Susan D. Stanley
First Vice President
Corporate Secretary

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people's bank

People's Bank
Bridgeport Center, 850 Main Street
Bridgeport, Connecticut 06604-4913

203 338 3316 Fax 203 338 3665

January 17, 2006

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

Re. Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications 70 FR 61068 (October 20, 2005)

Dear Mr. Feldman:

People's Bank ("People's") appreciates this opportunity to comment on the joint advance notice of proposed rulemaking ("ANPR") concerning possible revisions to the risk-based capital framework for depository institutions in the United States ("Basel I"). People's is a $10.8 billion FDIC-insured, state-charted savings bank, headquartered in Bridgeport, Connecticut and would expect to be subject to any revisions to Basel I that are ultimately adopted by the agencies.

General

As a general matter, People's concurs with the approach being considered by the agencies to provide more risk-sensitive measures for certain categories of exposures, while limiting the potential burden and costs associated with introducing more complexity into the process. We also agree with the agencies' concern that unless revisions are made, banks that remain subject to Basel I will be placed at a significant competitive disadvantage in the event that the revised Basel Capital Accord developed by the Basel Committee on Banking Supervision at the Bank for International Settlements ("Basel II") is implemented.

Given the considerable diversity among financial institutions in the United States, (not only in terms of size, but also in terms of charter, powers and activities), any risk-based capital scheme that is developed here must provide flexibility and choice, consistent with safety and soundness. Small, medium and large institutions should be able to choose capital measures that are appropriate for their size and the complexity of their operations. The institutions themselves are in the best position to judge whether the benefits associated with more flexible capital measures justify the additional regulatory burden and we believe that the choice of whether to adopt more

risk sensitive measures or to stay with the Basel I approach should be left solely to the discretion of the bank, and not be dictated based on asset size or any other factor.

Moreover, we strongly support an approach that would allow financial institutions to elect to apply a more risk-sensitive standard to some categories of exposures, while retaining the Basel I approach for others.

Finally, although it is critical that Basel I be revised to permit more risk sensitivity if Basel II is finalized, we believe that it is desirable to improve risk sensitivity even if implementation of Basel II is delayed. Accordingly, the agencies should consider implementing revisions to Basel I regardless of what happens to Basel II.

Our comments concerning specific aspects of the ANPR follow:

Use of External Credit Ratings

The agencies are considering allowing financial institutions to assign risk weights to an expanded universe of exposures, based on external credit ratings provided by recognized rating agencies. These risk weights would range from 20 percent for very highly rated exposures, to 350% for exposures that are two or more categories below investment grade.

While external credit ratings certainly provide a general indication of the likelihood of default, the underwriting and loan approval process is a far more accurate tool for evaluating the risk associated with a specific commercial loan. Given the agencies' goal to create a system that measures risk more precisely, we believe that it would be a step in the wrong direction to use a general measure of risk to assign risk weightings to commercial loans when a more exact measure (viz. the underwriting process) is available.

Moreover, the agencies have not cited evidence to suggest that non-investment grade borrowers present a significantly higher risk than unrated borrowers, yet one group would be assigned double the capital risk than the other. Because the proposed use of external ratings would not provide greater precision with respect to assessment of risk, and could result in disparate capital treatment for similarly situated borrowers (because the capital rules for unrated borrowers would remain unchanged) we recommend retaining the risk weighting for all commercial loans, regardless of the borrowers' external credit rating, at 100%.

External credit ratings can, however, play a valuable role in an enhanced risk-based system. For example, external ratings could certainly be used to risk-weight an investment portfolio. Similarly, we would support recognition of the external debt ratings of guarantors and collateralized exposures. We suggest that this recognition be extended to exposures secured by commercial properties when such properties have tenants whose debt securities carry an external rating that is at least investment grade.

1-4 Family Residential Mortgages: First and Second Liens

We strongly support the agencies' proposal to move away from a "one size fits all" approach to residential mortgage loans, and we believe that loan-to-value ratios outlined in the ANPR provide an appropriate measure for determining risk weights.

LTV ratios provide a strong indication of risk, are readily available and can be updated with relative ease. To determine the ratio, the numerator should be based on the net principal balance of the loan, while the denominator should be the appraised value of the property at the time of origination. We do not believe it would be either practical or cost effective to require banks to update information concerning collateral value.

Although LTV ratios are the most significant indicator of risk for residential mortgage loans, we believe it would be appropriate to permit (but not require) banks to incorporate a capacity measure in their risk-weighting process. Although it would be impracticable for bank to obtain accurate updated debt-to-income information for existing mortgage loans, credit scores are readily available and provide a good measure of borrower capacity. We believe that credit scores could appropriately be used in a revised risk-weight process for residential mortgage loans.

Given that relatively little principal amortization occurs during the early years of a 30 year residential mortgage loan, we do not believe that it is necessary to impose an additional capital charge to interest-only loans. For example, at the end of three years, the principal balance of a 30 year $100,000 loan will still be approximately $96,000, hardly a significantly lower risk than a non-amortizing loan. Even at the end of ten years, the principal balance of an amortizing loan would be reduced by less than 20%. Given the low level of amortization associated with standard loans during their early years, we believe that the agencies should consider imposing additional risk weights only for non-amortizing loans whose duration exceeds 10 years.

Negative amortization loans and loans whose LTV exceeds 100% do present greater risk than standard mortgage loans, however, and we believe that it would be appropriate to impose an additional capital charge on these types of transactions.

The proposal would require lenders holding both a first and a second lien to combine the loans for purposes of determining the LTV and thus the risk-weight. We believe that financial institutions should be permitted to calculate the LTV of the first and second lien separately, in order to more accurately reflect the true level of risk associated with each loan. We also believe that the LTV, not the lien type, should be the determining factor in determining risk weight and that as a result capital treatment should not differ based on whether the loan is a first or second lien.

Multifamily Residential Mortgage Loans

We support an approach which assigns lower risk weights to multi-family residential loans that have favorable features, such as strong performance history or low loan-to-value ratios, but we do not believe this will have a significant impact on the availability of credit in this area.

Other Retail Exposures

We believe that credit scores are an appropriate risk-sensitivity measure for retail exposures and we would support a system that adopted this approach. We believe that LTV and collateral values would not be practical or particularly useful for these types of exposures. These loans are often unsecured or are secured by collateral whose value (automobiles and consumer goods, for example) typically declines over time, rendering it less useful as a measure of risk than real estate collateral. The capacity of the borrower to repay, however, remains an important factor throughout the life of the loan.

Short-Term Commitments

A credit conversion factor of 20% should be applied to all commitments, regardless of term. This will help to avoid the artificial cliff effect that exists under the current rules. We support a zero conversion factor for loans that are unconditionally cancelable at any time or that effectively provide for automatic cancellation.

Loans 90 Days or More Past Due

It is unnecessary to impose an additional capital charge for loans 90 days or more past due. Financial institutions are already obligated to establish and maintain sufficient reserves for non-performing loans. The reserve process takes into consideration factors that may mitigate risk, such as the value of collateral, guarantees and LTV ratios and reserves are regularly reviewed and updated. Because of its greater precision, the reserve process is far superior tool for measuring risk associated with past due loans than is an automatic additional risk weight.

Commercial Real Estate Exposures

Because community and regional banks compete directly with large banks for commercial real estate loans, any revisions to the risk-based capital treatment of these loans should be as consistent as possible with Basel II requirements, in order to avoid putting smaller banks at a competitive disadvantage. We would support the provision of lower risk weights for commercial real estate loans that conform to certain conditions, such as shorter loan term and the presence of significant borrower equity.

Small Business Loans

We support a reduced risk weight for small business loans that meet certain conditions; however we recommend that the definition of such loans conform to the OTS definition: loans under $ 2 million on a consolidated basis to a single borrower. As with other aspects of the ANPR, we believe that financial institutions should be permitted to elect whether to collect and report the data necessary to support the reduce risk weight for small business loans or to continue to operate under existing Basel I rules.

Leverage Ratio

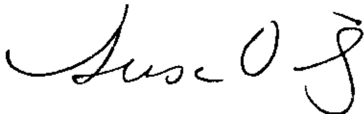
We concur with the agencies' proposal to maintain a minimum leverage ratio requirement for both Basel I and Basel II banks. A capital floor provides a critical safety net for the banking industry and should be maintained for all institutions, regardless of the sophistication of their risk-modeling systems.

Other

Given the agencies' laudable goal of promoting greater internal risk management activities for institutions of all sizes, we suggest that the agencies consider establish a simplified risk-modeling system for use by Basel I banks. Such a system would be particularly beneficial for those categories of assets, such as commercial loans, where Basel I banks compete directly with Basel II institutions and where even the more risk-sensitive measures suggested under this ANPR would not be enough to place both types of institutions on an equal competitive footing. Similarly, we suggest that the agencies consider providing an incentive for Basel I institutions to implement more comprehensive operational risk management programs by providing capital recognition for such programs.

Thank you for the opportunity to comment on this important issue. Please do not hesitate to contact me if you have any questions concerning the matters discussed in this letter.

Very truly yours,



Susan D. Stanley

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