

Trustmark Corporation
Post Office Box 291
Jackson, Mississippi 39205-0291
601 208 6651

Gerard R. (Jerry) Host
President and
Chief Executive Officer



Trustmark

October 22, 2012

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Robert E. Felderman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington DC 20429

**Re: OCC Docket OCC ID-2012-0008, 0009
Basel III Federal Reserve Board Docket No. R-1442
Basel III FDIC Docket RIN 3064-AD95, AD96**

Ladies and Gentlemen:

We appreciate the opportunity to provide comments on the Basel III proposals jointly published by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, “the agencies”) in the Federal Register on August 30, 2012. Our goal in submitting these comments is to contribute constructively to the rulemaking process by identifying areas of concern and recommending alternatives to the proposed rules consistent with the agencies’ efforts.

Trustmark Corporation is a \$9.9 billion diversified financial services company. We provide banking and financial solutions to individuals and corporate institutions. With 2,600 employees and 163 branch locations servicing Mississippi, Texas, Tennessee and Florida, Trustmark Corporation strives to achieve outstanding customer satisfaction by

understanding our customers' businesses and needs and providing appropriate financial solutions.¹

We have reviewed the proposals and evaluated the impact to not only Trustmark, but to our customers and the broader marketplace. We support the agencies' efforts to strengthen capital rules with the goal of promoting a more resilient banking sector. However, we are concerned that certain aspects of the agencies' proposed rules could create unintended adverse consequences for Trustmark, and the U.S. banking system in general. Because these proposals could create a substantial change in the way that banks do business, we urge the agencies to take more time to study the potential impacts of various components of the proposals and make the necessary changes to limit the introduction of complementary risks. This letter will address our concerns as they relate to the following topics:

1. Inclusion of unrealized gains or losses on all available-for-sale securities in Tier 1 Common Equity ("T1CE")
2. Limits on Mortgage Servicing Assets ("MSA") and Deferred Tax Assets ("DTA")
3. Risk-weight proposals for mortgage-related products
4. Simplified Supervisory Formula Approach ("SSFA")

1. Inclusion of unrealized gains or losses on all available-for-sale securities in tier 1 common equity

The proposed rules would require banks to include unrealized gains and losses from all available-for-sale ("AFS") securities currently recorded in accumulated other comprehensive income ("AOCI") as part of T1CE. This includes unrealized gains and losses from securities whose value changes solely as a result of changes to market interest rates. We understand that this proposed treatment is an attempt to accelerate the recognition of potential credit-related losses in regulatory capital. We believe that regulatory capital should be loss absorbing, and agree that it is appropriate to hold additional capital against securities whose value declines from increased credit risk, those that are other than temporarily impaired (OTTI). However, we do not feel it is appropriate to hold additional capital for securities which are temporarily impaired by the normal fluctuation of market interest rates rather than credit impairments. This requirement will undoubtedly add significant volatility to capital levels and lead to a misalignment of capital and risk. We are concerned that the proposals may lead to a reduction in bank lending capacity, unsafe and unsound asset/liability management practices and result in a negative impact on product pricing and availability to bank customers. These concerns are addressed in detail below.

The inclusion of the temporary unrealized gains or losses from an AFS portfolio introduces significant volatility to regulatory capital, which we feel is not in line with the spirit of the capital reform, to improve the quantity and quality of capital

¹ For further information on Trustmark Corporation, please see <http://www.trustmark.com/>

measures. Interest rate swings create increases and decreases in market value of securities that do not reflect realized or, in many cases, probable changes to value. This particular aspect of the Basel III Notice of Proposed Rulemaking (“NPR”) creates a misalignment of capital and risk. For example, compare a 5 year Treasury note to a 5 year fixed rate commercial loan. Both have the same level of interest rate risk, but different levels of credit risk. The capital charge for the commercial loan is 8.5 percent. The capital charge for the Treasury note is 4 percent (minimum Tier 1 Leverage). The commercial loan has a higher charge because it contains more credit risk. However, the comparison changes drastically in an up 400 bps rate shock scenario. The capital charge for the commercial loan remains at 8.5 percent, but the capital charge for the Treasury note increases from 4 percent to nearly 20 percent when accounting for the unrealized loss (including increase in DTA). The market value of the Treasury note issued by the U.S. Government reflects a temporary change in market interest rate levels rather than a change in credit risk. In our opinion, the inclusion of unrealized gains or losses greatly distorts the true measure of risk and may lead to investment and pricing decisions that reflect regulatory capital levels, instead of risk levels.

The volatility in capital calculations could also lead to significant variations in lending capacity. Under the current NPR, unless actions described below are taken, Trustmark’s capital will likely decrease in rising rate scenarios due to increasing unrealized losses from the AFS portfolio and the increasing value of the MSA. The reduction in capital will restrict the bank’s lending capacity, and depending on the magnitude of the capital reduction, could force Trustmark to reduce the size of its balance sheet by reducing total and risk-weighted assets in order to achieve the desired capital ratios. In doing so, it would restrict lending, and thereby impact the community and the consumers it serves. Systemic defensive balance sheet posturing strategies would hinder an economic recovery. Additionally, if the same reduction in lending capacity affects multiple lending institutions, any economic recovery could be systemically slowed. Alternatively, Trustmark could decide to raise additional capital to meet appropriate capital levels under all foreseeable interest rate scenarios. This may negatively impact product pricing and availability to its customers.

We are also concerned that the inclusion of AOCI in TICE would drive banks to unsound risk management practices. Banks use AFS investments to help stabilize interest income over the business cycle while providing a warehouse of liquidity that can be accessed during periods of high loan demand and/or declining deposit balances. AFS investments help manage the interest rate risk exposure created by core banking activities, which create a mismatch in interest rate risk exposure as the repricing and maturity of loans are generally much shorter than those of core deposits. The average life for these deposits typically matches or exceeds that of the securities they fund. Deposit values increase as interest rates rise, which partially, if not fully, offsets the unrealized loss experienced by the investment portfolio. The value increase from the deposits in rising rate scenarios is not currently represented in the proposed capital rules, yet the decline in value of an instrument they fund is. Additionally, the volatility to regulatory capital could influence a bank’s ability to hedge – economically sound decisions could be compromised if management were forced to modify decisions it believed to be in the best interest of the bank in order

to limit mark-to-market implications from one side of the balance sheet. It is our opinion that this represents an unbalanced view of an institution's capital and contributes to the capital volatility that is to be expected from rising interest rates.

We at Trustmark are concerned that the proposed NPR could force balance sheet strategies which favor either capital volatility reduction or interest rate risk management, where the benefits of one strategy would sacrifice the benefits of the other. Many of the principles from the interagency guidance on Interest Rate Risk Management, SR 10-1, could hold a lower priority in order to maintain stable regulatory capital levels. In order to minimize the impact on regulatory capital of unrealized gains and losses from the AFS portfolio, Trustmark may consider several options.

The first option would be to shorten the duration of the investment portfolio by selling longer dated securities and purchasing short term investments in order to reduce AOCI volatility. We at Trustmark are concerned about the systemic impact of multiple banking institutions implementing this strategy. The Demand for Municipal debt offerings and long term mortgage products could decline, which would increase Municipal debt expense and mortgage interest rates.

This strategy would likely create a highly asset sensitive balance sheet, which, under falling interest rate scenarios, could also decrease capital as net interest income declines. In order to minimize the risk to changing interest rates under this strategy, the bank may synthetically convert the short duration investments to longer assets utilizing derivatives. Hedge accounting complexities within U.S. GAAP may limit this strategy from a practical standpoint. Additionally, if many banks adopt the same strategy, we feel unintended systemic market issues related to counterparty credit risk and improper use of derivatives could arise.

Trustmark could also consider designating a large portion of its current AFS holdings into held to maturity ("HTM"). Unrealized gains and losses from securities designated HTM do not pass through the AOCI account into TICE. This solution may not be available in the near future as FASB is considering changes to HTM treatment. Additionally, this solution brings significant liquidity and interest rate risk management challenges, and is not viewed by Trustmark management as an effective solution to the capital volatility dilemma as HTM designations are irreversible. The ability to make changes to the investment portfolio is vital to interest rate risk management. This option would be severely limited under this strategy and would largely disregard the principles from recent interagency guidance on Interest Rate Risk and Liquidity Management (SR 10-1 & SR 10-6). We agree with the principles from both guidance letters, and have incorporated them into our risk management culture. The HTM strategy is clearly not our first choice to soundly and safely manage risk, but feel that it may be a necessary option in order to avoid the capital volatility that will result from the NPR as it is written today. We feel strongly that having to make decisions such as this should be avoided if possible, and fear that other banks may consider the same strategy if the NPR is approved. Our fear is that a systemic adoption of this strategy would reduce

the amount of liquid assets for all banks, which does not align itself at all with the spirit or intent of SR 10-6.

Trustmark is concerned about the competitive implications with the U.S. subsidiaries of foreign banks. We recognize the NPR is implementing the international regulatory framework of Basel III. However, accounting for AFS investment securities, DTAs arising from unrealized losses on those securities, and MSAs are all unique to U.S. GAAP. The interaction between Basel III and international accounting standards does not pose any of the aforementioned concerns to regulatory capital in most other countries. These foreign banks can avoid the capital volatility issues outlined above by simply moving their U.S. subsidiary's securities portfolio to the foreign parent. These same banks would then hold a competitive advantage in our markets. In rising interest rate scenarios, there is a strong likelihood that U.S. banks will have to raise additional capital to maintain the same lending capacity as our foreign competition. In turn, the foreign competition would hold both loan and deposit pricing advantages, which was simply created by different accounting standards. Additionally, it would likely invite an increase of foreign acquisitions of U.S. banks under rising interest rate scenarios, as the capital ratios for U.S. banks will decline (regardless of credit risk) and the capital ratios of the foreign banks remains unchanged. Many U.S. banks could be faced with the choice of a) issue capital and dilute shareholder value, or b) sell to a foreign bank and preserve shareholder value. A foreign acquirer could even avoid issuing new capital on such a transaction by re-valuing the deposits at closing, and moving the securities portfolio to the foreign parent. This could put U.S. banks up for sale at a deeply discounted price solely because interest rates rose.

We do not believe that including AOCI in T1CE will promote the desired supervisory objective. Instead, it will likely increase the volatility of bank balance sheets, which is contrary to our understanding of the objective of the Basel III Proposals. Given this and the other concerns highlighted above, we strongly encourage an alternative approach to the inclusion of AOCI in Tier 1 Common Equity. We recommend the exclusion of U.S. Treasuries, U.S. Agency securities, all GSE securities including mortgage-related issues, high quality general obligation municipal securities, and any zero risk weighted sovereign debt instrument from the AOCI and DTA limits. We also feel that this solution is consistent with paragraphs 71 and 72 of Basel III where "artificial volatility in common equity is undesirable and should be removed for prudential reasons".

2. Limits on Mortgage Servicing Asset (MSA) and Deferred Tax Assets (DTA)

Trustmark is concerned about the impact of the limits placed on both DTAs and MSAs. The NPR would require banks to deduct any DTA or MSA value that exceeds 10 percent of Trustmark's T1CE, or the combined amount of both that exceeds 15 percent. Trustmark hedges its MSA to preserve the long term value of the servicing asset from when it is originated by reducing its sensitivity to market interest rates. When interest rates increase, the value of the MSA increases and the hedge generates an offsetting loss, leaving the interest rate impact to earnings and

capital relatively unchanged. However, per the NPR, the MSA value increase would be subtracted a second time from regulatory capital (the first time being the offsetting hedge loss), solely because interest rates increased. It is our opinion that hedging the MSA is a sound risk management practice, and the lack of recognition for this could decrease our incentive to continue hedging the MSA. Like the inclusion of the unrealized gains or losses from the AFS portfolio, the value increase to the MSA from rising interest rate scenarios could reduce our T1CE solely from interest rate changes. We recommend removing the deduction for hedged MSAs. If a MSA deduction must exist, we recommend increasing the MSA individual and combined limits to 15 and 20 percent respectively; as we believe the DTA resulting from loan loss reserves would use the majority of the 15 percent combination limit.

As discussed above, the NPR places limits on the amount of DTAs and MSA (10% individually and 15% in aggregate). Included in the DTA bucket, is the DTA created from an unrealized loss in the investment portfolio. We feel this is overly punitive and is effectively a double taxation as the tax affected unrealized loss would have already been included in T1CE through the AOCI inclusion. Our recommendation therefore is to exclude from the DTAs subject to the 10% and 15% limits, any DTA that arises from an unrealized loss within the investment portfolio.

3. Risk-weight proposals for mortgage-related products

The proposal calls for splitting residential mortgage loans into two categories. Category one loans receive considerably favorable risk weighting treatment than category two. To qualify as a category one loan, the structure must provide for regular periodic payment which can-not:

- a) Result in an increase of the principle balance
- b) Allow the borrower to defer repayment of principle
- c) Result in a balloon payment

It is Trustmark's opinion that the changes to the residential mortgage risk weights are excessive relative to their inherent risk. The Category designation is based solely on the structure of the note, regardless of the risk characteristics of the borrower. According to the NPR, risk weights for first lien interest only or balloon residential mortgages carry more than twice the risk than that of their category 1 conforming counterpart. At Trustmark, the empirical evidence does not support this claim. Many community banks prefer to keep residential mortgage loans on their balance sheet to retain customer relationships after the loan origination. However, retention of conventional 30 year residential mortgages on a balance sheet can greatly increase interest rate risk, as evidenced by the Savings and Loan crisis experienced nearly two decades ago. New mortgage products and structures were created so that banks could retain mortgage customer relationships, while reducing the inherent interest rate risk from the conventional 30 year fixed rate product. While we understand the perception that many of these products were created solely to lower the monthly payment enough for customers to qualify for financing, this is not the only reason for their existence. We recommend that mortgage risk weights be re-assessed to align better with the risk content inherent in the loans. While there

is merit in the individual requirements proposed to bolster the safety and soundness of the mortgage market, many of the proposed changes could materially alter Trustmark's current mortgage business model.

It is our understanding that the intent of increasing risk weights for junior lien loans is to avoid the lending practice of underwriting a first lien loan at 80 percent LTV coupled with a junior lien loan of 20 percent LTV totaling for 100 percent financing. However, any consumers seeking a home equity loan from the same issuing bank, no matter how many years after the first lien's origination, would most likely be turned away because the bank would have to treat the combined liens as a category two loan and hold significantly more capital in order meet that customer's needs. A competing bank could offer the same customer a second lien loan and hold considerably less capital against it. Potential resolutions for this uncompetitive stance could include a lockout period. Example, all second lien loans against said property would require the same capital treatment for all banks after a specific number of years/months from the first lien's origination.

Please provide additional clarity on the credit enhancing representation and warrant provisions for sold loans. Please address what qualifies as a rep and warrant and how that definition interacts with sale conventions with FHLMC, FNMA, and GNMA. Would a loan with a 35% risk weight and a loan with a 200% risk weight each have a 100% risk weight if sold with a credit enhancing rep or warrant? Would the risk weight fall to zero after the expiration of the rep or warrant on a sold loan?

4. Simplified Supervisory Formula Approach

The NPR calls for replacing the use of credit ratings for securitization exposures with a formula-based approach. Based on our current staffing level, this change would significantly increase the workload for our staff, such that additional personnel may be required in order to fully comply with the ordinance.

The SSFA formula is the most likely method Trustmark would use to determine the risk weighting for all non-agency securities within our investment portfolio. The formula is a complex incorporation of underlying collateral risk weight, delinquencies and subordination. The formula contains a supervisory calibration parameter "p" that can only be one of two values, 0.50 or 1.50. The default application of this parameter is set to 0.50, however, the value is switched to the 1.50 value and applied to any security containing even \$1 of re-remic or re-securitized collateral. In instances such as this, the risk weighting can triple, even if the underlying structured products represent an insignificant portion of the total underlying collateral. This is especially evident when the formula is applied to legacy CLOs. Not only that CLOs often have less than 5% of re-securitizations as part of their collateral but those underlying structured products often mitigate some of the risk of the overall structure by increasing the diversification of the underlying collateral. In our opinion, this is a large disconnect between the applied risk weight and the actual risk exposure. One suggestion would be to scale the calibration parameter "p" depending on the percentage of re-remic and re-securitized collateral in the underlying assets. The other suggestion would be to allow an exemption from

the parameter “p” increase in CLOs where the amount of underlying structured products is less than a certain percentage of the overall assets (5% for example).

The SSFA formula also ignores explicit government guarantees on the underlying collateral in securitizations issued by non-governmental entities. An example is the securitization of government reinsured student loans where the issuer is a private entity. In this example banks must apply the SSFA method to determine the applicable risk-weights for these holdings. However, there is no accounting for the fact that the underlying assets in the securitization are 97% guaranteed by the U.S. government, which leaves the government in a 97% “first loss” position. As a result, the risk-weights calculated using the SSFA method will overstate the actual risk of loss in these tranches.

Please let us know if there are any questions to the above comments.

Sincerely,

A handwritten signature in blue ink that reads "Gerard R. Host". The signature is fluid and cursive, with the first name "Gerard" being the most prominent part.

Gerard R. Host
President and Chief Executive Officer