FIFTH THIRD BANK

October 22, 2012

Office of the Comptroller of the Currency (the "OCC")
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
E-mail: regs.comments@occ.treas.gov
Re: OCC Docket ID OCC-2012-0008 and OCC Docket ID OCC-2012-0009

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System (the "Board")
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
regs.comments@federalreserve.gov
Re: Docket No. R-1430; RIN No. 7100-AD87; and Docket No. R-1442; RIN No. 7100 AD 87

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation (the "FDIC")
550 17th Street, N.W.
Washington, D.C. 20429
E-mail: comments@FDIC.gov
Re: FDIC RIN 3064-AD95 and FDIC RIN 3064-AD 96

Via Electronic Mail

Ladies and Gentlemen,

This letter is in response to request for comment on the proposals by The Federal Reserve, the FDIC, and the OCC (together, the "Agencies") to change generally applicable capital standards in the U.S. banking industry, together "the Proposals."[1]

Fifth Third Bancorp is a $117 billion regional bank holding company based in Cincinnati, Ohio, operating primarily through its bank subsidiary, Fifth Third Bank. Fifth Third has over 20,000 employees and over 1,300 banking centers located in communities throughout the Midwest and Southeast. In these communities, Fifth Third provides significant support to our local businesses and the financial goals of over four million families, including over 800,000 mortgage and home equity customers, many of whom would be affected negatively by the introduction of the significant changes contemplated in these Proposals.

The Standardized Approach was developed by U.S. banking regulators for use in the U.S. to risk-weight the assets of non-internationally active banks with less than $250 billion in assets. The Basel III Capital Rule was developed through

[1] Federal Register, Vol. 77, No. 169, August 30, 2012

international agreement, which the U.S. supported, to strengthen capital levels throughout the U.S. and international banking systems. We fully support the application of the comparable capital rules to all domestic banking organizations, including appropriate capital attribution that is more risk-sensitive. We believe such general application to be consistent with:

- Encouraging the safety and soundness of individual institutions through more risk-sensitive measures
- Ensuring that risk-taking among banks of all sizes requires similar capital, thereby avoiding the creation of unwarranted competitive imbalances
- Supporting the safety and soundness of the banking system as a whole, by ensuring that risk-taking is not concentrated in institutions to which the rules do not apply.

Fifth Third participated in the preparation of a joint trade groups comment letter (the "Joint Trades Letter")[2] and a regional bank comment letter (the "Regional Bank Letter"),[3] and supports the positions therein. Rather than summarize the positions in those letters, this letter instead highlights the areas where we have the greatest concerns for impact on Fifth Third and our customers and on the U.S. economy and credit markets.

We believe that the Basel III capital rule, with certain adjustments, is generally appropriate for use in the U.S. Consistent with the position articulated in the Joint Trades Letter and the Regional Bank Letter, we believe that the Standardized Approach should be withdrawn and re-proposed after quantitative impact studies are conducted. These studies would serve to better calibrate the attribution of risk weightings; to ensure the general consistency of Standardized Approach and Advanced Approaches outcomes; and to carefully evaluate the impact on the banking system and U.S. economy, relative to the current generally applicable risk-weighting standards.

Residential Mortgages and Home Equity Loans/Lines of Credit (HELOCs)

Our primary concern with the Proposals is the proposed treatment of residential mortgage and home equity exposures under the Standardized Approach. We would note that two-thirds of the mortgages currently on Fifth Third's balance sheet were originated since the beginning of 2010. These mortgages reflect the effect of tighter underwriting standards and incorporate lessons learned from the experience of the recent housing recession. Our current mortgage holdings have also improved in quality due to the effect of charge-offs and other dispositions of troubled mortgages. In terms of our home equity portfolio, home equity lines of credit originated to prime borrowers (many of them also Fifth Third mortgage borrowers) represent more than 90 percent of our home equity loans; the remaining amounts outstanding being closed-end, home equity loans originated to prime borrowers. Despite these portfolio characteristics, we currently estimate that the Proposals would inflate our mortgage and home equity risk weighted assets by over 65 percent, which would alone represent more than 80 bps (more than $800 million) of additional required capital.[4]

Attribution of Risk to Senior and Junior Liens

The Standardized Approach classifies mortgages into Category 1 and Category 2 mortgages. The attributes chosen in the Standardized Approach to define a Category 2 mortgage do not, in our experience, demonstrate the differential risk that would justify the significant increase in risk weights ascribed to them by the Proposals, and certainly not the

[2] The comment letter in response to the Proposals jointly submitted by the American Bankers Association, the Securities Industry and Financial Markets Association, and The Financial Services Roundtable.

[3] A comment letter in response to the Proposals jointly submitted by a number of regional banking organizations, including Fifth Third.

[4] Our current estimate of the total effect of the Proposals on capital due to an increase in risk weighted assets is approximately 115 basis points, under the Standardized Approach relative to the current Basel I standards. The largest factor other than the treatment of mortgage and home equity loans is the treatment of unfunded commercial loan commitments over one year.

doubling or more of required capital.[5] While we believe this to be true in general, the use of the selected risk attributes are particularly not representative of risk for home equity lines of credit.

- During the recent housing recession, geographic characteristics produced the largest differences in loss experience in Fifth Third's mortgage and home equity portfolios. Geographies which experienced significant home price depreciation, particularly when combined with high unemployment, performed worst. Home price depreciation most directly impacted loans through their loan-to-value, whether the combined loan to value ("CLTV") of a junior lien or the loan to value ("LTV") of a senior lien. We also determined in 2007 that home equity loans originated through third parties were of significantly higher risk and ceased such originations at that time.

- In terms of factors that could be evaluated in advance, the most significant were LTVs (independent of geography), FICO and other similar credit scores, and debt-to-income (and the quality of the underwriting process with respect to determination of income). We also know that loans made to finance residential land or residential investment property are inherently more risky than other mortgages. We applied (and continue to apply) stricter underwriting standards and pricing to those types of loans.

- We have a relatively modest amount of first mortgages that would be categorized as Category 2 mortgages (without considering the effect of junior liens on them, discussed below). These are primarily traditional hybrid ARMs with interest rate caps different than prescribed in the proposals and mortgages that we have modified to make them more sustainable for borrowers (e.g., where a change in terms would cause it to change from a Category 1 to Category 2 mortgage, such as the deferral of principal or the extension of its maturity).

    - We believe it is critical that rules do not ascribe unnecessarily punitive treatment to traditional ARM loans. Some borrowers prefer loans with adjustable rates, particularly in more normal rate environments. Banks are better able to hold ARM loans in their portfolios than fixed rate mortgages, due specifically to the fact that the terms of those loans allow their rates to move with market interest rates. Interest rate cap structures that add additional payment protection for borrowers increase interest rate risk for lenders. The Proposals' promotion of a particular cap structure through the application of capital charges does not appear to take into account the overall risk to lenders, including protection against interest rate risk. We have no objection to more punitive treatment for "teaser rate" ARMs, where the initial rate is set meaningfully below the fully indexed rate, but loans with rates that *will move to* market interest rates are very different than those whose rates *may move with* changes in market interest rates.

    - We believe it is critical that capital rules not punish the voluntary, sustainable modification of loans for borrowers. The Proposals exempted HAMP program modifications in recognition of this public interest but not proprietary modifications. Fifth Third initiated a substantial proprietary loan modification program in 2007, well in advance of the introduction of the HAMP program. Our modifications have generally outperformed HAMP modifications serviced on behalf of the GSEs. We believe this is because they are structured for sustainability by taking into account the borrower's ability to service all of his or her indebtedness, not just the mortgage. This aspect of the Standardized Approach would tend to discourage modifications in the industry and run counter to public policy goals, including those supported by the Agencies, which seek to encourage banks to work with distressed borrowers.

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[5] These attributes seem to derive from the Qualified Mortgage standards in the Dodd-Frank Act, which were not set due to the calibration of risk to banks which make such loans. These attributes include whether or not a mortgage or home equity loan has an interest-only period, a balloon maturity, is longer than 30 years, or if interest rates are permitted to adjust more than two percent in the initial year, more than two percent in any year, or more than six percent over the life of the loan. The proposal would also increase risk weights for negative amortization mortgages and mortgages without documented income, which we would not dispute likely involve significant inherent risk.

Impact of Requirement to Combine Junior Liens with Senior Liens for Risk Attribution

We believe the treatment in the Standardized Approach of junior and senior lien loans held by the same lender could have a significant and negative impact on the availability and flow of consumer credit. The Proposals would treat these loans almost as if they were the same loan. The Proposals' assignment of significant incremental risk weightings to senior lien mortgages, due solely to effects from junior lien loans, is not at all consistent with our experience. This treatment would result in significant different capital outcomes for the same risk – whether that is comparing two institutions holding an identical junior lien loan, or whether that is comparing the treatment of junior liens under the Standardized Approach compared with the Advanced Approaches.

- The Proposals would cause an otherwise Category 1 first mortgage to become a Category 2 mortgage – automatically doubling its risk weight or more – if the junior lien were a Category 2 loan.
- The Proposals would also require the lender to apply the CLTV of the junior lien loan to measure the LTV of the senior lien mortgage, even though the CLTV is not the senior lien's LTV, and even though the junior lien is fully subordinated to the senior lien (and would absorb all losses up to its value before the senior lien would incur losses). This circumstance derives from the requirement that senior and junior liens to the same borrower be combined under the Proposals and fails to distinguish between the significant differential risk of senior and junior collateral positions.
- We do not believe the presence of a junior lien meaningfully increases the risk of loss on a senior lien any more than any other debt the borrower carries, such as unsecured credit. We certainly do not believe that senior lien mortgages have been demonstrated to be more risky if the same bank holds the junior lien rather than another bank. In fact, junior lien loans in our own portfolio behind our own first mortgages have performed significantly better than those behind another lender's mortgage. The current proposal would encourage junior lien lending to occur away from the senior lien holder, which we do not believe would be a desirable outcome; it may create incentives for institutions holding both liens to release the junior lien simply to avoid an excessive capital charge.
- The Proposals' treatment of a (typically) small junior lien position extended by the same bank that made the senior lien loan can easily cause the risk weighting attributed to the senior lien to double or triple. When viewed from the perspective of making such a junior lien, the effective risk-weighting ascribed to a junior lien could easily be in the many *hundreds* of percents.[6] In contrast, a junior lien made by a lender behind another bank's first mortgage would receive a risk weight under the Proposals of 100 percent and no more than 200 percent.
- Mortgage customers commonly request home equity lines of credit from the bank that made their first mortgage. While no loans performed particularly well during the crisis, a majority of HELOCs performed reasonably well as shown in a Federal Reserve Bank of New York study published in August 2012.[7] Therefore, we do not understand the punitive treatment of such home equity loans. It may be that the Agencies' Proposals were intended to address "piggyback" junior liens (where a junior lien is originated simultaneously to fund the equity position in the first mortgage). The results of the aforementioned study suggest that piggyback situations present higher risk. We would therefore request that the Agencies only require combination of senior and junior lien loans where the loans are funded simultaneously. We believe that maintaining the proposed treatment of junior liens would seriously inhibit relationships between borrowers and their primary bank and lead to unwarranted disruptions in the provision of credit to residential mortgage and home equity borrowers throughout the industry.

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[6] This is because home equity loans and lines of credit are usually much smaller than the first mortgage in front of them, and the treatment drives significant changes to the risk weighting ascribed to the larger senior lien mortgage (which otherwise would not apply to it based on its inherent characteristics).

[7] *See* Federal Bank of New York Staff Report No. 569.

We support the recommendation in the Joint Trades Letter and the Regional Bank Letter that a Standardized Approach utilize separate sets of risk weights for senior and junior lien mortgages, as was proposed by the Agencies in the 2008 Standardized Framework. This approach would eliminate the issues outlined above. We would also note that these issues would not arise under the Advanced Approaches, where the measurement of risk and capital attribution is derived from probability of default and loss given default for loans based on their own risk. In the Advanced Approaches, the mere presence of a Category 2 attribute would not cause a doubling of the risk weighting for such a loan, nor would the attributes and CLTV of a junior lien dominate the risk weightings ascribed to related senior liens.

Competitive Balance among Banking Organizations Utilizing Different Risk-Weighted Asset Approaches

We believe the final Standardized Approach should apply to all banking organizations in the U.S. to ensure that similar risks require similar capital. We also believe that banks using the Standardized Approach should not suffer disadvantages relative to Advanced Approaches banks, particularly with respect to mortgage lending.

- The Agencies requested comment on the advantages and disadvantages of applying the Standardized Approach to some banking organizations, while allowing other banking organizations to continue to use the generally applicable Basel I approach for the determination of their risk weights.[8] We do not believe this would be at all appropriate. We also do not know how such an approach would comply with the Dodd-Frank Act requirement that all banking organizations be bound by the same generally applicable capital requirements.
  - As proposed, the Standardized Approach would be highly punitive – in its specifics and in the aggregate – to any bank required to use it. We believe the burden of its impact on capital and changes in business practices to avoid these impacts would be significantly more consequential than its impact on data collection and reporting (though this would be burdensome).
  - Applying different risk-weighting approaches to banks of different sizes would punish and competitively disadvantage the institutions to which the proposed Standardized Approach would apply. Institutions that are not required to utilize it would be allowed to hold much lower capital for taking the same risks. It is therefore critical that the Standardized Approach be appropriately calibrated so that it works for, and can be applied to, banks of all sizes.
  - The Standardized Approach would have the greatest impact on residential real estate lending and commercial real estate lending. While these were the areas that most commonly caused banks to fail, the concentrations in those areas were more common among smaller institutions than mid-sized and larger institutions, and virtually all failures were among mortgage-oriented thrifts or commercial banks with less than $10 billion in assets.[9]
  - If, nevertheless, some banks are not required to apply the Standardized Approach, it is all the more critical that the Standardized Approach not cause unwarranted increases in risk weights, and that it include less dramatic changes from the current rules; otherwise, the differential effect of the rules would naturally cause risks to concentrate in banks to which the new rules do not apply.
- It is also important that institutions using the Advanced Approaches and the Standardized Approach have capital requirements that are at least generally consistent for risk weights and that are consistent in terms of capital requirements.
  - The Dodd-Frank Act requires banks subject to the Advanced Approaches to measure their capital ratios under both the Advanced Approaches and the Standardized Approach and use the more conservative of the two

[8] Federal Register, Vol. 77, No. 169, August 30, 2012, 52893-4.

[9] The largest non-thrift to fail had $25 billion in assets (Colonial); the next largest had $11 billion.

methods. The Advanced Approaches may in the aggregate be more conservative for some large banks due to its application to large capital markets businesses (even though their mortgage businesses are also significant in size). The practical result may be that the punitive nature of the Standardized Approach on mortgage and home equity lending would not come to bear on such an institution's mortgage activities.[10] The Standardized Approach as proposed would require traditional banks to make dramatic changes to their mortgage activities to avoid capital charges. We believe a study of outcomes for firms subject to the Advanced Approaches who must compute their risk-weighted assets using both methods would inform an appropriate calibration of the Standardized Approach. This study and calibration would also help ensure that the nature of the Standardized Approach does not create competitive imbalances in the mortgage business, which is so important to virtually all banks and to the U.S. economy.

- The Proposals included minimum capital requirements that would apply to all banking organizations. These requirements also include minimum ratios supplemented by capital conservation buffers. The buffered minimums (e.g., 7 percent for the Tier 1 common ratio) would effectively serve as the minimum capital requirements. The Agencies have noted that firms subject to the Advanced Approaches should compute their risk-weighted assets, to the extent allowed by the Dodd-Frank Act, in a manner similar to their international competitors.[11] The same concern should apply when considering all U.S. banks as *domestic* competitors. We would not object to the use of the Advanced Approaches for computing capital conservation buffer requirements, provided that the Standardized Approach produces risk weighted assets for similar risk that is generally consistent with the Advanced Approaches. Based on industry disclosures to date from Advanced Approaches banks and Standardized Approach banks, we believe that this is unlikely to be the case based on the current Proposals.

- There are no domestic competitive balance issues involved with firms using the Advanced Approaches method to compute any required countercyclical capital buffers or G-SIB buffers, and we would have no objection to that approach.

Treatment of Unrealized Gains and Losses

We support the comments included in Joint Trades Letter and Regional Bank Letter with respect to maintaining the existing treatment of unrealized gains and losses on investment securities (i.e., excluding both gains and losses from regulatory capital computations).

- Fifth Third's current pro forma Basel III capital ratio estimates actually benefit by approximately 45 basis points due to the proposed inclusion of these gains and losses in capital. We do not believe that these should be included in capital despite the fact that we benefit from their inclusion.

- Our securities portfolio represents just 17 percent of our assets and is managed in the context of the overall interest rate risk position of our entire balance sheet, most of which does not result in changes in value recorded in shareholders' equity due to changes in interest rates.

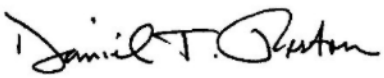
[10] This non-intuitive outcome is not due to a flaw in the Advanced Approaches but the combination of the methods and risk weights proposed for the Standardized Approach. A number of large Advanced Approaches institutions have large capital markets activities relative to their traditional activities such as mortgages. Section 171 applies to Advanced Approaches institutions at the enterprise level, rather than the business level. For traditional banks, the impact of the Standardized Approach's assignment of high risk weights to certain mortgage / home equity loans would be unavoidable for them except by ceasing the activity and/or divesting affected loans.

[11] Federal Register, Vol. 77, No. 169, August 30, 2012, 52804.

- In any event, we believe that capital rules should not be changed with respect to the inclusion of unrealized gains and losses, at least until the Liquidity Coverage Ratio proposal is finalized. The interactions of that proposal and the effects of a given proposed treatment of these unrealized gains and losses in capital should first be studied to ensure that they do not interact in a way that creates more risks than are protected against.

We appreciate the opportunity to comment on the Proposals and recognize the difficult task the Agencies face in developing new capital standards for the entire industry. We believe that taking the time to study the impact of the Proposals, and to work with the industry to calibrate generally applicable standards to risk, will create a stronger banking system and a stronger economy, and help maintain competitive balance domestically and internationally for U.S. banking institutions. Thank you for your consideration in this matter.

Sincerely,



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