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May 13, 2011

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Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

RE: Federal Deposit Insurance Corporation
12 CFR Part 327
Federal Register / Vol. 76, No. 38, February 25, 2011 / Rules and Regulations
Assessments, Large Bank Pricing
Final Rule: Risk-Based Assessment System for Large Insured Depository Institutions

Ladies and Gentlemen:

On behalf of its members, RMA supports the general aim of the FDIC's Final Rule. RMA and its member banks strongly support the concept of applying risk-based evaluation tools in the determination of FDIC assessment fees, and we encourage the FDIC to look for approaches that charge a premium for taking greater risk. We are concerned, however, that the definitions, as they appear in the Final Rule for

“leveraged loans” and for “subprime loans,” will yield a ratio that does not accurately represent the risk incurred and, therefore, we respectfully request that the FDIC reexamine the definitions of those terms.

The Final Rule is intended to better capture risk at the time it is assumed by the institution. It also seeks to better differentiate risk among large insured depository institutions during periods of good economic and banking conditions by determining how they would fare during periods of stress or economic downturns. Further, it seeks a better understanding of the losses that the FDIC may incur if a large insured depository institution fails.

The context of our focus is on the definition of *higher-risk assets,* more specifically the definition of two of the four components of this ratio: (a) leveraged lending and (b) subprime loans. The ratio appears as one element of a scorecard, concentration measure, under the larger category of *ability to withstand asset-related stress*. It is applicable to both highly complex institutions and large insured depository institutions.

*Higher risk assets* are defined as the sum of C&D loans (funded and unfunded), leveraged loans (funded and unfunded), nontraditional mortgages, and subprime consumer loans. In the chart below, we outline our concerns and proposed resolutions for your consideration.

| | FDIC Definition – Final Rule | Concern | RMA Proposed Definition<br>**Bold indicates proposed change** |
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| Leveraged Loans | Leveraged loans include: (1) All commercial loans (funded and unfunded) with an original amount greater than $1 million that meet any one of the conditions below at either origination or renewal, except real estate loans; (2) securities issued by commercial borrowers that meet any one of the conditions below at either origination or renewal, except securities classified as trading book; and (3) securitizations that are more than 50 percent collateralized by assets that meet any one of the conditions below at either origination or renewal, except securities classified as trading book.<br>• Loans or securities where borrower's total or senior debt to trailing twelve-month EBITDA (i.e. operating leverage ratio) is greater than 4 or 3 times, respectively. For purposes of this calculation, the only permitted EBITDA adjustments are those adjustments specifically permitted for that borrower in its credit agreement; or<br>• Loans or securities that are designated as highly leveraged transactions (HLT) by syndication agent.<br>Note:<br>The total liabilities to asset ratio test has been removed from the definition; the remaining tests are consistent with the OCC Handbook. | • No distinction is made for several important criteria, resulting in a ratio that, as currently defined, will be the same, but with a much different risk profile *<br>1. No distinction is made for the type of transaction, i.e. the use of the funds.<br>o Short term, e.g. working capital, or<br>o Long term, e.g. buyout, recapitalization.<br>2. No distinction is made for the type of collateral.<br>o Secured (w/ tangible assets), or<br>o Unsecured.<br>3. No distinction is made for the type of industry and or business activity.<br>o E.g. traditional, high-operating -leverage industries, e.g. floor -plan financing vs. enterprise value.<br>• Without these distinctions, i.e. a more granular view, the measure has become homogenized, compromising its value as a differentiator between and across institutions.<br>o For instance, a bank that primarily pursues a short-term, secured leveraged lending book of business | Leveraged loans include: All commercial loans (funded and unfunded) that meet any one of the conditions below at either origination or **renewal – provided that the loan was determined to be leveraged prior to renewal,** except real estate loans: **(Source - 2008 OCC Comptroller's Handbook)**:*<br>• **"Proceeds used for buyouts, acquisition, and recapitalization.**<br>• **Transaction results in a substantial increase in borrower's leverage ratio. Industry benchmarks include a twofold increase in the borrower's liabilities, resulting in a balance sheet leverage ratio (total liabilities/total assets) higher than 50 percent, or an increase in the balance sheet leverage ratio more than 75 percent. Other benchmarks include increasing the borrower's operating leverage ratios [total debt/EBITDA (earnings before interest, taxes, depreciation, and amortization) or senior debt/EBITDA) above defined levels such as above 4.0X EBITDA or 3.0X EBITDA, respectively.**<br>• **Transaction designated as a highly leveraged transaction (HLT) by the syndication agent.**<br>• **Borrower rated as a non-investment-grade Company with a** |

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| | | will have a significantly lower risk profile than a bank that pursues a long-term, unsecured strategy. However, as currently defined, both of these banks would be viewed the same.<br>• The use of a single ratio (operating leverage ratio) is overly simplistic, especially without simultaneously taking into consideration a number of other factors, such as the purpose of the financing. *<br>• An original amount of $1 million or greater will result in the inclusion of the small business banking book where the volume of transactions are sufficiently large and other factors, such as personal guarantees and government guarantees, help to mitigate the risk.<br>• By broadly including loans that are defined as leveraged at renewal, you may be including loans that became leveraged as the result of a deteriorating economy versus a loan whose purpose at origination was leveraged. | **high debt to net worth ratio.**<br>• **Loan prizing indicates a non-investment-grade company.**<br>• **The OCC broadly considers a leveraged loan to be a transaction where the borrower's post-financing leverage, when measured by debt-to-asset, debt-to-equity, cash flow-to-total debt, or other such standards unique to particular industries, significantly exceeds industry norms for leverage.**<br>• **Banks engaging in this type of activity should define leveraged lending within their lending policy. Examiners should expect the bank's definition to clearly describe the purpose and financial characteristics common in these transactions."**<br><br>*** Also, 2001 OCC, FRB, FDIC, and OTS Sound Risk Management Practices paper on Leveraged Lending –**<br>• **"A transaction is considered leveraged when the obligor's post-financing leverage as measured by debt-to-assets, debt-to equity, cash flow-to-total debt, or other such standards unique to particular industries significantly exceeds industry norms for leverage. "** |

* The operating leverage ratio, by itself, is not the best measure of risk for all borrowers in all industries. The nature and reasonable predictability of business earnings and cash flow, particularly for amortizing debt, allows for substantially more financial leverage in some

industries than in others. Public utilities, for example, have always enjoyed more leverage than other industries, e.g. contractors that are generally considered highly risky, even for relatively small measures of working capital borrowings. Secured traditional asset-based lending, with well conceived collateral values and margin requirements and controls, though highly leveraged by the proposed measures, may bear considerably less risk of loss than a borrower with a substantially lower operating leverage ratio. However, the latter borrower may be far more risky if it is in an industry that has little tangible asset value and large proportions of enterprise value-type intangible assets on its balance sheet.

The proposal to use a single ratio as the measure of risk in leveraged loans, i.e. a single proxy, is diametrically opposed to the well thought out and increasingly complex credit risk-rating systems in use that take far more into account than the proposed ratio. Bank risk-rating systems are designed to measure the probability of default (PD) and the loss given default (LGD), and to provide for this assessment throughout the economic and credit cycle. The definitions of *criticized* and *classified* assets used by the banks mirror the traditional regulatory definitions, and they are tested frequently by the industry's primary regulators. Accordingly, the use of a single ratio as a proxy for risk is inappropriate and inconsistent with the historical practices of commercial bank regulators, international regulatory practices (and probable U.S. adoption in some form) regarding Basel II.

Lastly, a single ratio will produce an undesirable level of volatility through the cycle. It will be pro-cyclical with the kinds of defects that plagued the calculation of the loan loss provision and the ALLL during the most recent cycle. It will not apply a consistent measure of risk to individual loans or portfolios of loans in commercial banks, and it will produce unfair and unintended consequences in the assessment of risk of the insured banks.

| | FDIC Definition – Final Rule | Concern | RMA Proposed Definition<br>**Bold indicates proposed change** |
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| Subprime Loans | Subprime Loans include loans made to borrowers that display one or more of the following credit risk characteristics (excluding subprime loans that are previously included as nontraditional loans) at origination or upon refinancing, whichever is more recent.<br>• Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months; or<br>• Judgment, foreclosure, repossession, or charge-off in the prior 24 months;<br>• Bankruptcy in the last 5 years; or<br>• Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.<br>• Loans identified by an insured depository institution as subprime loans based upon similar borrower characteristics and securitizations where more than 50 percent of assets backing the securitization meet one or more of the preceding criteria for subprime loans, excluding those securities classified as trading book.<br>Note:<br>The definition excludes any reference to FICO or other credit bureau scores. The Rule focuses on borrower credit history. | • The use of a single ratio (debt service-to-income) & threshold is overly simplistic without simultaneously considering other undefined factors that are indicative of a stressed borrower. *<br>• The definition does not make any distinction as to size or type of 30-day and 60-day delinquency (i.e., a large installment loan or mortgage is clearly more important than a small retail trade).<br>• No distinction is made for the size of the judgment, foreclosure, repossession, or charge off (e.g., someone with a minor medical charge-off with otherwise impeccable credit would be classified as subprime under this definition).<br>• The ability to accurately determine the required credit bureau attributes at the time of origination for an already existing portfolio as several of these attributes are not retained in most loan origination systems. This leads to a best efforts attempt to reconstruct bureau attributes at the time of origination or refinance which depending on the sophistication of the institution, could result in disparate outcomes for similar portfolios. | Subprime Loans include loans made to borrowers that display one or more of the following credit risk characteristics (excluding subprime loans that are previously included as nontraditional loans) at origination or upon refinancing, whichever is more recent.<br>• Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months; or<br>• Judgment, foreclosure, repossession, or charge-off in the prior 24 months;<br>• Bankruptcy in the last 5 years; or<br>• **A measure of risk presented by the applicant, produced by a credit scoring algorithm/system, that conforms to sound mathematical practices, regulatory guidance and rules, as well as any applicable laws.**<br>○ **The credit scoring algorithm/system may be provided by either a vendor (e.g. FICO or Vantage) or developed internally, or some combination of the two resources.**<br>○ **The measure of risk, i.e. a relatively high probability of default, would establish a threshold (subject to product type** |

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| | | | **and collateral) for determining what is considered subprime. The threshold would be determined by the market or the institution.**<br>• Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.<br>• Loans identified by an insured depository institution as subprime loans based upon similar borrower characteristics and securitizations where more than 50 percent of assets backing the securitization meet one or more of the preceding criteria for subprime loans, excluding those securities classified as trading book. |

* For example:

1. Residual Income:

A head of household with:

a) $3,000 of monthly income at 50% DTI has $1,500 of residual income to cover living expenses and cushion for debt service.

b) $10,000 of monthly income at 50% DTI has $5,000 of residual income to cover living expenses and cushion for debt service.

The financial flexibility for b) is certainly much better than a) and not likely a subprime borrower without some other negative factor.

2. Asset Base: Clients with larger net worths, but lower income (i.e. retirees) could become classified as subprime due to this 50% DTI

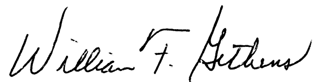
criteria when the ratio is not indicative of their ability to repay their obligations due to asset depletion availability.

3. The debt-service ratio calculation is undefined leaving broad room for interpretation:
   - How is a payment calculated for revolving debt (% of balance or line, what %).
   - When can a near full-term installment loan be excluded from the calculation (3-month remaining or 6-months remaining or more)?
   - What income is included?
   - How is irregular income treated?

In addition, while not the focus of this letter, compliance with the definitions, as defined, presents significant issues regarding a bank's ability to report their position. The information is not readily accessible and in some cases, not available at all. The effort and cost burden, associated with complying will be significant. And, even if an abundance of resources were available – money, people, systems capabilities, etc. the ability to report for the June 30, 2011 deadline will be impossible for most if not all banks.

We hope that you find this helpful, and if you wish to discuss this further, we would welcome the opportunity.

Best Regards,



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