COLONIAL
SAVINGS

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PRESIDENT

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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
(R 7100, RIN AD87)

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
(RIN 1557-AD46)

Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429
(RINs 3064-AD95, 3064-AD96, and 3064-AD 97)

Re: Regulatory Capital Rules under Basel III

To Whom It May Concern:

Colonial Savings, FA (Colonial) thanks the Board of Governors of the Federal Reserve System (Fed), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) (collectively the Regulators) for the opportunity to comment on the three proposed regulatory capital rules (the Proposal). Colonial is a privately held, federally chartered thrift institution celebrating its 60th year in business, primarily as a residential mortgage lender and servicer. We operate eight retail deposit branches in the Dallas/Fort Worth, Texas market, and 25 mortgage loan origination offices around the United States. On average we originate approximately $3 Billion in mortgages per year and currently service $18 Billion in first lien residential mortgages for Fannie Mae, Freddie Mac, Ginnie Mae and various other institutional investors. We are one of the very few thrifts in Texas to have survived the banking crisis of the 1980s, and are doing well so far in our effort to survive this most recent financial downturn that began in 2008.

However, the Basel III proposal is the biggest threat to our survival that we've ever encountered. Before delving into our discussion of the most important adverse impact this proposal suggests—treatment of Mortgage Servicing Rights, let me outline our general impressions;

1) The Proposal would create an unlevel playing field for US banks relative to their European counterparts. An example—the risk weights for residential loans under the US proposal range from 35 percent to 200 percent. The European proposal for residential loans caps out at 35 percent. Another example—the European proposal gives lower risk weight credit for mortgages with private mortgage insurance in place. The US proposal does not.

2) The Proposal would adversely affect consumers by creating artificially tight-ER credit conditions and higher costs due to the risk weights assigned to defaulted loans and the higher cost of capital generally.

3) The additional layering of Basel III on top of other new and proposed mortgage related rules will further stifle real estate finance as overlap and apparent conflict between rules will force lenders to take the most conservative implementation path.

4) Arbitrary (and likely inaccurate) risk-weighting would lead to uneconomic decisions concerning assets and liabilities. The prescriptive nature of these risk weights will lead to the unintended consequence of over-valuing low risk weighted assets, while under-valuing arbitrarily assigned high risk weighted assets.

5) The complexity of the Proposal and the concomitant costs and infrastructure required to comply with the proposal will be onerous for relatively small banks like us. It's as though Regulators want to hasten the growth of the "Too Big To Fail" banks (who probably <u>do</u> have the means to deal with these rules), by relegating the rest of us to the category of "Too Small to Comply", thus forcing us out of the market.

   But our most pressing concern is with the Proposal's treatment of Mortgage Servicing Rights (MSRs) The extremely punitive treatment of MSRs under the proposal is an over-reaction to the recent economic crisis, and will very likely drive a large portion of servicing from regulated banks and thrifts to less regulated entities. We have built a successful, well-capitalized business based on a sustainable model of minimizing credit and interest rate risk while establishing long term relationships with homeowners. Ours has never been an "originate to sell" model, but rather an "originate to service" model. We've tried to make sure that the loans we've made were sustainable ones because we planned on having the relationship with the borrower for many years into the future—we knew we'd have to live with our mistakes! The proposed treatment of MSRs—excluding 90 percent of the contributory value of MSRs to the common equity component of Tier 1 Capital, AND THEN risk weighting the remaining 10 percent at the level of 250 percent—will not only severely restrict our ability to grow, but will actually require us to take steps to shrink our successful business. In fact, we may have to shrink our current limited economies of scale to the extent that the business cannot compete. Alternatively, we will have to explore moving our servicing out of the thrift and into a non-bank enterprise. Frankly, we don't understand the public policy benefit of doing either of those.

We believe that the existing regulatory capital treatment of MSRs is appropriate, and the Basel III limits on MSRs should NOT be adopted in the United States.

The proposal, as I have stated, is extremely complex and will require extraordinary resources in order for Colonial to comply. I have not attempted to address the impact that other sections of the proposal would have, choosing instead to address the item most important to us—the treatment of MSRs. But, after our review of the Proposal overall, we believe that the differences between the US version of Basel III and the proposal for the European Commission are so pervasive that US Banks will have a major disadvantage in competing with overseas banks (many of whom we have to compete with here in our backyard). **We firmly believe that you, as the prudential regulators in the US, should**

rescind the entire proposed structure, and after addressing its most problematic elements (such as risk weights and treatment of MSRs) consider re-issuing a Proposal with less prescriptive capital standards.

Again, we appreciate the opportunity to share our comments with you. Should you have any questions or wish to discuss, please let me know.

Yours truly,

J. David Motley, CMB
President

JDM/mlm