Washington Trust Bank
Member FDIC

October 9, 2012

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

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

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Re: Notices of Proposed Regulations Pertaining to the Regulatory Capital Framework

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Notices of Proposed Regulations ("NPRs") related to the implementation of Basel III (*Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *and Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements*. These NPRs were approved and published on June 7, 2012, by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "Banking Agencies").

Washington Trust Bank ("WTB" or the "Bank") is a 110 year old, $4 billion community bank based in Spokane Washington that is regulated by the Federal Deposit Insurance

Corporation and the State of Washington Department of Financial Institutions. Washington Trust Bank is 100 percent owned by W.T.B. Financial Corporation, a financial holding company also headquartered here in Spokane and regulated by the Federal Reserve. We are a broad product line financial institution serving the banking needs of both businesses and consumers. Like all community banks, we pride ourselves in the crucial role we play in meeting the banking services and financial needs of our customers and the contribution we make supporting the economic vitality and development of the communities we serve.

We understand that the financial crisis took a heavy toll on the industry and the FDIC Insurance Fund, and the reverberations are still being felt today across the globe. We are very supportive of a strong and healthy banking system and recognize that the cost of widespread bank failures is borne, in significant part, by those banks that had the financial strength to survive the crisis. For that reason, we think it is appropriate to explore ways to strengthen the industry and ensure its resilience to future economic downturns. While we recognize strengthening the banking industry is the intent of the proposed capital regulations, we believe there is a persuasive case that the implementation of the regulations as proposed will have materially adverse side-effects and public policy implications that require serious reflection.

It is our belief that the complexity, burdens and unintended consequences of the proposed capital regulations will have a lasting and adverse impact on community banks, the customers we serve and the crucial role we play in our nation's economy. The NPRs will significantly complicate and potentially compromise risk management and financial performance industry-wide. Through discussions with many of our peers, our concerns are shared widely and we hope that the comments that follow, which focus on the issues we believe are most troubling, will be considered seriously in your deliberations on the appropriate regulatory response to the financial crisis. We respectively request that the proposals be rethought to ensure they accomplish the dual objectives of strengthening the industry, while avoiding and/or minimizing detrimental unintended consequences.

UNREALIZED GAINS AND LOSSES IN THE NUMERATOR ARE BROADLY PROBLEMATIC:

The most significant aspect of the proposed regulations that we believe has profound implications for the financial management of our bank is the inclusion of Accumulated Other Comprehensive Income, including in particular, unrealized gains and losses from available for sale ("AFS") investment securities, in the numerator of the regulatory capital ratio. This feature of the NPRs will distort traditional measures of capital adequacy, is directionally inconsistent with prudent interest rate risk ("IRR") management, will put Banking Agencies' supervisory responsibilities at odds with financial reality, results in significant regulatory capital ratio volatility, greatly diminishes the utility of the bond portfolio in IRR management, discourages on-balance sheet liquidity, is poorly timed given the current rate environment and will adversely impact the industry's performance and ability to attract capital.

- **Inclusion of AOCI in the Numerator Will Distort Capital Adequacy:** Passing unrealized gains and losses in a bank's investment portfolio through to regulatory capital and the numerator of the regulatory capital ratio distorts, rather than makes more accurate, an institution's capital position and capital adequacy. Conceptually, capital is a financial representation of enterprise value. By passing a valuation adjustment from just one small quadrant of one half of the balance sheet through to capital, the proposed regulation ignores the off-setting valuation adjustments given a change in interest rates from the loan, deposit and borrowing portfolios of the bank. For our bank, the loan, deposit and borrowing portfolios are collectively six times the size of the investment portfolio (loans, deposits and borrowings totaled \$6.5 billion, while the bank's investment portfolio totaled \$1.2 billion at June 30, 2012). By omitting these much more sizable and collectively off-setting components of the balance sheet, the proposed construction of regulatory capital distorts enterprise value. The practical consequence will be that regulatory capital will be either overstated in a falling rate environment, or understated in a rising rate environment. This treatment moves regulatory capital and the regulatory capital ratio farther away from, rather than closer to, a reliable representation of enterprise value and capital adequacy.
- **Directionally Inconsistent with Prudent IRR Management:** As a commercially focused bank, our customer and product mix naturally tend toward an asset sensitive IRR position. As a consequence, we temper our natural balance sheet IRR positioning by having a bond portfolio structured "longer" than our loan portfolio, which reduces our asset sensitivity and the volatility of our earnings. Mitigating IRR is an appropriate goal for both management and the Banking Agencies. Given our "natural" balance sheet positioning, inclusion of unrealized gains and losses from our AFS portfolio in the definition of regulatory capital creates outcomes that are directionally inconsistent with our IRR model and contrary to sound financial logic.
    - Table 1 and Chart 1 below, which were derived from our IRR model, reflect the asset sensitive position of our balance sheet. When rates rise, the model value of our financial assets fall (**\$194 million** given a 300 basis point rate shock), but the value of our financial liabilities fall even more (**\$234 million**), resulting in an increase in enterprise value, represented by the improvement in Economic Value of Equity (**\$40 million**).

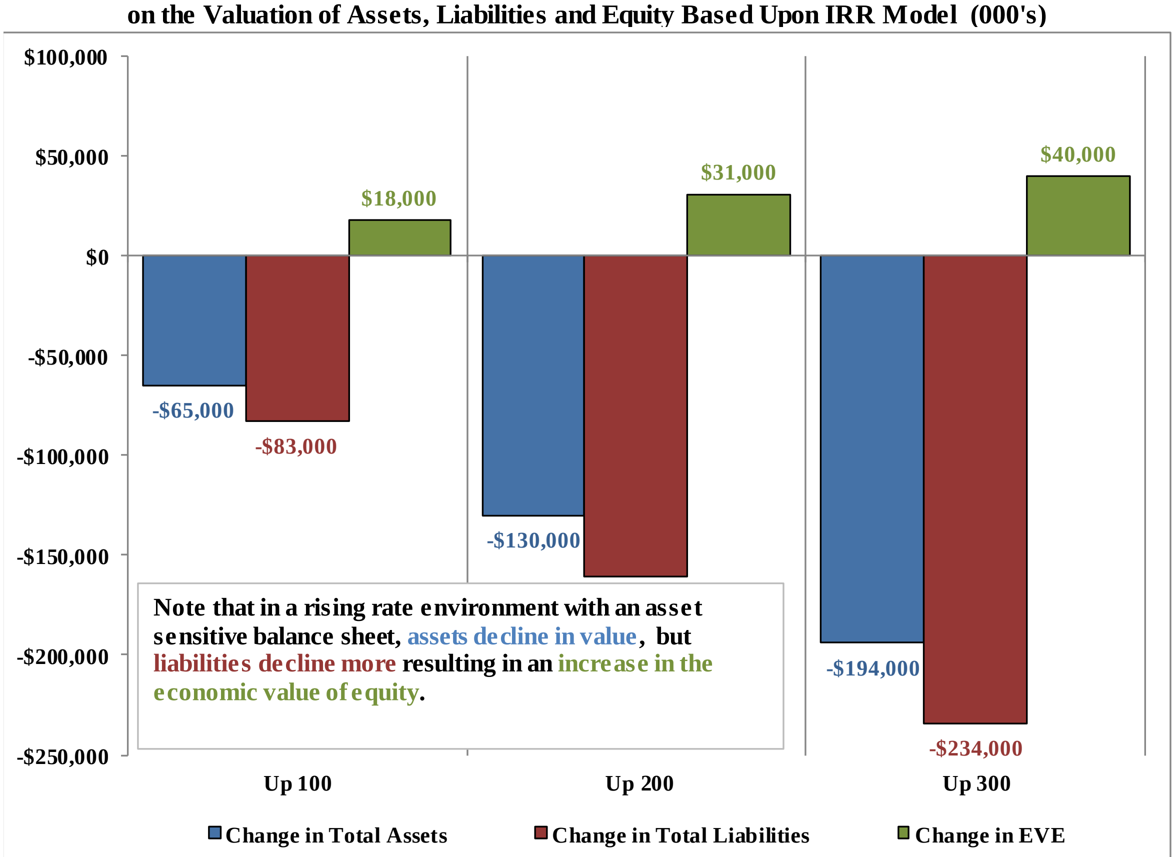
TABLE 1

EVE Changes on Summarized Balance Sheet in Flat and 100 bps Rising Rate Environments
(Based on June 30, 2012 Asset Liability Model Run)
$s in 000s

Balance Sheet Category	Flat	Up 100	Up 200	Up 300
Assets				
Cash and Other Assets	277,000	277,000	277,000	277,000
Investments	1,192,000	1,163,000	1,130,000	1,098,000
Change in Investments	N/A	(29,000)	(62,000)	(94,000)
Loans	2,751,000	2,714,000	2,681,000	2,650,000
Change in Loans	N/A	(37,000)	(70,000)	(101,000)
Total Assets	4,220,000	4,155,000	4,090,000	4,026,000
Change in Total Assets	**N/A**	**(65,000)**	**(130,000)**	**(194,000)**
Total Liabilities	3,463,000	3,380,000	3,302,000	3,229,000
Change in Total Liabilities	**N/A**	**(83,000)**	**(161,000)**	**(234,000)**
Economic Value of Equity (EVE)	757,000	775,000	788,000	797,000
Change in EVE	**N/A**	**18,000**	**31,000**	**40,000**
Total Liabilities and Equity	4,220,000	692,000	627,000	563,000

CHART 1

Comparison of the Impact of a Rising Rate Environment
on the Valuation of Assets, Liabilities and Equity Based Upon IRR Model (000's)



- Table 2 and Chart 2 below show the directional difference between the change in value of investments and EVE given a rise in rates, demonstrating the nonsensical nature of passing bond valuations through to equity while ignoring changing valuations of the rest of the balance sheet. The result will be a capital regulation that signals deterioration, while enterprise value actually improves.

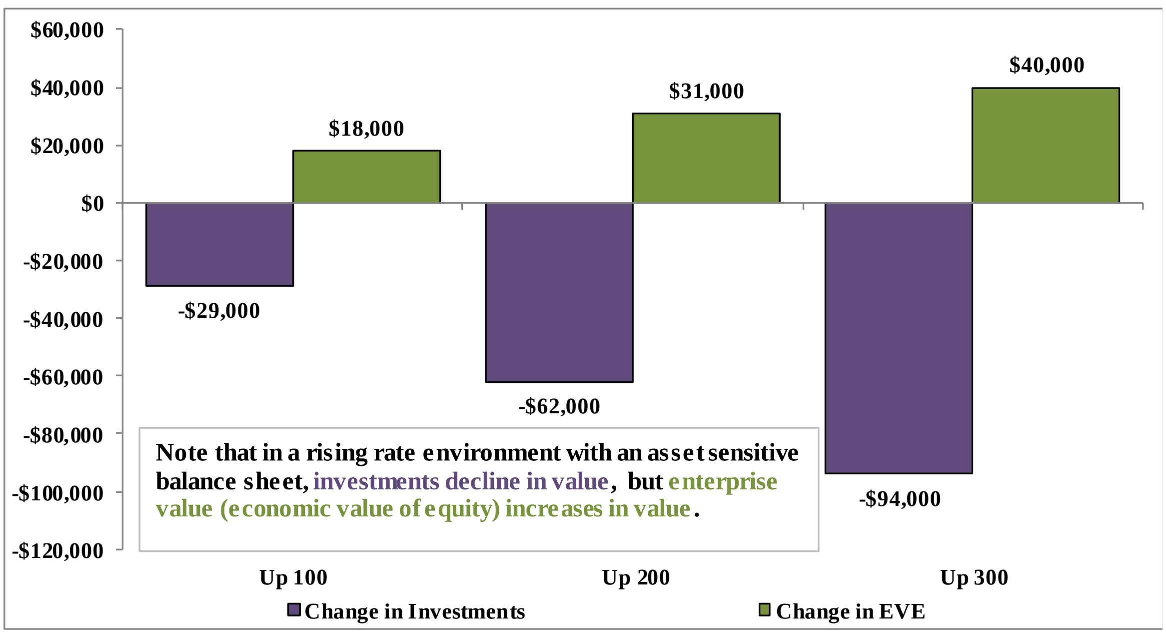
TABLE 2

EVE Changes on Summarized Balance Sheet in Flat and 100 bps Rising Rate Environments
(Based on June 30, 2012 Asset Liability Model Run)
$s in 000s

Balance Sheet Category	Flat	Up 100	Up 200	Up 300
Assets				
Cash and Other Assets	277,000	277,000	277,000	277,000
Investments	1,192,000	1,163,000	1,130,000	1,098,000
Change in Investments	**N/A**	**(29,000)**	**(62,000)**	**(94,000)**
Loans	2,751,000	2,714,000	2,681,000	2,650,000
Change in Loans	N/A	(37,000)	(70,000)	(101,000)
Total Assets	4,220,000	4,155,000	4,090,000	4,026,000
Change in Total Assets	N/A	(65,000)	(130,000)	(194,000)
Total Liabilities	3,463,000	3,380,000	3,302,000	3,229,000
Change in Total Liabilities	N/A	(83,000)	(161,000)	(234,000)
Economic Value of Equity (EVE)	757,000	775,000	788,000	797,000
Change in EVE	**N/A**	**18,000**	**31,000**	**40,000**
Total Liabilities and Equity	4,220,000	692,000	627,000	563,000

CHART 2

Comparison of the Impact of a Rising Rate Environment
on the Valuation of Investments and Equity Based Upon IRR Model (000's)



- Table 3 and Chart 3 below show the directional difference between the change in the value of investments and net interest revenue given a rise in rates, which demonstrates the problem of a regulation that could trigger a deficient capital position, while the same catalyst results in improved financial performance.

TABLE 3

EVE Changes on Summarized Balance Sheet in Flat and 100 bps Rising Rate Environments
(Based on June 30, 2012 Asset Liability Model Run)
$s in 000s

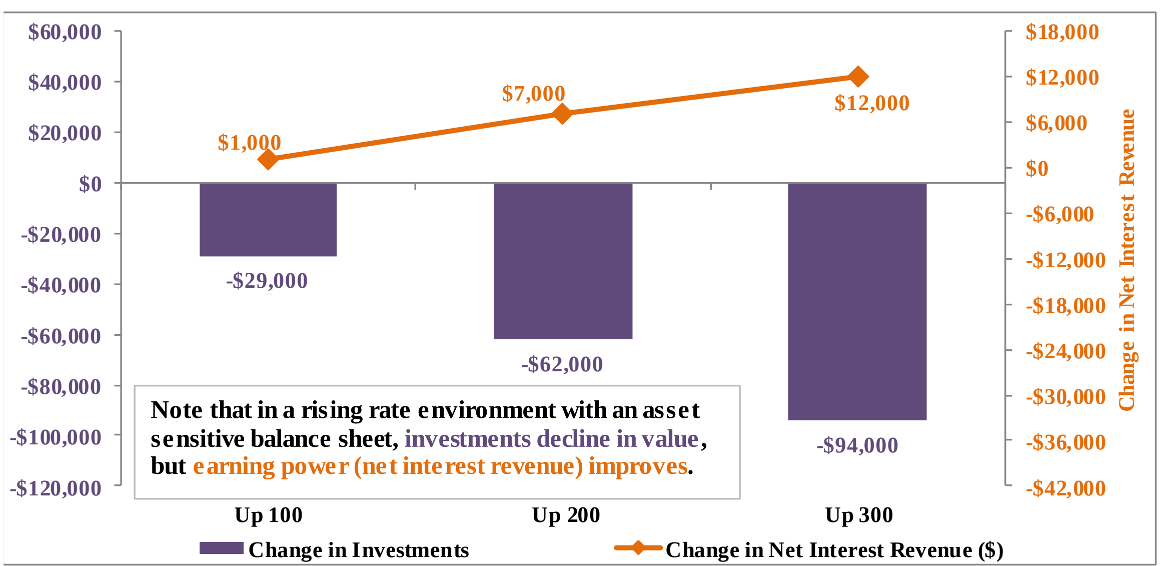
Balance Sheet Category	Flat	Up 100	Up 200	Up 300
Assets				
Cash and Other Assets	277,000	277,000	277,000	277,000
Investments	1,192,000	1,163,000	1,130,000	1,098,000
Change in Investments	**N/A**	**(29,000)**	**(62,000)**	**(94,000)**
Loans	2,751,000	2,714,000	2,681,000	2,650,000
Change in Loans	N/A	(37,000)	(70,000)	(101,000)
Total Assets	4,220,000	4,155,000	4,090,000	4,026,000
Change in Total Assets	N/A	(65,000)	(130,000)	(194,000)
Total Liabilities	3,463,000	3,380,000	3,302,000	3,229,000
Change in Total Liabilities	N/A	(83,000)	(161,000)	(234,000)
Economic Value of Equity (EVE)	757,000	775,000	788,000	797,000
Change in EVE	N/A	18,000	31,000	40,000
Total Liabilities and Equity	4,220,000	692,000	627,000	563,000

Net Interest Revenue Changes in Flat and 100 bps Rising Rate Environments
(Based on June 30, 2012 Asset Liability Model Run)
$s in 000s

Income State Performance	Flat	Up 100	Up 200	Up 300
Projected Net Interest Revenue	138,000	139,000	145,000	150,000
Change in Net Interest Revenue ($)	**NA**	**1,000**	**7,000**	**12,000**

CHART 3

Comparison of the Impact of a Rising Rate Environment
on Valuation of Investments and Net Interest Revenue Based Upon IRR Model (000's)



- **Supervisory Responsibilities will be at Odds with Financial Reality**:
  - As the above analytics demonstrate, a rising rate environment is favorable to our Bank both from an enterprise value and earnings perspective. As is commonly understood, the current low rate environment is challenging for the banking industry since it results in compressed margins, diminished earning power and subpar financial performance. A rising rate environment would benefit the majority of institutions in the banking industry. The problem is that adoption of the proposed regulation, which would result in a significant reduction in the industry's regulatory capital position and regulatory capital ratios in the event of rising rates, would indicate just the opposite. This will put the Banking Agencies in the position of potentially pursuing supervisory and enforcement actions against institutions based upon deteriorating regulatory capital ratios, when their financial health and performance is actually improving, which makes no sense.
  - The other factor complicating the Banking Agencies' supervisory responsibilities is that the decline in value of a bank's bond portfolio, which would be a driver of inadequate regulatory capital and therefore potential regulatory action, will be temporary. As the bonds the institution holds approach maturity, their valuation approaches par, first diminishing and then eliminating altogether the decline in value that was purely a creature of rising rates. With the passage of time, bond valuations would improve and regulatory capital ratios would recover. Therefore, it is quite possible that a regulator will be faced with taking supervisory or enforcement action against an institution for what amounts to a recognized temporary capital adequacy shortfall.
- **Introduces Significant Capital Ratio Volatility:** By passing temporary changes to the valuation of the investment portfolio through to regulatory capital, the proposed regulation creates significant volatility in an institution's regulatory capital ratios. Using a hypothetical $100 million bank (see Table 4 below), even a relatively modestly positioned bond portfolio with a duration of three would subject the bank to 184 basis points of capital ratio volatility from a 300 basis points ("bps") change in rates. Applying this same approach to our balance sheet, our modestly positioned bond portfolio (also with duration of roughly three) would adversely impact our risk based capital ratios by approximately 175 bps. Absent any mitigation strategies, we would need to self-impose a "Bond Portfolio Numerator Volatility Buffer" of up to 175 bps, or more than $65 million, in order to insulate our capital compliance from a 300 bps rise in market interest rates. Assuming an internal target of a 12 percent total risk based capital ratio, that $65 million capital buffer effectively reduces our balance sheet capacity by roughly $550 million, which would otherwise be available for loan and deposit growth.

TABLE 4

HYPOTHETICAL IMPACT OF A 300 bps CHANGE IN RATES ON CAPITAL RATIOS GIVEN PROPOSED INCLUSION OF UNREALIZED GAINS AND LOSSES IN CAPITAL

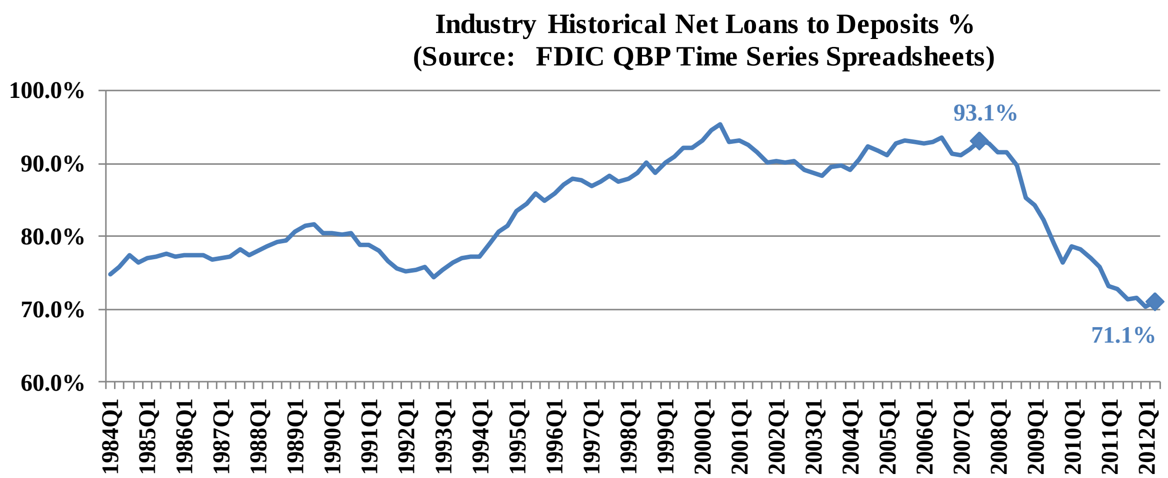
	Balance	Duration	Δ in Rates	Δ in Value	Tax Effect	Balance
Investments	$ 25,000	4	3.00%	$ (3,000)	$ 1,000	$ 23,000
Other Assets	75,000					75,000
Total Assets	$ 100,000					$ 98,000
Liabilities	$ 90,000					$ 90,000
Capital	10,000			$ (3,000)	$ 1,000	$ 8,000
Liabilities and Capital	$ 100,000					$ 98,000
Memo Items:						
Equity to Assets Ratio	**10.00%**					**8.16%**

Decline in capital ratio approximates 184 bps

- **Undermines the Utility of Investments for IRR Management Purposes:**
    - A community bank's investment portfolio is its most important IRR management tool. A bond portfolio is the right tool for IRR management because it is highly liquid, easily understood, can be repositioned relatively easily, contributes to earnings, supports liquidity, can be pledged as collateral for borrowings and is a risk based capital efficient asset class. By introducing an artificial construct that results in significant capital ratio volatility tied to the bond portfolio, bank management will be compelled to diminish the role of investments for IRR management purposes, with wide ranging and adverse consequences in other key risk management areas of the bank.
    - IRR management is currently a point of emphasis by the regulators (and rightly so), which makes it illogical and counter-productive to take out of the hand of bank management the singularly most important tool available to mitigate the "natural" risk profile of the core components of the balance sheet (loans and deposits). We strongly recommend that the proposed regulation be revised to strike this harmful mechanism.
- **Discourages On-Balance Sheet Liquidity:** The proposed capital regulation will likely have the impact of discouraging on-balance sheet liquidity across the industry. The regulation effectively imposes a "penalty" (through increased capital ratio volatility and a de facto Bond Portfolio Numerator Volatility Buffer) for holding more on-balance sheet liquidity. You could rightly argue that the liquidity profile of the industry for the ten years preceding the downturn was stressed with an almost continuous net loans to deposits percentage in excess of 90.0 percent (see Chart 5

below showing historical FDIC industry data for net loans to deposits). Recent data shows a much more moderate funding stress level at 71.1 percent and the regulatory capital framework that gets implemented ought to encourage continuation of a strong liquidity position. If the industry's strategy to reduce regulatory capital ratio volatility is to reduce the size of the investment portfolio or move holdings into held to maturity, then the effective impact of the proposed capital regulation is lower levels of on-balance sheet liquidity, which is undesirable from both the industry's and the Banking Agencies' perspectives.

CHART 4



- **The Regulation is Poorly Timed:** Choosing this point in history, given record low interest rates and unprecedented (and unsustainable) monetary accommodation, to begin adjusting regulatory capital by changes in the valuation of investment securities is inadvisable. Given the unprecedented size of the Fed's balance sheet (> $3 trillion), the size of the national debt (> $16 trillion), the size of the federal budget deficit (> $1 trillion annually) and the unchartered territory of the Fed's monetary policy, there are a wide range of unpredictable future rate environments that could confront the industry. As an industry, we must and will manage that uncertainty and risk, but to institute an ill-advised, single asset class, mark to market into regulatory capital at this moment could have disastrous implications for the industry and FDIC Insurance Fund should the rate environment get out of control. We would assert that losing control of interest rates, given current extraordinary market conditions, is at least a "fat tail" event worth considering. Compounding the adverse (though in the case of higher quality instruments, temporary) impact of a significant rise in rates on portfolio valuations is the fact that investment portfolios are currently "oversized" by historical standards, which will only multiply the negative consequences for regulatory capital and regulatory capital ratios of a rise in interest rates.
- **Adverse to Performance and Ability to Attract Capital:** Introducing added volatility into regulatory capital ratios will hurt financial performance and impact the

industry's ability to attract capital. The volatility that the proposed capital regulation introduces will encourage investments into shorter and lower yielding instruments, adversely impacting profitability. Additionally, that volatility will necessarily result in bank management holding excess capital to protect against an adverse regulatory action based on a temporary investment portfolio valuation. That excess capital will lower investor returns (return on equity) and diminish the industry's ability to attract capital. Given the adverse impact to the community banking model from debit card interchange fee revenue and increased regulatory compliance burdens, layering on another headwind to financial performance is unnecessarily harmful and unwise in our judgment.

- **Commentary on Alternatives:**
  The proposed regulation also requests commentary on excluding unrealized gains and losses on certain debt issuances (U.S. government and agency debt obligations and U.S. government-sponsored entity debt obligations) from regulatory capital. We again believe this alternative is unwise and counter-productive from a risk management perspective. Excepting out favored issuers from the proposed capital framework does not overcome the fundamentally flawed notion that fair valuing a small component of a much larger balance sheet is an improved reflection of the financial standing and viability of a bank.

  Additionally, providing capital relief for favored classes of securities issued by the U.S. government and its agencies amplifies the already favorable capital treatment that class of issuers receive in terms of risk weighting and will likely encourage even greater concentrations by the industry in government debt. Further encouraging the banking industry to increase its exposure to U.S. government debt at this precarious time when the national debt is $16 trillion, the rating on U.S. Treasury securities has been downgraded from AAA for the first time in history, the annual federal budget deficit is in excess of $1 trillion and the two largest issuers of agency debt (Fannie Mae and Freddie Mac) are in bankruptcy is unwise.

  Moreover, encouraging further concentration in government debt by the banking industry will solidify the linkage of the health of the U.S. financial system with the health of the U.S. government and its financially troubled agencies. Strengthening this linkage, at this moment in history, will increase the risk profile of the industry, is bad public policy and is detrimental to the risk exposure of the FDIC insurance fund. As a country, we run the risk of a financially weak public sector also threatening the banking and financial system, as is currently happening in Europe.

RISK WEIGHTING OF ASSETS:

The proposed changes to the risk weighting of assets for risk based capital purposes is overly complex and challenging from a management information systems perspective, reduces the industry's capacity to foster economic development and growth, will have a profound impact on the availability and pricing of credit to residential and small business borrowers, will diminish the attractiveness of the key asset class qualifying as eligible collateral at the Federal Home Loan Banks and is contrary to important public policy initiatives designed to support the availability of affordable housing.

- **Risk Weighting Structure is Overly Complex and Burdensome:** The proposed system of stratifying the risk weighting of assets is overly complex and will pose a significant management information system and reporting challenge to the community banking industry. It will impose substantial costs on an industry whose profitability is already hampered by regulatory burdens, a low rate environment, narrowing margins and diminished revenue sources.
- **Reduces Capacity to Finance Economic Development and Growth:** Based upon an analysis of the potential impact of the proposed risk weightings to our bank's balance sheet, we estimate that our risk weighted assets could increase by approximately $440 million, or 14 percent. That increase in the denominator effectively reduces our regulatory capital ratio by 175 bps. Looked at differently, that increase in risk weighted assets effectively represents balance sheet capacity that is no longer available to make loans or grow deposits, which diminishes our capacity to fulfill our role of fostering economic development and growth. That reduction in lending capacity would be replicated in significant measure across the entire industry and has significant public policy and macro-economic implications. In order to "neutralize" the estimated 175 bps decline in our risk based capital ratios, we would have to raise an incremental $50 million in new equity capital.
- **Adverse to the Availability and Pricing of Residential Finance:**
    - By significantly increasing the risk weighting of 1-4 family residential mortgages, the proposed regulation will have the likely effect of reducing the availability and/or increasing the cost, of financing for residential properties, which will further challenge our nation's housing recovery. Moreover, while it is not our temperament to advocate for high loan-to-value ("LTV") lending, the effect of scaling risk weights with LTV as dramatically as proposed (from 35 percent for low LTV SFR 1st lien position loans to 200 percent for high LTV junior lien loans) will be to constrain credit availability to low down-payment borrowers. Importantly, constraining credit availability to lower income and low down-payment borrowers will be especially adverse to the housing and economic recovery at a time when such a high proportion of residential borrowers across America have seen their home values fall and their LTVs soar.
    - In addition, by significantly increasing the risk weighting of 1-4 family residential mortgages, the regulation will require banks to hold more capital against this asset

class, which will raise the cost of financing to consumers and discourage banks from holding single family home loans on their balance sheets. Combining this impact with the uncertain future, but scaled back role, of Fannie Mae and Freddie Mac, we are left wondering who will provide affordable financing to the nation's homeowners?

  - Moreover, it is our experience in our own loan portfolio, and we believe somewhat common in the industry, for small business entrepreneurs to make use of equity in their homes as collateral for small business loans. The proposed regulation will make that type of financing much more expensive, if available at all, which will likely have an adverse impact on our nation's small business entrepreneurs, a vitally important, job creating sector of our economy.
  - Finally, it is a common and prudent practice to structure what otherwise might be an unsecured loan to a quality retail or business customer, in a way that the borrower's personal residence is collateral for the loan in an "abundance of caution". This practice improves the credit position of the bank and can help the borrower negotiate a lower loan rate. It is often also true that the resulting LTV is relatively high and given the proposed risk weightings, this type of loan structure could result in a higher capital "charge" than if the bank had just made an unsecured loan. It makes more sense to construct a regulatory capital framework that favors secured lending over unsecured lending and we recommend that this be considered as you contemplate alternatives to the NPRs.

- **Diminishes the Economics of Holding Key Eligible FHLB Collateral:** The Federal Home Loan Bank System ("FHLBs") has its fundamental origins in promoting affordable housing and a strong linkage between the FHLBs and community banks is crucial. The FHLBs provide an incredibly valuable risk management and funding resource for the industry. They are crucial partners supporting, in particular, the liquidity and interest rate risk management efforts of the industry. Residential loan collateral is central to maintaining access to the financial resources of this crucial financial partner. To the extent the proposed regulation diminishes the attractiveness of holding residential finance assets on the industry's balance sheet, the proposal also diminishes the utility of the FHLBs to the community banking industry.
- **Discouraging Residential Finance is Contrary to Public Policy:** It is not too much of an exaggeration to say that the full force of the federal government is being brought to bear on improving the health and vitality of the residential sector of the economy. To the extent that the proposed regulation diminishes the availability and/or increases the cost of financing for the nations' homeowners, it will be counter to current public policy and hamper the economic recovery.
- **The Regulation is Backward Looking and Misdirected:** Given the substantial decline in home values across the country and the stronger underwriting standards prevalent in the industry, the risk profile today of a recently originated single family home loan is substantially lower than the risk profile before the economic downturn.

Constructing a massively complex regulatory capital framework around that market segment seems disproportionately focused on the last problem, which may prove too narrowly focused to be effective in preventing future shocks to the industry.

ADVERSE AND UNINTENDED CONSEQUENCES:

There are aspects of the proposed regulation that we believe have the potential for adverse and unintended consequences, many of which were highlighted above.

- In order to minimize regulatory capital ratio volatility, the proposed regulation provides an incentive for community bank management:
  - To hold less, rather than more liquidity on its balance sheet increasing the bank's liquidity risk profile;
  - To move a greater proportion of its investment portfolio into held to maturity reducing liquidity and financial flexibility;
  - To hold shorter and lower duration investments hampering earnings and capital formation;
  - To hold shorter and lower duration investments accentuating asset sensitivity and increasing the bank's interest rate risk profile;
  - To hold shorter and lower duration investments, essentially favoring regulatory risk over IRR, liquidity, earnings and capital formation;
  - To explore the use of derivatives as an alternative tool to manage interest rate risk, which most community banks are not likely equipped to do well or prudently on a large scale.
- In order to minimize the adverse impact of the proposed changes to asset risk weightings on risk based capital ratios, community bank management will likely be incented:
  - To reduce or eliminate HELOC lending, which will be adverse for the housing recovery;
  - To reduce or eliminate higher LTV lending, having an adverse impact on low down payment/high LTV borrowers just at the time when the Fed is trying to help households refinance into lower costing loans;
  - To reduce the availability and pricing of residential finance, which will be adverse for the housing recovery and bank profitability, and diminish the quantity of collateral for FHLB borrowings elevating liquidity risk across the industry;
  - Discourage taking residential collateral as an "abundance of caution" for otherwise credit-worthy borrowers, potentially increasing credit risk to the bank and loan pricing to its customers;

CONCLUSION:
On its face, the proposed regulation isn't a dramatic or inadvisable change to regulatory capital ratio minimums. Ostensibly, it appears to not raise capital ratio requirements at all. But in reality, given the changes to the construction and composition of the numerator and risk weighted denominator, the practical impact of the proposed regulation is a de facto substantial increase in risk based capital requirements. Based upon our preliminary estimates for Washington Trust Bank, the practical effect of the proposed capital regulation is approximately 400 bps (175 bps due to changes to asset risk weightings, 175 bps due to the volatility resulting from the inclusion in the numerator of unrealized gains and losses from available for sale investments and 50 bps from the proposed Capital Conservation Buffer, which extends above well capitalized minimums). Absent steps we will be compelled to take to minimize this impact, we would need to raise in excess of $100 million in new capital in order to "neutralize" the adverse impact from the proposed capital regulation on our regulatory capital ratios. At the same time the proposed regulations make investing in banks potentially less attractive due to increased balance sheet volatility. Translated a different way, that 400 bps impact to our capital ratios effectively reduces our balance sheet capacity by over $1 billion, which is balance sheet capacity that would otherwise be available to grow loans and support the nation's economic recovery.

Strengthening the industry's capital position while preserving the industry's ability to make competitive returns and attract new capital, is a rational response to the financial crisis. However, generally maintaining the existing regulatory capital ratio framework, but significantly transforming and complicating how both the numerator and denominator are constructed in order to accomplish a higher capital requirement seems misdirected. This approach suggests a level of precision in looking backwards at the financial crisis and an ability to accurately calibrate risk weightings on select asset classes that we suspect is difficult to accomplish. It also implies a measure of faith going forward that a defined and codified risk weighting structure will appropriately address the unknowable future risks facing the industry when the next downturn occurs.

We also are very concerned by the myriad of potential unintended and adverse consequences that the regulation could present to both bank management and the Banking Agencies. The economic crisis has focused the entire industry on the importance of a robust and disciplined enterprise risk management capability and management teams are accustomed to balancing these risks (capital, earnings, liquidity, credit, and interest rate). It should be true that if you manage those risks well, you have also effectively managed regulatory risk too. One worrisome possible outcome of the proposed regulation, as outlined on the previous page under Adverse and Unintended Consequences is that managing the regulatory risk associated with falling below well capitalized minimums may not be aligned with managing the bank's other key financial risks. We believe further study and deliberation is called for before a decision is made to proceed with the NPRs as currently constructed.

The safety and soundness of the industry is largely a function of the extent to which risk profile is aligned with the capacity to withstand risk. The NPRs try to address both of these elements, but we see that combining the two effectively into a regulatory capital framework is a difficult objective to achieve. We want a strong industry and our nation needs a resilient financial system in order to minimize the challenges of the next economic downturn. We respectively request that our concerns and the concerns of the industry be seriously considered as you deliberate a sensible regulatory capital framework for the community banking industry.

Respectively,

Larry V. Sorensen
Chief Financial Officer
Washington Trust Bank