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October 22, 2009

Office of the Comptroller of
The Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Docket ID: OCC-2009-0013

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
Docket No.: OP-1369

Regulation Comments
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Docket ID: OTS-2009-20016

Re: Correspondent Concentration Risks Proposed Guidance

Ladies and Gentlemen:

The American Bankers Association (ABA)¹ appreciates the opportunity to comment on the above-captioned proposal on correspondent concentrations.² The proposal states that a bank is to identify, monitor, and manage correspondent concentrations, for both credit and funding exposures. The ABA agrees with the fundamental principle underlying the guidance, namely, that a bank should take steps to ensure that it understands its concentration risks and is managing those risks appropriately. The guidance as proposed affords banks significant flexibility to manage the risks in a way that is appropriate for a given set of circumstances, and we commend the use of guidance to address correspondent concentrations. We urge the agencies to retain this flexibility in the final guidance and to clarify the additional issues discussed below.

¹ The ABA brings together banks of all sizes and charters into one association. The ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$14 trillion in assets and employ more than two million men and women.

² The proposal was published in 74 *Fed. Reg.* 48955 (Sept. 25, 2009).

Discussion

The following issues would benefit from additional clarification.

Significance of the concentration thresholds. In discussing when a bank has a credit or funding concentration, the proposal notes that the federal banking agencies –

have generally considered credit exposures greater than 25 percent of Tier 1 capital as concentrations. While the Agencies have not established a liability concentration threshold, the Agencies have seen instances where funding exposures as low as 5 percent of an institution's total liabilities have posed an elevated liquidity risk to the recipient institutions.³

The guidance as proposed wisely stops short of saying that these thresholds may not be exceeded. Rather, the guidance directs banks to establish “prudent correspondent concentration limits, as well as ranges or tolerances for each factor being monitored.” Notwithstanding this direction for banks to establish their own limits and ranges, the primary concern expressed by our members is that the concentration thresholds will be applied as caps on the amount of business that a bank may conduct with a correspondent.

Imposing one-size-fits-all caps on the volume of correspondent concentrations would disrupt several correspondent relationships even where potential risk issues are well managed and addressed. A bank that has established the limits and ranges called for in the guidance, is monitoring the correspondent relationship, and has adequate contingency plans for managing the concentration risks should be viewed as addressing correspondent concentration risk in a manner consistent with safe and sound banking.

Moreover, using the guidance to impose caps would effectively amend the Federal Reserve Board's Regulation F⁴ without adequate explanation of the basis for such a change. Regulation F currently imposes a cap only on interday credit exposures to any one correspondent at 25 percent of a bank's total capital (as opposed to the Tier 1 threshold identified in the proposal), and even then only if the bank cannot demonstrate that the correspondent is at least “adequately capitalized.”⁵ Elsewhere Regulation F requires banks whose exposures to correspondents are “significant” to have policies and procedures that require periodic reviews of the correspondent and to set internal exposure limits when the correspondent's condition creates a significant risk that payments will not be made in full or on a timely basis.⁶ This regulation codifies prudent banking practices and strikes the appropriate balance between the need for clarity and the need for flexibility. Any changes to this regulation should be made through a full notice-and-comment rulemaking and not through guidance.

³ *Id.* at 48958.

⁴ 12 C.F.R. Part 206.

⁵ A correspondent will be “adequately capitalized” under Regulation F if it has a total risk-based capital ratio of at least 8 percent, a Tier 1 risk-based capital ratio of at least 4 percent, and a leverage ratio of at least 4 percent.

⁶ *Id.* at § 206.3(b) and (c).

We believe it would be appropriate to clarify in the final guidance the role of the thresholds by stating explicitly that a concentration will be viewed as an indicator of potentially heightened risk rather than a ceiling on correspondent transactions. Without such a statement, the thresholds may be applied by examiners and bankers alike as hard caps.

Calculating credit and funding exposures. The proposal directs banks to calculate credit and funding exposures on both a gross and net basis. Given the extensive list of transactions identified by the agencies as illustrative of the types of exposures that should be aggregated,⁷ the guidance is likely to impose significant additional burden on affected institutions. This burden could be responsibly minimized in our view by focusing on the net exposures. Such an approach would be consistent with the Federal Reserve Board's Regulation F, which states that "[t]ransactions covered by netting agreements that are valid and enforceable under all applicable laws may be netted in calculating credit exposure."⁸ Regulation F also carves out a number of transactions that may be excluded from the calculation of a credit exposure to a correspondent. We believe the netting provision and the carve-outs in Regulation F are appropriate and that, here again, the agencies should avoid effectively amending the regulation by the issuance of guidance that does not set forth the basis for such a change.

Loan participations. The guidance states that banks that maintain credit exposures in, or provide funding to, other financial organizations are expected to manage the risks effectively. Loan participations are included within "credit or funding exposures" as discussed in the proposal. Presumably this is intended to refer to situations where a bank holds a participation interest in a loan that either was made to the other financial institution or that was originated by that institution. It should not refer to the situation where one financial institution acquires a large participation interest in a loan originated by a third party and then sells pieces of that participation to other banks. In that situation, the banks that hold the participation interests have exposure to the borrower, not to the intermediary institution that sold the interests. We suggest that the final guidance clarify this point.

Effective date. The proposal identifies, among other things, the types of transactions a bank should aggregate when determining whether it has a concentration. As noted above, the list of transactions to be monitored is extensive,

⁷ To identify credit concentrations, a bank is to aggregate all exposures to a correspondent, including (but not limited to) the following:

- Due from accounts;
- Fed funds sold on an "as principal" basis;
- The over-collateralized amount on repurchase agreements;
- The under-collateralized portion of reverse repurchase agreements;
- The current positive fair value on derivatives contracts;
- Unrealized gains on unsettled securities transactions;
- Loans to (or for the benefit of) the correspondent, its holding company, and its affiliates; and
- Investments (such as trust preferreds, subordinated debt, and stock purchases) in the correspondent, its holding company, and its affiliates.

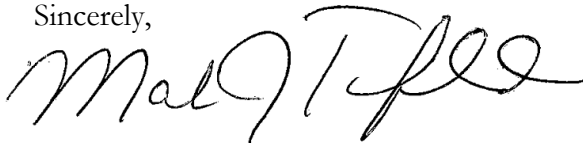
⁸ 12 C.F.R. § 206.5(c).

and the monitoring is to be done on both a net and gross basis. The guidance directs a bank to identify its correspondent concentrations by looking at all of its (and its affiliates') credit and funding exposures to a correspondent (and the correspondent's affiliates). We hear from several of our bankers bank members that the monitoring will result in a significant additional burden imposed on them. These institutions provide a wide range of essential services for their respondent banks. They expect to expand these services to include providing reports to their respondents about the respondents' aggregate correspondent transactions in order to make it easier for the respondents to comply with the guidance. These bankers banks are in the process of preparing the information but will require sufficient time to ensure that the information is compiled accurately. Accordingly, we urge that the final guidance not be effective until at least 90 days following publication of the final version.

* * *

We appreciate the agencies' consideration of our views. We commend the agencies for responding to recent failures of correspondent banks in a manner that preserves flexibility for affected institutions to manage risk in an appropriate way. We urge the agencies to preserve this flexibility and to clarify the additional points noted above. If you would like to discuss our views further, please do not hesitate to contact me at (202) 663-5042 or mtenhund@aba.com.

Sincerely,

A handwritten signature in black ink, appearing to read 'Mark J. Tenhundfeld', with a stylized, cursive script.

Mark J. Tenhundfeld