

Massachusetts Bankers Association

March 26, 2007

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

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

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
Attention: No. 2006-49
1700 G Street, NW
Washington, DC 20552

To Whom It May Concern:

On behalf of our 205 commercial, savings, cooperative, and savings and loan members throughout Massachusetts and New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the banking regulatory Agencies' joint Notice of Proposed Rulemaking (NPR) on proposed changes to the risk-based capital framework for depository institutions in the United States. We commend the Agencies for continuing the process of developing risk-based capital requirements for those institutions that are not required to adopt the Basel II framework. We also appreciate the work that was done in the NPR to address many of the concerns raised by MBA and others who commented in response to the Advanced Notice of Proposed Rulemaking (ANPR). We remain concerned, however, that if adopted without changes, the NPR will still leave many community banks at a significant competitive disadvantage compared with Basel II institutions.

We will again focus our comments on areas of particular concern to our member banks. These include: one-to-four family residential mortgage lending; commercial real estate exposures and multi-family residential lending; and debt exposures guaranteed by the government sponsored enterprises, specifically the Federal Home Loan Bank system. We will also provide general comments on a number of other issues raised by the Agencies in the NPR.

Residential Mortgage Lending

As you know, residential mortgage lending is a significant business line for many regional and community banks in Massachusetts and throughout New England. Under the current Basel I capital rules, first lien residential mortgage loans have a 50 percent risk weighting. In the NPR, the Agencies have proposed a system of risk weighting that relies on loan-to-value (LTV) ratios. Under the proposal, residential mortgages would be assigned risk weights from 20 percent to 150 percent.

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MBA supports the use of LTV to determine risk-weights, however we believe the proposed risk weight categories should be expanded to include a zero percent risk weight for those loans with LTVs of less than 30 percent. These are extremely low-risk loans, and we do not believe they should be subject to the same capital charge as loans with LTVs up to 60 percent.

We are still concerned that some residential mortgage loans, particularly those with LTVs greater than 90 percent, will increase substantially. Significant increases in these risk weightings may reduce the ability of our member banks to make loans available to first-time homebuyers and other borrowers with limited down payment resources. As community banks face increased competition for low- and moderate-income homebuyers from non-regulated lenders that have no Community Reinvestment Act (CRA) obligations, requiring banks to hold additional capital for these loans will only force some banks out of the market. Many homebuyers in underserved areas may then be forced to obtain higher cost, riskier loans from unregulated lenders.

As we noted in our comment letter on the ANPR, while we support the use of LTV ratios in determining risk-weightings, we also support the Agencies allowing, but not mandating, institutions to periodically update LTVs to better reflect the risk of their portfolios. However, we believe that the LTV ratios must be based on the appraised value of the property at the time of closing, not the purchase price. Many external factors determine purchase price and appraisals provide banks with a home value that is commensurate with similar properties in the area.

Private Mortgage Insurance

We agree with the NPR that institutions should be able to use loan-level private mortgage insurance (PMI) to reduce LTV ratios. However, we disagree with the Agencies' position that pool-level PMI cannot be used to reduce LTV. We believe that pool-level PMI provides important risk-mitigation features and demonstrates an institution's pro-active approach to risk management. We encourage the Agencies to allow some LTV reduction for loans covered with pool-level PMI.

Junior Liens

We remain concerned that the NPR requires institutions holding both the first lien and any junior lien to assign the loans a risk-weight based on the combined LTVs. This will result in substantial capital increases in many cases and could discourage banks from offering second lien products to borrowers where the institution holds the first lien. This reduces customer choice and could force borrowers to obtain loan products from lenders with less stringent underwriting and credit assessments.

The Agencies also propose increasing the risk-weighting for stand-alone second liens or home equity lines of credit (HELOCs). Under the proposal, in cases where the LTV of the combined loans is less than 90 percent, the risk weighting would be 100 percent. In cases where the LTV exceeds 90 percent, the Agencies propose increasing the risk-weighting to greater than 100 percent. As we stated in our previous comment letter, we are extremely concerned with any approach that increases risk-weights beyond 100 percent since this is not proportional to the risk of these products. Higher risk-weights for these loans

only put community banks at a competitive disadvantage with Basel II institution and unregulated mortgage lenders.

Commercial Real Estate & Multi-family Residential

While we understand the Agencies remain concerned with commercial real estate exposures, we are disappointed that revisions to the current treatment of certain asset categories, such as multi-family residential lending, were not included in the NPR. We believe these loans should be stratified according to risk using LTV ratios and other credit indicators.

As you may know, many of our member banks provide financing to multi-family housing developments. We believe that proactive risk management procedures, along with prudent underwriting, should be able to reduce the capital charge for these loans. We suggest using LTV ratios, similar to the treatment of one-to-four family residential mortgage loans, to determine the risk weighting for multi-family properties.

We are also concerned that the Agencies have not proposed a more risk-sensitive method of addressing capital requirements for commercial real estate exposures. As we stated in our previous comment letter, commercial real estate lending is one area where many community banks compete directly with large, Basel II institutions. Discouraging prudent commercial real estate lending because institutions are unable to adequately align their capital with the risk of their portfolios could greatly reduce the availability of credit in the marketplace.

Government-Sponsored Enterprises

Under the current Basel I capital framework, debt exposures issued or guaranteed by the government-sponsored enterprises (GSEs) are assigned a 20 percent risk weight. The Agencies are seeking comments on whether ratings from nationally recognized statistical rating organizations (NRSROs) should be used to more accurately determine the risk weight of GSE debt.

MBA is strongly opposed to the use of NRSRO ratings to risk-weight GSE debt. As you know, debt issued by the Federal Home Loan Bank (FHLBank) system is unrated, while debt issued by Fannie Mae and Freddie Mac is rated. FHLBank advances are an important funding source for many community banks that may not have access to Fannie Mae and Freddie Mac financing. We are extremely concerned that any system that does not recognize the unique system of guarantees for FHLBank debt will be particularly detrimental to community banks. We urge the Agencies to retain the current treatment of GSE debt.

Other Issues

The Agencies have requested comments on whether non-Basel II institutions should be able to choose to adopt the Basel IA framework or remain under the current Basel I capital regime. We support the ability of institutions to opt-in based on portfolio, business lines, and asset size. We oppose any arbitrary conditions or requirements on institutions opting-in to the Basel IA framework. However, we remain

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concerned that a trifurcated capital system should be carefully considered by the Agencies to ensure that it not present problems for US institutions in the future.

Once again, we commend the Agencies for issuing the NPR and working to develop a risk-based capital system for non-Basel II banks. Any Basel IA system must maintain the competitive balance between Basel II institutions and other banks, and we believe the current proposal falls short in several areas. While we understand the need to move forward with the Basel process, we strongly believe that the Basel IA proposal must be refined to better reflect the risk at community and regional banks.

Thank you again for the opportunity to comment on the proposal. If you have any questions or need additional information, please contact me at (617) 523-7595 or via email at [jskarin@massbankers.org](mailto:jskar@massbankers.org).

Sincerely,

A handwritten signature in black ink, appearing to read "Jon K. Skarin". The signature is fluid and cursive, with a long horizontal stroke at the end.

Jon K. Skarin
Director, Federal Regulatory & Legislative Policy

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