

October 26, 2009

**Electronically & VIA Hand-Delivery**

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551  
Docket No. OP-1369

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

Federal Deposit Insurance Corporation  
Robert E. Feldman, Executive Secretary  
Attention: Comments  
550 17<sup>th</sup> Street, NW  
Washington, D.C. 20429

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

**Re: Comments on the Proposed Correspondent Concentration Risks Guidance**

Dear Sirs and Madams:

This letter is submitted to the Board of Governors of the Federal Reserve System (the "Board") on behalf of Compass Bank, a wholly owned subsidiary of Banco Bilbao Vizcaya Argentaria, S.A. ("Compass"), in response to the Board's request for comment on the Proposed Correspondent Concentration Risks Guidance issued September 25, 2009 (the "Proposed Guidance").

Compass conducts a regional general commercial banking and trust business at over 700 bank offices located in Alabama, Arizona, California, Colorado, Florida, Georgia, New Mexico and Texas. As of this writing, Compass has assets of \$68 billion and total deposits of \$54 billion. Of particular relevance to the subject matter of the Proposed Guidance, Compass maintains a robust Correspondent Services Division through which it provides correspondent services to banking institutions across the United States, providing a litany of services and products such as Fed Funds transactions, repurchase and reverse repurchase transactions, securities transactions, derivative transactions, loans to banks and bank holding companies, collection, clearing and settlement services, etc.

Compass appreciates the Board's time and effort in preparing the Proposed Guidance, and we hope that the following comments are helpful to the Board in its efforts to regulate and manage exposure levels existing between financial institutions.

A. Generally

Compass largely agrees with the central concept of the Proposed Guidance, i.e., that institutions should actively identify, monitor and manage their exposures to other banks. However, we believe the Proposed Guidance deviates in significant respects from Federal Reserve Regulation F: Limitations on Interbank Liabilities. Such deviations have the potential to create great confusion among Fed member banks, and we encourage the Board to revise the Proposed Guidance in a manner that harmonizes its provisions with that of Regulation F.

B. The Proposed Guidance Deviates from Regulation F with Respect to Correspondent Concentrations in Significant Ways

(1) The Proposed Guidance Removes Tier 2 Capital when Calculating Exposures

In laying the foundation for the Proposed Guidance, the Federal Banking Agencies (the "Agencies") announce their belief that a credit exposure to a correspondent greater than 25% of an institution's Tier 1 capital is a "concentration." A concentration to a correspondent exceeding this amount is to be avoided under the Proposed Guidance, and the existence of such is a call to action for any bank so exposed.

As a Fed member bank, Compass is subject to Federal Reserve Regulation F, which regulates much of the same subject matter as covered by the Proposed Guidance.<sup>1</sup> Given that the two pieces of authority govern the same topic, one would expect the provisions of each to be in harmony. Unfortunately, this expectation is not met due to the manner in which the Proposed Guidance defines a concentration. Where Regulation F defines a "concentration" as an exposure to a correspondent greater than 25% of the bank's total capital (which includes both Tier 1 and Tier 2 capital), the Proposed Guidance's identification of a "concentration" contrasts this by defining a "concentration" to be an exposure to a correspondent greater than the 25% of the bank's Tier 1 capital (Tier 2 is conspicuously omitted from the equation).

The Proposed Guidance's elimination/omission of Tier 2 capital from factoring into whether or not a concentration exists is troubling and has the potential to create issues both for banks operating under Regulation F and for the Board in supervising these banks. For example, due to calculating an exposure to a correspondent based on the exposed bank's total capital, a bank may have an exposure to a correspondent under

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<sup>1</sup> Regulation F requires institutions' policies and procedures to limit exposure to correspondents when the form for maturity of an institution's exposure creates a significant risk that payment will not be made in a full or timely manner. Regulation F also requires institutions to reduce credit exposure to a correspondent to below 25% of the institution's total capital if the correspondent is no longer at least "Adequately Capitalized."

Regulation F that is entirely acceptable. However, upon the elimination of Tier 2 capital from the equation, which would occur under the Proposed Guidance, this same exposure could be an “actionable” concentration under the Proposed Guidance.

While Regulation F would not require the bank to reduce its exposure to the correspondent, the Proposed Guidance, as drafted, seemingly would. Based on the apparent conflict between Regulation F and the Proposed Guidance, banks could face criticism despite compliance with Regulation F. Presumably, Fed member banks would avoid criticism by ensuring they followed the Proposed Guidance, and as a result, the Proposed Guidance would effectively amend Regulation F. This may or may not be the Board’s intent.

## (2) The Proposed Guidance Makes Correspondent Capital Levels Irrelevant

Another significant conflict with Regulation F is created by the Proposed Guidance’s failure to assure institutions that exposures exceeding 25% of Tier 1 capital are permissible if the correspondent banks to which they are exposed are at least “Adequately Capitalized”. Due to this omission, a bank could be opening itself to criticism for any exposures exceeding 25% of Tier 1 capital, even if the correspondents to which it is exposed are “Well Capitalized.”

Currently under Regulation F, due to its “Well Capitalized” status, Compass, as correspondent, could hold funds in excess of 25% of another bank’s Tier 1 capital. However, many would interpret the Proposed Guidance, as drafted, to mean that exposures beyond 25% of a bank’s capital are no longer permissible, regardless of a correspondent’s capital levels. Applying this interpretation to the Fed Funds market could have unintended adverse consequences. For example, by virtue of the perceived 25% of Tier 1 prohibition, an institution with excess reserves could not allow certain correspondents to bid on its excess reserves/Fed Funds if the institution had preexisting exposures to such correspondents. This is true regardless of how well capitalized these correspondents may be. The net effect is that creditworthy purchasers of Fed Funds are effectively removed from the market by the Proposed Guidance for excess reserves/Fed Funds, which Regulation F currently permits.

In a time when we as an industry are trying to increase lending, increase liquidity and generally repair the capital markets, it seems counterintuitive to remove credit worthy purchasers from the Fed Funds market. With the elimination of would-be purchasers of Fed Funds, and recognizing that the Federal Reserve is not subject to the same 25% of Tier 1 capital scrutiny imposed on correspondent banks, a near monopoly could result in the Federal Reserve for excess reserves under the Proposed Guidance.

## C. Forcing Exposures to Multiple Correspondents may have Adverse Consequences

Because of the 25% of Tier 1 capital limitation on correspondent exposures and the perceived elimination of capital adequacy standards as they apply to correspondents, banks may be required to enter into transactions with a greater number of “upstream”

correspondents than currently required under Regulation F. As a result, this may cause such banks' earnings to be reduced by "as agent" or other increased operational fees associated with the increased transactional activity. In addition, and perhaps more importantly, an institution attempting to reduce concentrations under the Proposed Guidance may actually increase its risk by exposing itself to correspondents having inferior capital, earnings and credit quality ratios than the original upstream correspondent permitted by Regulation F. That is to say, forcing a bank to do business with more correspondents may actually increase the overall Probability of Default on correspondent exposures it holds.

D. The Proposed Guidance Fails to Adequately Discuss the Varying Degrees of Risk Associated with Different Types of Exposures

While the Proposed Guidance focuses on the creditworthiness of a bank's correspondents, it fails to address the varying degrees of credit risk inherent in particular transaction types, or indeed that banks can consider such in developing their policies and procedures under the Proposed Guidance. In the latter parts of the Proposed Guidance, there is a brief passage that speaks to reducing exposures over tolerance levels, by way of, for example, reducing the volume of uncollateralized/uninsured funds. However, this appears to be the only indication in the Proposed Guidance that different types of exposures carry varying degrees of risk.

While ratios are important tools for identifying which exposures represent concentration risks, ratios do not differentiate among the range of risk categories different types of transactions may exhibit. For example, there is no doubt that there is less credit risk associated with an overnight Fed Funds transaction than there is with long-term unsecured debt. Accordingly, while concentrations may be deemed to exist at certain thresholds, the true indicator of the risk presented by the concentration will be borne out by the various types of transactions underlying the concentration.

In developing policies and procedures under the Proposed Guidance (or under Regulation F), banks should be able to take into account the varying types of transactions comprising their exposures. However, the text of the Proposed Guidance, as drafted speaks very little to this concept. At the least, the Proposed Guidance should expressly provide that banks are permitted to consider the varying degrees of risk presented by different transaction types when monitoring and managing exposures. This would include, for example, consideration of collateral pledged in the bank's favor and short-term versus long-term transaction maturities. Further, given the relative safety of Fed Funds sold on an overnight basis, we would argue that Fed Funds should be exempted from the 25% capital limitation altogether.

E. The Proposed Guidance Fails to Provide Clear Guidance to Correspondents

While the Proposed Guidance generally leaves it up to banks to specify in their policies what information, ratios, and trends management will review with respect to correspondents, it would helpful to have more direct guidance on the types of information

banks should require. In this respect, clearer direction than the Proposed Guidance offers would not only benefit banks with correspondent exposures, but would especially benefit correspondents in developing and making available the required information. This is certainly true for correspondents that provide services to multiple banks. In lieu of responding to multiple unique data requests, it would be more efficient to develop, maintain and regularly provide one set of data to each bank with whom a correspondent does business.

#### F. Funding Exposures

To this point, we have not addressed portions of the Proposed Guidance covering funding exposures. Compass agrees with the prudential limitations and other guidance on funding exposures contained in the Proposed Guidance. We specifically would like to note that the Fed Funds market has become extremely illiquid, and we support efforts to have banks question their reliance on this market in their emergency funding plans.

Large lines from a correspondent, in this environment, may not be as reliable as they have been in the past. This is especially true if the line is from a relatively small correspondent that has issued a high volume of Fed Funds guidance lines. The viability of such lines should be called into question by recipient banks as even a slight deterioration in the advancing bank's financial condition could impair its ability to accommodate advances. We believe the final guidance should focus more on this area.

#### G. The Proposed Guidance May Violate the Administrative Procedures Act

Because the Proposed Guidance deviates from the provisions of Regulation F in several different respects, the Proposed Guidance may represent a violation of the Administrative Procedures Act (the "Act"). Specifically, at 12 USC 552(a)(1), the Act provides:

- (a)(1) Each agency shall separately state and currently publish in the Federal Register for the guidance of the public. . .
- (D) substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency; and
- (E) each amendment, revision, or repeal of the foregoing.

While the Proposed Guidance has been published in the Federal Register, the Proposed Guidance's provisions, as drafted, can arguably be interpreted as amending, revising, and indeed repealing certain parts of Regulation F. Case law interpreting the Act has held that only legislative rules (i.e., rules having the force of law) can amend a prior legislative rule. In addition, when an agency does not hold out a rule as having the force of law, it may still be legislative if it is inconsistent with a prior rule having the force of law. In light of such holdings, because the Proposed Rule may be construed to amend, revise or

repeal sections of Regulation F, the Proposed Guidance may be invalid under the Act due to its being a procedurally invalid legislative rule.<sup>2</sup>

#### H. Conclusion


To remove potential states of confusion, Compass recommends that in determining concentration limits, a bank should consider its total capital, i.e., its Tier 1 and its Tier 2 capital, under the final guidance issued. This will bring the guidance into harmony with the credit exposure limits of Regulation F.

In addition, the Board should clarify under the final guidance that banks can take into account the capital adequacy levels of the correspondent institutions with which they conduct business, as well as consider the varying degrees of risk posed by different transaction types in evaluating the risks presented by an overall exposure to a correspondent. Further, the final guidance should provide greater detail with respect to the types of information banks should request from correspondents, and cast more light on the overreliance by banks on Fed Funds guidance and similar lines issued by banks when such lines represent a high ratio of advancing banks' capital.

With these changes, we believe the final guidance to be issued will permit banks to enter into correspondent transactions prudently and consistently. Without these changes, the Proposed Guidance would seem to constitute a revision to Regulation F that will require a rulemaking that requires full compliance with the Act.

We appreciate the Board's and the other Agencies consideration of our comments.

Respectfully,

A handwritten signature in black ink, appearing to read 'M. Meadows', with a long horizontal flourish extending to the right.

M. Brandon Meadows,  
Corporate Counsel

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<sup>2</sup> "An agency is not allowed to change a legislative rule retroactively through the process of disingenuous interpretation of the rule to mean something other than its original meaning." *Hemp Industries Ass'n v. Drug Enforcement Admin.*, 333 F.3<sup>rd</sup> 1082 (9<sup>th</sup> Cir. 2003) (quoting *Caruso v. Blockbuster-Sony Music Entertainment Centre at the Waterfront*, 193 F.3d 730 (3<sup>rd</sup> Cir. 1999)).