertainty.**

   The confusion resulting from the use of "a stabilization period" has been increased by the Agencies' background commentary's use of the technical term "bridge loan" (Federal Register, page 49990) inconsistently with the normal context in which the term is used and understood. The Agencies use the term "bridge loan" in the specific and limited context related to the proposed rule's provision that a permanent loan have a clearly identified ongoing source of repayment. However, lenders and borrowers commonly use the term much more broadly and hence considerable confusion and uncertainty have been generated. The paragraph about bridge loans in the Agencies' background comments should be deleted so that the permanent loan exemption can be understood with clarity and applied with consistency.

BENEFCIAL COMPONENTS

The beneficial components of the HVADC Exposure proposal are as follows:

1. **The definition of HVADC would make it clear that in ADC "acquisition" refers to land acquisition and that "development" refers to land development, and thus would provide explicit consistency with the OCC's Comptroller Handbook.**
2. **The HVADC definition's articulation that the intended scope is for loans that primarily provide ADC financing or refinancing provides helpful clarity.**
3. **The direction that a "permanent loan" does not include unsold lots or units of for-sale projects would provide helpful consistency with the Call Report instructions about how to report construction loans that are not combination construction-permanent loans.**
4. **The grandfathering intention to not require retroactive adoption of new requirements, depending upon what the Agencies determine after responding to stakeholder input, would likely be helpful to banks by lessening business disruption and administrative costs.**

PRIMARY RECOMMENDATIONS

1. **Exempt ADC loans with significant borrower contributed capital from being HVADC exposures.**

   The exemption from HVCRE exposure based on a minimum level of borrower contributed capital appropriately accounts for the lower level of risk inherent in such a transaction. This fundamental risk based principle should be replicated in the HVADC rules.

   We concur with the American Bankers Association's recommendation that the minimum required capital for the exemption be 15% of cost as adjusted to include the appraised value of land held for five years or more. Should the Agencies not agree to 15% of cost, replicating the HVCRE exemption requirement of borrower contributed capital being at least 15% of the "as completed" appraised value would at least be superior to having no capital based exemption since the inclusion of this exemption is so essential and fundamental to banks being able to continue to provide safe and profitable ADC loans.

2. **Remove the words “a stabilization period” from the section in which “permanent loan” is defined.**

   The Agencies’ Question 5 requested comment on the clarity of the permanent loan exemption and on the ease of determining qualification for the exemption. The words “a stabilization period” make the permanent loan exemption very unclear, complex and subject to a variety of interpretations, depending on the circumstance being considered. This in turn increases the difficulty of determining what qualifies for the exemption.

   The definition of “permanent loan” itself is clear but this clarity is lost with the inclusion of “a stabilization period”. Removal would ensure clarity as well as consistency with the Call Report instructions.

3. **Eliminate the “bridge loan” paragraph from the Agencies’ supplemental comments (82 Fed. Reg. 49990)**

   The Agencies’ comments in this paragraph conflict with their clear definition of permanent loan. Elimination of this paragraph would ensure clear understanding and ease of determining whether an exposure qualifies for the permanent loan exemption.

4. **Alternatively, adopt the provisions in the Act Clarifying Commercial Real Estate Loans (H.R. 2148) with incorporation of the HVADC definition’s concept of what is primarily financed.**

   This bill makes clarifying improvements to the requirements for banks concerning HVCRE. It preserves the fundamental principle that transactions with substantial borrower capital invested should not be penalized with higher capital costs.

We urge the Agencies to follow the above recommendations to prevent banks from being exposed to a variety of adverse impacts that the proposed rules would produce.

Sincerely yours,

Texas Capital Bank

Ken Frankenfeld
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