Commerce Bank

Post Office Box 419248
Kansas City, Missouri 64141-6248
(816) 234-2000

March 26, 2007

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
ATTN: Docket No. 06-15

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
ATTN: Docket No. R-1238

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

RE: NPR for Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications

Ladies and Gentlemen:

We appreciate the opportunity to comment on the NPR, commonly referred to by banking industry participants as Basel 1A. This letter responds to the Agencies' request for broad comment on possible modifications to the proposed risk-based capital standards.

Our bank has participated with The Risk Management Association ("RMA") and a significant number of large and midsize banks in the development of a response to the Agencies that shares our concerns and offers recommendations for your consideration.

We would offer three themes for comment that are also highlighted in the RMA response on behalf of its member banks.

> **Standardized Option in the 2004 Framework is Superior to 1A Proposal:** Middle market and small business loans make up the vast majority of loan portfolios at Midsize regional and community banks, like ours. The 1A proposal includes a risk weight of 200 percent for unrated credits, while the Standardized Option risk weights these credits at 100 percent. Risk weighting these credits at 200 percent would greatly disadvantage Midsize regional and community banks.
>
> The 1A proposal to allow the use of external credit ratings issued by a NRSRO to assign risk weights to direct loans, loans collateralized by obligations of rated issuers, or loans guaranteed by rated issuers provides virtually no relief or benefit to Midsize regional and community banks whose portfolios are overwhelmingly made up of unrated middle market

3250

and small business loans. The agencies even noted in the release of December 26, 2006, published in the Federal Register, that "the agencies acknowledge that expanding the use of external ratings may have little effect on the risk-based capital requirements for existing loan portfolios at most banking organizations."

2004 Basel II Framework is Superior to U.S. Proposals for AIRB and 1A: The RMA response points out that "the 2004 International Framework provides a range of options for determining credit and operational risk so that banks, subject to the approval of their primary supervisor, can adapt an approach appropriate to their risk profile and the markets in which they operate." RMA goes on to say that the Framework was designed as a "forward looking approach" that was intended to have the "capacity to evolve with time." The Basel 1A proposal offers no such benefit or opportunity for Midsize regional and community banks.

Most Midsize regional banks, like our own, have been working, with regulatory oversight over the past 10 to 20 years, toward the development of internal risk rating systems for loans within the portfolios that have substantial similarities. The regulatory agencies have continued to encourage all banks to develop and use internal risk rating systems, and many of the features that we have adapted, like a credit facility dimension that assesses "loss given default" on our more problematic credits, have been at the urging of our principal regulator.

It is unlikely that the measurement and calibration of the accuracy of these systems will measure up to the expectations that are being associated with Basel II AIRB expectations. Nevertheless, the performance of the portfolios of banks that have developed and employed these internal risk rating systems over that timeframe have performed most favorably.

The choices that might be available under the Foundation Option in the 2004 Basel II Framework would provide the opportunity for regulators, at their sole discretion, to recognize the advances that Midsize regional and community banks are making with their credit risk management tools.

Competitive Equality and Inequality: (From our letter of January 16, 2006) The argument has been made that by allowing and/or requiring the 10 to 20 largest U.S. banks to employ AIRB methodologies, consistent with what will be required of foreign banks, all of whom compete on an international basis, it will level the playing field in terms of the determination of required capital levels. It will have the effect of allowing these banks to price their credit and non-credit products competitively based on similar levels of risk and capital requirements.

By allowing the largest of U.S. banks to employ AIRB methodologies and compete more effectively with foreign banks on matters of capital and returns on capital, there will be an adverse impact on the competitive environment between these very largest banks and smaller Midsize regional and community banks. This will be particularly true for publicly traded large and Midsize regional banking companies, like our own bank.

The protection of a strong domestic competitive environment should be of greater concern and a higher priority for our U.S. banking regulators than the competitive environment of our very largest banking institutions in the international markets.

Conclusion: With these factors considered, we strongly solicit your consideration for the full implementation of the 2004 Framework as advocated in the RMA response on behalf of the largest majority of its members and the banking industry as a whole. The response points out that while "institutions may choose to adapt one of the three options included in the 2004 International Framework, these firms must receive regulatory approval to do so."

Allowing the banks to adapt options from the entire 2004 Framework will provide the opportunity to recognize the achievements that have been gained with the encouragement and in-bank supervision of our regulatory agencies in the management of risk. It will encourage further development of risk management systems for this vast majority of U.S. banks in the future.

Yours very truly,

Robert C. Matthews, Jr.
Chief Credit Officer
Executive Vice President

cc: David W. Kemper
Bayard Clark
J. Daniel Stinnett