First Citizens Bank

Edward L. Willingham, IV
President

October 18, 2012

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

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

Re: Basel III Capital Proposals

Madam and Sir:

Thank you for the opportunity to provide comment on the Basel III proposals (the "Proposals")[1] that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively, the "Banking Agencies").

We are a North Carolina-chartered, non-member, commercial bank, with assets in excess of \$21Billion. Headquartered in Raleigh, North Carolina, we serve the financial needs of customers in 17 states and the District of Columbia. Our conservative philosophy and practices allowed us to weather the recent economic turmoil, and in fact positioned us to acquire the assets of six failed institutions through FDIC-assisted transactions.

We recognize the need for reforms in certain areas of our industry and applaud the Banking Agencies for their continuing efforts to foster and preserve safety and soundness. While we generally support the Proposals, as explained below, we do not agree with those concerning the treatment of unrealized gains/losses in available for sale ("AFS") securities or the risk-weighting of residential mortgages.

AFS Securities

The Proposals would require that regulatory capital calculations capture changes in fair market value of AFS securities. We understand this proposed treatment to be an effort to accelerate

[1] The Proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements* and *Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

recognition of potential credit-related losses or, jointly or alternatively, to capture interest rate risk in regulatory capital. We believe that the proposed treatment serves neither goal, but rather would result in unwarranted negative impacts to both regulatory capital and interest rate risk management practices.

As to potential credit-related losses, the proposed treatment misses the mark. The majority of securities held in U.S. banks' securities portfolios are instruments of the U.S. government and its agencies and government sponsored entities; the market values of those securities reflect current interest rates, not credit spreads. Capital recognition of fair market value of those securities would therefore capture temporary changes in interest rates, not credit impairments.[2]

As to capturing interest rate risks, the proposed treatment would be incomplete and, we submit, largely ineffective in achieving that goal—the small benefit received would not justify the resulting negative impacts to current risk management practices or to regulatory capital. U.S. banks on average hold 23% of their assets in securities portfolios; the proposed treatment would therefore miss over 75% of assets which may generate interest rate risks. Given U.S. banks' enterprise-based management of interest rate risks, the benefits obtained could not offset the disruption to sound risk management practices.

Regardless of the objective, the impacts on regulatory capital will be driven by interest rates. While rates have been held low over the past 4 years, the proposed treatment creates a substantial risk of artificial volatility in capital ratios once rates return to normal. To counter that potential volatility, banks may, inter alia, shorten the duration of investment portfolios at the expense of earnings and long-term capital formation; expand held-to-maturity portfolios, impacting balance sheet flexibility and interest rate risk management; and/or substitute credit risk for duration risk to maintain yields. It is further likely that the proposed treatment will drive banks to reduce lending, requiring that they hold capital to counter realized or potential volatility.

Residential Mortgages

While the Proposals impact several aspects of residential mortgage lending, our concerns focus on the proposed risk-weighting methodologies, specifically the methodologies' reliance upon a single aspect or limited aspects of a credit profile in determining risk-weighting. As proposed, a single factor, such as a high loan-to-value ratio ("LTV"), can require that a loan with an outstanding overall credit profile be relegated to Category 2 and a geometrically higher risk-weighting. Using our example, a loan with a high LTV but whose borrower has a very low debt-to-income ratio and/or very high net worth must be downgraded to a Category 2. Conversely, a loan with a low LTV but a high debt-to-income may be weighted as a Category 1. A risk-weighting methodology should be developed that adopts a broader, if not complete, analysis of credit profiles and which cannot be subordinated by a single factor.

[2] Moreover, we anticipate that the Financial Accounting Standards Board's and the International Accounting Standards Board's joint development of a loss-recognition approach for other-than-temporary impairment of securities and loans will address this issue for both U.S. and foreign banks.

Additionally, any changes to methodologies and risk-weighting should be prospective, only applicable to loans originated on or after January 1, 2013. Retroactive application could result in a decline of the fair market value of existing residential mortgages and a corresponding devaluation of those portfolios. A failure to grandfather existing loans will inevitably force banks to hold additional capital to offset the new risk-weighting mandates or sell the affected loans.

We appreciate the Banking Agencies efforts on behalf of the industry and the public. While we have questions regarding other elements of the Proposals, we are compelled to voice our concerns on these two.

Again, thank you for this opportunity. Please contact the undersigned if you have any questions regarding these issues.

Sincerely,

Edward L. Willingham, IV
President

cc: Ken Black, Chief Financial Officer
Barry P. Harris, IV, Chief Legal Officer