BANK of the OZARKS

December 19, 2017

Via: Email - comments@FDIC.gov
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429

RE: RIN 3064-AE59
Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 – Notice of Proposed Rulemaking by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "Agencies") regarding the proposed new high volatility acquisition, development or construction loan definition ("New HVADC Rule")

Dear Mr. Feldman:

It is with great concern that I write to you today about the proposed New HVADC Rule that is currently in the rulemaking process. As you know, the new rule and definition are ostensibly designed to simplify and relax the regulatory burden imposed upon community banks by the existing High Volatility Commercial Real Estate (HVCRE) rules promulgated under Basel III. While these purported goals may be worthy and appealing, we believe that the new rule would have serious negative consequences upon the safety, soundness and affordability of future acquisition, development and construction ("ADC") loans within the banking system.

Despite the abundance of criticism which has been levelled at the existing HVCRE rule, most banks – including ours – can at least appreciate its core underlying logic. This logic draws a correlation between the amount of equity which is invested by a borrower into a given real estate project and the relative riskiness of that loan. This principle is embodied in the so-called "15% contributed equity" exemption. To qualify for this exemption, a borrower must contribute equity in an amount equal to 15% of a real estate project's "as complete" appraised value prior to a bank advancing ADC loan proceeds into the project. ADC loans which meet this contributed equity requirement (along with certain other requirements contained within the existing HVCRE rule) are able to avoid an HVCRE designation and its companion risk weight requirements.

The New HVADC Rule would entirely remove any contributed equity exemption for future ADC loans and would instead treat virtually all ADC loans in a similar risk-assessed manner. Going forward then, it would be virtually impossible for a banking institution to make an ADC loan which would not trigger an added risk weight requirement. This will obviously result in far many more ADC loans being indiscriminately classified as being "high volatility" and therefor subject to punitive capital requirements. In recognition of this, the new rule proposes reducing the current high volatility risk weight from a 150% risk weight to a 130% risk weight. In our view, this apparent "concession" represents a misguided move from currently sound banking regulation and is simply poorly formulated policy as more loans would move from 100% risk weight to 130% than would move from 150% risk weight to 130%.

To categorize all ADC loans as being "highly volatile" is to ignore the risk mitigation which can flow from prudent loan underwriting, equity requirements and lending standards. The existing HVCRE rules at least recognize this and work to encourage institutions to exercise proper levels of caution in order to minimize their ADC loan risk exposures. The New HVADC Rule would do nothing to encourage an institution to make a less risky ADC loan since all such loans would now carry an increased risk weight regardless of the loan's underlying characteristics. In short, this new rule will reduce current incentives encouraging safe and sound lending practices and, to the contrary, may lead to a laxation of prudent loan underwriting discipline and more risky ADC loans being originated by the banking industry as a whole.

It also seems likely that the New HVADC Rule would result in higher across-the-board pricing for all future ADC loans since virtually all such loans would now be subject to an HVADC classification. This increased pricing would essentially represent an artificial regulatory surcharge upon ADC financings with no real benefit being conferred upon the overall safety and soundness of the banking system or the public at large.

One of the concerns expressed by the Agencies in their Notice of Rulemaking, was a concern that the current HVCRE definition is "unclear, overly complex, burdensome to implement, and not applied consistently across banking organizations." While we certainly agree with some of these sentiments, we believe that the appropriate means of fixing the existing confusion is to add more clarity and elaboration to the existing rule. If that were to be done, then banking institutions would have the tools necessary to confidently and consistently underwrite their ADC loans in a manner which conforms to both the rule and prudent lending standards. Likewise, banking regulators would have improved guidance necessary to promote more consistent enforcement.

Instead of totally eradicating the 15% contributed equity exception from the existing HVCRE rule, we feel that a better and more sensible approach would be to leave it largely intact but modified in order to:

- Further refine and clarify some of the uncertainties which have arisen in connection with interpretation of the current HVCRE rules (and the FAQ's that have been issued in connection therewith); and
- Introduce a scaled risk weighting approach which would allow for a more graduated reserve impact calibrated against relative risk exposure. Along these lines we would suggest that a loan-to-value (LTV) approach be applied to ADC loan risk weighting as follows:

  (i) LTV 60% or less – no added risk weighting;
  (ii) LTV 61-75% - 125% risk weight; and
  (iii) LTV 76% and above - 150% risk weight.

In addition, the proposed New HVADC Rule does not address any changes to risk weightings on the unfunded commitments related to ADC loans. Under the current rules, banks are required to include up to 50% (one-half of 100%) of their unfunded commitments in their risk-weighted assets. Under current rules, banks that have ADC loans with corresponding unfunded commitments are already burdened with a significant amount of required additional capital for these unfunded commitments. It is unclear if the proposed New HVADC rule would include a change in that percentage to 65% (one-half of 130%), which would be another detrimental impact of the proposed rule.

We also believe the Agencies are drastically miscalculating the impact on capital required under these changes. The proposed rule states the following:

> "the FDIC estimates that there could be a maximum increase in risk weighted assets of approximately $2.6 billion, or less than one percent of the aggregate risk weighted assets for the 2,338 FDIC-supervised small banking entities"

By our own calculations, our risk weighted assets would increase over $1.1 billion for just our institution alone and would increase over $2.9 billion if the unfunded commitment percentage were to change from 50% to 65%. Given the relatively small sample size used by the Agencies in their analysis, we feel that the analysis doesn't consider the impact to the banking industry as a whole and should be considered misleading.

In addition, under the proposed New HVADC Rule the Agencies are proposing that 1-4 family ADC loans would generally not be considered HVADC and would be risk-weighted at 100%. However, ADC of condominiums would generally be considered HVADC and would be risk-weighted at 130%. We believe condominiums should be considered 1-4 family ADC loans.

The result of these changes would be increased costs to borrowers as banks would need to charge higher interest rates and fees to offset the higher capital requirements and would either result in these borrowers going to unregulated non-bank lenders and/or would hamper development of new projects.

In summary, we believe the New HVADC Rule to be a fundamentally flawed and should not be implemented as proposed as it would have serious negative consequences upon the safety, soundness and affordability of future ADC loans within the banking system.

Sincerely, [redacted]

George G. Gleason
Chief Executive Officer and
Chairman of the Board