FIRST NIAGARA

October 22, 2012

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

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

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

Re: Federal Reserve Notice of Proposed Rulemaking regarding Regulatory Capital: Standardized approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (Docket No. R-1442, RIN 7100-AD87), Office of Comptroller of the Currency Notice of Proposed Rulemaking Regulatory Capital: Standardized approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (Docket ID OCC-2012-0009, RIN 1557-AD46), Federal Deposit Insurance Corporation Notice of Proposed Rulemaking regarding Regulatory Capital: Standardized approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (RIN 3064-AD96)

Ladies and Gentlemen:

First Niagara Financial Group, Inc. and its wholly –owned national bank subsidiary, First Niagara Bank, National Association (collectively referred to herein as "FNFG") appreciates the opportunity to comment on the notice of proposed rulemaking ("NPR") by the Board of Governors of the Federal Reserve System (the "Board"), the Office of the Comptroller of the Currency (the "OCC") and the Federal Deposit Insurance Corporation (the "FDIC" and together with the Board and the OCC, the "Agencies") regarding proposed changes to the Agencies' general risk-based capital requirements for determining risk-weighted assets.

FNFG is a $36 billion multi-faceted bank holding company, headquartered in Buffalo, New York, with a community banking model that provides customers with a full range of products and services. FNFG is a community based lender that focuses on a simple banking business model where we provide funding for small businesses and use local dollars to provide consumers with personal financing for a variety of purposes such as purchasing homes or automobiles. As a community based lender, FNFG competes in its markets with local teams empowered to make lending decisions in their markets, enabling us the ability to deliver a real "community bank" experience. FNFG prides itself on its

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disciplined credit underwriting practices as evidenced by its Best-In-Class asset quality metrics through and after the credit crisis. Given the importance of regulatory capital requirements to the banking industry, FNFG is interested in all aspects of the proposed changes in the NPR regarding the Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements ("Standardized NPR") Regulatory Capital, as well as the recently released NPR Implementation of Basel III, Minimum Regulatory Capital ratios, Capital Adequacy, Transition Provisions and Prompt Correct Action ("Basel III NPR").

FNFG supports the goals and objectives of the Agencies to revise and harmonize the current rules for calculating risk-weighted assets to enhance risk sensitivity and address other perceived weaknesses in the current risk weighting framework used to assign different levels of risk to different classes of assets. While FNFG understands that the Agencies are seeking to increase the risk sensitivity of capital requirements associated with a banking organization's on and off balance sheet exposures, there are a number of issues that need to be addressed prior to implementation of the proposed changes to the current risk weighting framework.

FNFG is a member of the American Bankers Association (ABA). We have worked with the ABA and its member banks to develop a thoughtful and constructive response and we whole-heartedly support the comment letter submitted by the ABA. In this letter, FNFG is commenting/highlighting four specific areas that warrant additional consideration:

1. Implementation should be delayed for smaller institutions, such as FNFG, to afford sufficient time to enhance systems –The burden for smaller institutions is disproportionately higher thus requiring more time.
2. Risk weighting framework for 1-4 family residential mortgage exposures – Consistent with the viewpoint expressed by the ABA, the increased capital is not supported by empirical evidence and is not relative to risk weightings for other assets.
3. Treatment of High Volatility Commercial Real Estate ("HVCRE") – Consistent with the viewpoint expressed by the ABA, the capital treatment needs to be more collateral focused.
4. Treatment of securitization exposures under the Simplified Supervisory Formula Approach ("SSFA") – Consistent with the viewpoint expressed by the ABA, the rules do not encompass all relevant risk measures to assign risk weightings including loss history, structure and appropriate "de-minimis" levels.

FNFG supports the need to better align regulatory requirements with the Basel II standardized approach and understands the intent to increase risk sensitivity of certain assets; however, FNFG believes that a comprehensive deliberation and vetting process related to certain of the concepts proposed in the Standardized NPR is required in order to thoroughly understand the impacts and any unintended circumstances of the changes on banking organizations, the U.S economy and consumers.

1. **We strongly urge the Agencies to delay the implementation timeline requirements in the Standardized NPR for banking organizations with less than $50 billion in consolidated assets ("excepted institutions").**

FNFG understands the need to increase the risk sensitivity of the risk weighting for certain assets and to incorporate aspects of the Basel II standardized framework into the risk weighting framework for U.S. banking organizations. However, there is no requirement in Basel III that it must be applied to all banking organizations on the same timeline.

As proposed, the Standardized NPR imposes extensive burdens on the excepted institutions to implement all changes to their existing balance sheets by January 1, 2015. There are substantial changes proposed to the calculations of risk weighted assets that will require banking organizations to overhaul their internal reporting process, capital management infrastructure, business strategies and product decisions, which will strain the resources of excepted institutions. Larger banks that are internationally active have greater resources to adjust to the proposed changes due to their size and prior efforts related to Basel II and the SCAP or CCAR exercises. Unless the implementation deadline for the requirements is extended for excepted institutions, the requirements will place undue burden on such institutions.

2. **We strongly urge the Agencies to (1) grandfather the current risk weightings for existing 1-4 family mortgage exposures, (2) provide sufficient empirical loss data to set the criteria for designation as Category 1 or Category 2 loans and (3) decrease the proposed risk weightings to be in line on a relative basis to other loan types.**

Given the significance of the changes to risk weightings proposed for 1-4 family mortgage exposures, it is unfair to apply the changes to 1-4 family mortgage exposures on a retrospective basis. Banking organizations should be allowed to react to the changes in risk weightings in their 1-4 family mortgage product decisions and pricing. Accordingly, the current risk weighting framework for all 1-4 family mortgage exposures existing prior to the final rule should be grandfathered. Institutions that require greater levels of capital on their existing assets should be addressed via the supervisory process on an exception basis.

With respect to the risk weighting framework that is proposed for 1-4 family mortgage exposures under the Standardized NPR, it does not appear to be commensurate with the level of risk in certain cases. Although certain types of 1-4 family mortgage exposures were a key driver of the financial crisis, the criteria set forth in the Standardized NPR to designate loans as category 2 loans captures more products than those that were the key drivers of the financial crisis. Given the higher risk weightings that will be applied to category 2 loans, sufficient empirical data needs to be presented supporting each factor that is used to trigger inclusion in category 2. For example, although the criteria used for category 2 appears to be targeting the product types that were key drivers of the financial crisis, such as option ARMs, the criteria broadly captures all interest only and balloon loans as well as many of the traditional residential mortgage ARMs and home equity lines of credit. Consistent with FNFG's historical experience with its portfolio, FNFG does not agree that any variable rate 1-4 family mortgage exposures without caps in place to allow an increase of no more than 200 basis points in 12 months and no more than 600 basis points over the life of the loan represent elevated levels of credit risk compared to category 1 loans. The same is true of FNFG's interest only first lien 1-4 family mortgage exposures. Given the significantly higher levels of risk weightings that are proposed for category 2 loans, it is imperative that the Agencies fully support each criteria triggering category 2 status with sufficient empirical data to justify the elevated level of inherent credit risk.

The risk weighting framework proposed for 1-4 family mortgage exposures represents a significant deviation from the Basel Agreements' standardized approach and places U.S. banking organizations at a competitive disadvantage as it will substantially increase the cost of holding mortgages. In addition to being significantly higher than the risk weightings under the Basel II standardized approach, the maximum risk weighting for 1-4 family mortgage exposures is higher than the risk weightings of any other type of loan including all commercial loans and unsecured loans. While FNFG understands the tiered approach to risk weighting based upon the loan to value ("LTV") ratio associated with the loan, the maximum risk weighting should be capped at no more than 150% based upon the risk weighting proposed for past due loans as well as the maximum risk weights applied to all other types of loan exposures. Additionally, private mortgage insurance ("PMI") should be recognized in the calculation of the LTV as it represents a risk mitigation tool. To recognize the possibility that PMI providers may not be financially sound as evidenced during the financial crisis, the use of a haircut to the amount would protect against the possible insolvency of the PMI providers as opposed to disregarding it in full.

FNFG urges the Agencies to reconsider the criteria that are used to differentiate the higher risk 1-4 family mortgage exposures as well as the range of risk weightings that it determines to reflect the varying levels of risk. The final rule will have a significant impact upon the banking industry, its appetite for extending credit under 1-4 family mortgage products and ultimately the pricing at which the industry will make such funds available to the consumer. While we agree that changes to risk weightings ultimately should be made to help better reflect the inherent credit risk of certain, limited 1-4 family mortgage exposures, it is important to acknowledge that the more significant the change to current risk weighting levels, the more those products will ultimately cost the consumer. In order to adjust to the substantial increase in the cost of holding, banking organizations would need to increase pricing for the majority of all 1-4 family mortgage borrowers and reduce the availability of credit extended to fund such loans.

3. **We strongly urge the Agencies to (1) grandfather the current risk weightings for existing HVCRE exposures, (2) tier the proposed risk weightings based upon risk and (3) clarify the definition of HVCRE.**

The proposed treatment for HVCRE requires data that is not easily accessible and would require manual review of loan files in order to identify whether HVCRE loans meet the criteria to be exempt from the 150 percent risk weighting. Specifically, in order to identify whether or not a borrower has contributed capital in the form of cash or other unencumbered readily marketable assets prior to the advancement of funds and that such capital contribution is contractually required to remain in the project throughout the life of the project is not readily available on systems and requires manual inspection of physical loan documents. In order to alleviate the burden on organizations to manually pull loan data that is not readily available on the loan system for existing HVCRE loans, FNFG asks that the changes to the risk weighting of HVCRE loans are applied on a prospective basis and the current risk weighting framework is grandfathered for all HVCRE loans existing prior to the effective date of the final rule. Through the examinations process, regulators have the ability to require more capital on a case by case basis where necessary.

Similar to 1-4 family mortgage exposures, the value of the underlying real estate or collateral that is securing HVCRE loans is an important factor in the level of risk associated with the loan. As opposed to assigning a risk weighting of 150 percent to all loans that do not meet the outlined criteria, FNFG asks that HVCRE loans that do not meet the criteria are assigned a risk weighting that is tiered based upon the underlying LTV ratio with the maximum risk weighting of 150 percent.

As drafted, the language of the Standardized NPR appears to indicate that any commercial real estate ("CRE") loan that was originated as a construction loan and which subsequently flipped to a permanent loan would qualify as HVCRE. The proposal stipulates that a credit facility that finances or <u>has financed</u> the acquisition, development, or construction of real property." Clarification is needed as to whether it is the intent of the proposal to continue to include CRE loans in HVCRE after they have converted from a construction loan to permanent financing which is not representative of the overall risk profile.

4. **We strongly urge the Agencies to revise the SSFA to (1) utilize empirical loss data to take into account the underlying credit quality of the collateral, (2) consider all aspects of credit enhancement, including soft credit enhancement features built into securitization structures and purchase discounts and (3) narrow the definition of re-securitization exposures to allow for a de-minimis level of re-securitization exposures in a structure.**

To perform the calculation for a securitization exposure under SSFA, a number of inputs is needed including the weighted average total capital requirement of the underlying exposures calculated under the approach stipulated for the asset class in the Standardized NPR, the current amount of delinquencies on the underlying collateral of the securitization, the tranche's credit enhancement (attachment point) and the level at which total principal loss occurs (detachment point). Under the proposal, the approach does not provide for risk sensitivity related to the credit quality of the underlying assets or consider all types of credit enhancement.

Securitizations with low empirical losses generally have lower credit enhancement compared to other securitizations with higher historic losses. The underlying collateral of these securities should start with a lower weighted average total capital than is proposed. As proposed, the undifferentiated treatment of collateral regardless of underlying credit quality in combination with the credit enhancement aspect provides incentive for investors to invest in securitizations with lower credit quality collateral and higher levels of credit enhancement. The weighted average total capital requirement of the underlying exposures using the standardized approach does not take into account underlying asset quality for asset backed securitizations ("ABS"). For example, if a portfolio includes both prime and subprime auto ABS, the weighted average total capital requirement considered in the SSFA formula would be the same for both as there is no distinction in the standardized approach for the risk weightings applied to prime or subprime auto loans. Continuing the example from above, prime auto ABS typically have lower levels of external credit enhancement due to the higher credit quality of the assets. Despite the higher credit quality associated with the underlying assets, they would receive worse treatment for risk weighting purposes under the proposed approach and be assigned higher risk weightings than similar subprime auto ABS with lower credit quality that require higher levels of external credit enhancement. Historic loss data should be utilized to determine the weighted average total capital requirement of the underlying exposures rather than utilizing the standardized approach.

Given the importance of credit enhancement to the level of risk associated with securities, it is important that SSFA take into account all types of credit enhancement. As currently proposed, SSFA does not consider soft credit enhancement features, such as excess spread, that protect the bond holders against principal loss. Each securitization includes excess spread that typically serves as the first protection against losses before subordinated junior bonds in the securitization structure. As such, it is an important credit enhancement feature that should be recognized in the calculation of credit enhancement for SSFA purposes. In addition, SSFA does not consider the protection against principal loss that is provided when securities are purchased at a discounted price (i.e. price below par). In effect, the purchase discount below par acts as a credit support feature and a banking organization does not incur a loss until the loss of the contractual par amount over the life of the security exceeds the amount of discount at purchase. For example, if a bond is purchased at a price of $0.80 and $0.15 in principal is lost over the life the bond, there is no impairment or loss to the banking organization. SSFA should be revised to reflect the credit support provided by a discounted purchase price.

SSFA should be revised to (1) build in further risk sensitivity related to the underlying collateral to ensure that, all else being equal, securities with better credit quality assets in the underlying collateral pool receive lower risk weightings and (2) include all other structural features that absorb credit losses such as excess spread to more fully reflect the related levels of risks associated with securitization exposures. Both adjustments need to be incorporated into the SSFA to ensure that (1) higher credit quality assets are not penalized due to lower levels of credit enhancement built into structures as a result of lower levels of inherent credit risk and (2) risk weightings of securities fully reflect all factors that provide credit enhancement and protection against loss.

The proposed definition of "re-securitization" as any "securitization in which one or more of the underlying exposures is a securitization exposure" appears to be targeting CDO squared securities, but is too broad in its nature. In particular, the definition as drafted would have a significant negative impact on business lending. Typically, collateralized loan obligations ("CLOs") often include a small amount of other CLOs in their underlying securitization exposures. Based upon the definition, these CLOs would be deemed a re-securitization with substantially higher risk weightings, which will reduce a banking organization's appetite to hold the securities in their portfolio. FNFG does not expect that CLOs with a de minimis level of other CLOs in their structure were intended to carry the dramatically higher risk weights called for in the Standardized NPR. Accordingly, FNFG asks that a minimum threshold for the percentage of underlying exposures that are comprised of securitization exposures be implemented in order to qualify as a re-securitization.

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FNFG appreciates your consideration of its comments on the Standardized NPR. Please contact the undersigned at (716) 270-8611 (e-mail: gregory.norwood@fnfg.com) with any questions about FNFG's comments.

Very truly yours,

Gregg W. Norwood

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