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July 1, 2010

Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, D.C. 20429-9990  
Attention: Comments  
comments@FDIC.gov

Mr. Feldman,

On behalf of SunTrust Bank, I would like to take this opportunity to provide certain comments to the Federal Deposit Insurance Corporation's ("FDIC") notice of proposed rulemaking that significantly changes the risk assessment system applicable to large institutions, issued May 3, 2010 (the "NPR").

As stated in the NPR, comments were requested to address the appropriateness of the proposed weights and basis point ranges. Additionally, one of the goals of the NPR is to mitigate the pro-cyclicality of the current risk assessment system. We have three (3) primary concerns regarding the proposed risk assessment system:

- The proposed risk assessment system double and triple counts certain elements, resulting in scores mostly dependent on a small number of factors;
- The proposed risk assessment system fails to mitigate the pro-cyclicality of assessments and, in certain instances, may exacerbate the pro-cyclicality; and
- The subjective authority given to examiners under the proposed risk assessment system is inappropriate and ineffectual.

In addition, we will address your question as to the best way to integrate stress testing into the question of Deposit Insurance.

#### Weights Assigned to Performance Score Components and Measures

After reviewing the FDIC's proposed methodology for computing bank insurance assessments, we find several concerns. First, we believe the methodology entails an improper upward-bias in the assessments due to the sample period used in calibrating its components. Second, we believe the methodology may assign inappropriate weights to the components of a bank's score that is the basis for the assessment rate. Finally, we believe the statistical evidence demonstrates the proposed measures are inadequate predictors of future expert judgment risk rankings, albeit less inadequate than current measures.

By virtue of the sample period chosen to estimate certain model parameters, we believe the proposed methodology entails an inherent tendency to over-inflate assessments. For example, one sub-

component of the asset-related stress score is a bank's Tier 1 common capital ratio. Table 6 in the NPR shows the score for this sub-component would be based on a minimum cutoff ratio of 5.8% and a maximum cutoff ratio of 12.9%. However, after issuing additional common equity in response to a severe regulatory stress test (the "SCAP"), most large banks are currently managing Tier 1 common capital to historically high levels. This has clearly influenced the calibration of the minimum and maximum cutoff values as the FDIC notes that the minimum and maximum cutoff values generally represent a measure's 10th and 90th percentile values based upon data from first quarter of 2000 to the fourth quarter of 2009. One could foresee even very conservatively managed banks targeting long-run Tier 1 common capital ratios relatively close to the proposed minimum cutoff value, which would result in an inflated asset-related stress score and insurance assessment that is not necessarily commensurate with a bank's inherent risk.

Our second concern relates to the weightings of the various component measures. The CAMELS component ratings of banks account for things such as capital adequacy, asset quality, management administration, liquidity, earnings and sensitivity to market risk of an individual institution. The scorecard for large institutions accounts for the CAMELS ratings in its scorecard, but then also scores and considers such factors as capital ratios, asset quality as a ratio of reserves and liquidity, which are already incorporated into a bank's CAMELS rating. By substantially re-scoring certain components of the CAMELS ratings, particular items may be given disproportionate consideration and others, such as management, may be diminished disproportionately.

This point becomes evident in a closer examination of the proposed methodology. A bank's assessment rate is based on a total score, which is the product of a performance score and a loss severity measure. The performance score has three components: a CAMELS score, an asset-related stress score, and a funding-related stress score. By definition, the CAMELS score has six sub-components. In addition, the asset-related stress score has four sub-components and the funding-related stress score has three sub-components. Therefore, the performance score superficially appears to have 13 separate sub-components. However, once one recognizes that a bank's primary regulator would explicitly or implicitly consider all of the asset- and funding-related stress sub-components in assigning a CAMELS score, the performance score really only incorporates six truly distinct sub-components. Some of these sub-components receive substantially more weight than others; capital, for example, receives particular emphasis by virtue of its heavy weight in the CAMELS score and the non-linear form of the equation  $(S = \min(25 + [(20/3) * (C^2 - 1)], 100)$  where S is the CAMELS score and C is the CAMELS rating) chosen to translate a bank's CAMELS rating into a CAMELS score.

Another example of inappropriately weighing certain component measures, which may be in part due to data related to the recent crisis, is the data used to estimate the loss severity score. In appendix D, Table D.2, Asset Loss Rate Assumptions are given. 1-4 Family Closed-End First Liens are given a loss rate of 19.4%. Credit Card Loans are given a loss rate of 18.3%. While these rates may be reasonable for the recent crisis, it is unclear that they will be accurate predictors of loss going forward, particularly if the next crisis, as is likely, does not come with an asset bubble. We appreciate the necessity of making assumptions for these rates, but would strongly suggest that when doing so the longest possible time series is used, to reduce biases that will result from focusing on the past several years.

A third concern regarding the methodology is related to the predictive power of the proposed measures. Although the FDIC puts forth models which suggest that following such a scorecard in the past would have more accurately predicted the expert judgment risk ranking for banks in 2009, there are some notable problems with this assertion. One problem is that past performance is, unfortunately, no assurance

of future results. For instance, the growth-adjusted portfolio concentration risk weights categories of portfolio concentrations based on SCAP loss rates, but those portfolios that experienced the greatest losses in the most recent crises may not be what cause the greatest losses in the next crises. Consequently, the inherent assumptions behind such a scorecard, that those factors which predicted the financial institutions with the most problems as a result of this financial crisis, will replicate themselves for future financial crises should not be assumed because circumstances and risks not only may, but are likely to change.

Another problem with the predictive power of the methodology is illustrated by use of the adjusted R-square statistic from regression results to contend the proposed measures accurately predict future expert judgment risk rankings much better than the current measures. While the R-square statistics are notably higher for the proposed measures than the current measures, they show that the proposed measures still explain less than half of the variability in the expert judgment rankings just three years ahead (as shown at Chart 1 in the NPR). This is particularly problematic if the goal is to avoid pro-cyclical assessments.

### Pro-cyclicalities of Assessments

Although the commentary to the proposed rulemaking suggests that the pro-cyclicalities of assessments is mitigated by a focus on long-term risk, in reality many of the measures presumably penalize financial institutions with higher assessments once they are facing a crisis. First, the CAMELS ratings have some elements of pro-cyclicalities naturally embedded in them. Specifically, some of the measures described in the “Ability to Withstand Asset-Related Stress” portion of the scorecard, such as (i) the ratio of criticized and classified items to Tier 1 capital and reserves, (ii) underperforming assets to Tier 1 capital and reserves, and (iii) the ratio of core earnings to average total assets are significant only when the financial institution has already begun to experience little to no earnings, and possibly losses, during times of financial crisis. The scorecard weighs asset stress heavily for large and highly complex institutions versus funding-related stresses; however, it is the ability, or lack thereof, of financial institution to fund itself that may be most important during financial stress.

Second, we are concerned that the proposal giving the FDIC the flexibility to update the minimum and maximum cutoff value and weights used in each scorecard annually without notice-and-comment rulemaking portends to greater pro-cyclicalities of assessments. A secondary purpose of the notice-and-comment rulemaking is that some level of advance notice is given to the member banks of changes in significant costs that the member banks must incur and the changes are justified by substantial evidence. The ability to adjust minimum and maximum values and weights suggests that the changes will be made after risks have materialized, which implies that assessments will be higher for certain activities after the financial institutions have engaged in the activity and are suffering the market consequences for their actions. Therefore, the interest of the FDIC to act quickly and alter assessment methodologies, values and weights as the market shifts introduces a pro-cyclical mode of assessment.

### Subjectivity of Assessments

While the scorecard is detailed in terms of certain ratios and formulas that would be examined in developing the result of any particular score, the fact remains that producing the score falls outside of a formula and into the hands of an individual examiner. Assuming the score would be a comparison of certain ratios to the median, average and mean ratios of a peer group or all large banks, the NPR makes it clear that the score of any particular financial institution would still be left within the discretion of an examiner with, presumably, little ability for an appeal. This opens the possibility for the FDIC or its

individual examiners to pick winners and losers in the marketplace by its use of the assessments. While the need for flexibility to more rapidly assess and account for future risk can be appreciated, such flexibility presumes a level of sophistication and near clairvoyance at assessing and appreciating risk combined with honesty and integrity to apply in a completely impartial and consistent manner. The purpose of this argument is not to cast aspersions, but rather question whether any organization or person can accurately anticipate the genesis of the next crisis.

Moreover, due to the sensitivity of the information involved in properly assessing the risk of a bank, it will be impossible to ever know whether or not any particular bank is judged fairly vis-à-vis its competitors. It's unclear whether the reasoning of an examiner for adjusting a particular factor up or down will be a matter of public record, but given the inherent sensitivity of such information, we would imagine it would be treated similar to CAMELS ratings. The downside is each examiner in each FDIC office may develop a different sense about what is risky or what is not and adjustments may vary widely. Even if the discrepancy is only perceived and not real, because there is no method of demonstrating there are no discrepancies across banks (for which exercise a regulator would need to share sensitive and competitive information about banks with their competitors), this risk will exist and likely lead to greater distrust and suspicion about the entire process.

### Proposed Solution

We believe that a critical component of effective deposit insurance pricing and measurement is the integration of stress testing into your approach. This is challenging, as the traditional approach to stress testing does not lend itself to bank-to-bank comparisons, which is why it has not been used more broadly in the past. The Supervisory Capital Assessment Process ("SCAP") from 2009 provided valuable information in how a horizontal comparison of banks can be combined with stress testing. The Board of Governors of the Federal Reserve (the "Federal Reserve") provided 19 banks with a predetermined "adverse" economic scenario, and requested that these banks forecast their performance over a two year period based on the given set of unemployment, GDP, and home price paths. We would recommend that the FDIC work with the Federal Reserve, OCC, and other regulatory bodies to create an annual "adverse" economic forecast, updated quarterly, and integrate this into the standard supervisory review process of the banks. It would not be necessary to do the intensive review or have the tight deadlines as in 2009 because the original SCAP led to the development of the process and tools that makes this process much more "business as usual". By making the SCAP a standard part of the regulatory process, banks will be able to plan around it, reducing the disruption it may cause to banks. This approach would also lead to a more uniform view of risk across the Federal Reserve, OCC, and FDIC, which would benefit everyone, and would result in significant focus placed on the estimation and analysis of critical risks in the industry. It would also ensure that risks that have been identified as critical in one regulatory agency are fully understood by the others.

The results of this process would allow for a meaningful comparison across financial institutions similar to the approach taken in the SCAP. It would provide information both in terms of loss severity and the performance score. The specifics as to how it would be integrated into the process proposed are unclear, but it seems reasonable that measures such as the total drop in capital ratios, or the aggregate loss over a given horizon could be easily integrated into your current capital and concentration measures.

## Conclusion

We understand the challenges presented in devising a methodology to assess risk at financial institutions in an effort to require those institutions that take more risks pay higher premiums than those that do not. The proposed system, however, would appear to diagnosis those risks that financial institutions experienced leading up to the present crisis as opposed to whatever may be the risks that financial institutions will face in the future. Consequently, those risks that were the primary risks faced by financial institutions leading up to the present crisis are double counted (or triple counted) and would continue to be so even when the financial markets have changed. Many of the risks that are the focus of the proposal are cyclical risks that are most pronounced during a crisis and less so during good years. Therefore, it is our view that a more tailored approach is required to accurately address the specific risks faced by a financial institution and minimize the pro-cyclicality of assessments. While it may be difficult to accomplish such an individualized approach and maintain fairness and objectivity, to achieve effective deposit insurance pricing and measurement it will be necessary for the financial regulators to cooperate and develop a complete view of each financial institution and assess its individual risks accordingly.

Regards,

A handwritten signature in cursive script, appearing to read "McHenry Kane".

McHenry Kane

Cc: Ray Fortin  
Jim Sproull  
Mark Chancy  
Aleem Gillani