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July 9, 2004 Via email to regs.comments@federalreserve.gov

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

Re: Docket No. R-1193; 12 CFR Parts 208 and 225; Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital; 69 Federal Register 28851; May 19, 2004

Dear Ms. Johnson:

The American Bankers Association appreciates the opportunity to comment on the proposal of the Federal Reserve Board (Board), "Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital". The American Bankers Association (ABA) supports the proposed risk-based capital standards related to trust preferred securities and the definition of capital, but recommends some minor changes, as described below. The ABA brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes the ABA the largest banking trade association in the country.

In 1996, the Board approved the inclusion of trust preferred securities (TPS) in bank holding companies' (BHCs) tier 1 capital. Because TPS are cumulative, they currently are limited, together with directly issued cumulative perpetual preferred stock and other minority interest in the form of cumulative preferred stock, to no more than 25 percent of a BHC's core capital elements. Because of recent changes in the accounting treatment of TPS, the Board has reviewed its current capital treatment of TPS. The Board now proposes to continue permitting BHCs to include outstanding and prospective issuances of TPS in their tier 1 capital, but subject to stricter quantitative limits, which would apply to a broader range of capital instruments issued by the BHC.

ABA appreciates the Board's effort to address the appropriate regulatory capital rules for TPS in response to an accounting change made by the Financial Accounting Standards Board (FASB). The FASB change required deconsolidation of the trusts that issue trust preferred securities from BHC balance sheets (FASB Interpretation No. 46-Revised – FIN 46R). Because the regulatory treatment of TPS was linked to the consolidation of minority interests in these trusts, and the trusts were required to be deconsolidated, it was important that the Board address what the future capital treatment would be for TPS. We strongly support the Board's decision that TPS should continue to qualify as tier 1 capital and commend the Board for recognizing the valuable contribution that TPS play in the financial market system.

There are two points in the Board's proposal on which the ABA recommends modification. First, the Board proposes that the aggregate amount of a BHC's cumulative perpetual preferred stock, TPS, Class B minority interest, and Class C minority interest (collectively referred to as restricted core capital elements) would be limited to 25 percent of core capital elements, net of goodwill (15% is recommended for internationally active BHCs). Effectively, the proposal is lowering the current 25 percent limit, which currently is determined on a basis that does not deduct goodwill. ABA believes that this is unnecessary. Second, ABA believes that the proposed transition period of three years is unnecessarily short.

<u>Deduction of Goodwill</u>
We believe that goodwill should not be deducted from total capital in calculating the percentage of total capital that qualifies as tier 1 capital. Such a constraint of goodwill could, in essence, impose a goodwill cap, and effectively discourage mergers and acquisitions. Often, banks rely on acquisitions to expand into new geographic areas to meet the needs of customers or to gain the ability to expand products and services to customers. We believe that TPS are no different now than prior to FIN 46R, and the amount of tier 1 capital should not be limited because the accounting rule changed. ABA is further concerned that the deduction of goodwill is unnecessary to conform to the proposed Basel II New Capital Accord. The Board advances as a primary reason for this restriction that "deduction of goodwill for the purpose of this limit is also consistent with the direction taken by the Basel Committee on Banking Supervision in its consultative paper on a new capital accord." [69 <u>Fed. Reg</u>. 28854.] However, the New Capital Accord is only going to be mandatory on the eight to ten largest, internationally active banks, while this limitation will apply to all BHCs. Governors and staff of the Board have repeatedly assured ABA and its member banks that the New Capital Accord will not apply to most banks, yet the Board now states that it wants to apply this part of the New Capital Accord to all BHCs. We believe that this is contradictory to the Board's position on the scope and application of the New Capital Accord and is unnecessary. We urge the Board to reverse its proposal to subtract goodwill from total capital as part of the capital treatment of TPS.

<u>Transition Period</u>
If the Board decides to adopt the proposed changes to goodwill, more time will be needed for banks to make the necessary changes to capital. The change in accounting for goodwill (made by the FASB in 2001) requires that goodwill is no longer amortized through earnings, but rather held on the balance sheet and tested for impairment. In circumstances where a BHC has engaged in growth through acquisition, the BHC may have acquired a substantial amount of goodwill, which could translate into a substantial amount to be deducted. This, along with circumstances where a BHC has the maximum amount of accumulated debt on the balance sheet, would result in the need for adequate time to transition into alternate funding vehicles. Finally, the proposed three-year transition period appears to correlate more with the expected implementation date for the New Capital Accord than from any inherent necessity for such a change. (We note that a three year

transition period would be closer to September, 2007, rather than the stated March 31, 2007, of the proposal, which, by the time the proposal is finally adopted, would correspond to a two and one-half year transition period.) ABA believes that a more moderate transition period is appropriate and recommends that it should be no less than five years.

In conclusion, ABA appreciates the quick and thorough action taken by the Board to address the appropriate regulatory capital rules for TPS in response to the accounting change, and we support the Board's decision to continue to include TPS in tier 1 capital.

If you have questions or want to discuss this letter in more detail, please contact Gwen Ritter at 202-663-4986, Paul Smith at 202-663-5331 or me at 202-663-5318.

Sincerely,

Donna J. Fisher

Donna Fisher

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