ARVEST®

April 16, 2010

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

Sent by email to: baselcommittee@bis.org

RE: CONSULTATIVE DOCUMENT – STRENGTHENING THE RESILENCE OF THE BANKING SECTOR

Members of the Basel Committee:

Please accept these comments on behalf of Arvest Bank. Arvest Bank is a retail commercial bank chartered under the laws of the State of Arkansas. The primary banking regulator is the Arkansas State Bank Department and the primary federal regulator is the Federal Reserve Bank of St. Louis. Arvest Bank is a member of the Federal Deposit Insurance Corporation (FDIC). The bank is a wholly-owned subsidiary of Arvest Bank Group, Inc., a bank holding company that is privately owned. Arvest bank had total assets at December 31, 2009 of slightly more than $11 billion and operated 230 banking locations in the states of Arkansas, Kansas, Missouri and Oklahoma. While we have a modest volume of international transactions, mostly letters of credit, wire transfers and other electronic payments, we are certainly not a "large internationally active bank".

We are familiar with the comments of the American Bankers Association (ABA) with respect to the Consultative Document and generally support the points made therein. This letter is not intended to repeat the many points raised in the ABA but rather to focus on selected issues of what we believe are of great significance to U.S. banks who operate in a manner similar to Arvest Bank.

We steadfastly believe in the importance of a sound banking system to the success of the American economy. Although we are sometimes referred to as a "regional bank" we operate as "community banks" through 16 principal geographic regions focused on

P.O. Box 799, Lowell, AR 72745 – 479-750-1400
www.arvest.com

servicing the retail banking needs of customers, both business and personal, in those geographic areas. We are the proverbial "Main Street Bank" rather than a "Wall Street Bank". We have long been home loan lenders and have developed over the years a considerable degree of specialized knowledge and experience in mortgage servicing. As a result, we have a business unit that services mortgages for third party investors across the U.S. We were not a participant in the subprime loan market.

We respectfully submit our comments contained on Exhibit 1 attached hereto.

Sincerely

J. Robert Kelly

J. Robert Kelly
Executive Vice President/Finance

Exhibit 1

ARVEST BANK
COMMENTS TO BASEL COMMITTEE ON CONSULTATIVE DOCUMENT ON CAPITAL
APRIL 16, 2010

1. Basic capital measure

The purpose of a basic capital measure should be to measure the ability to absorb losses. These losses, by definition, are those not already provided for by reserves (such as the allowance for loan losses) or prior write-downs (such as impairment charges). Therefore, the capital cushion is to be a shock absorber for the unexpected future events resulting in losses.

However, a capital standard premised on a worst case scenario is not meaningful. Likewise, a capital standard that makes adjustments for selected items needs to have a very high degree of assurance backed by data of the financial relevance of such adjustments. Otherwise, the capital measure is distorted leading to inevitable mis-allocations of capital which would be counter-productive to economic growth and stability.

2. Components of Capital

We believe the baseline should be total shareholders' equity as determined by generally accepted accounting principles ("GAAP") subject to an independent third party audit. With the continuing convergence of US GAAP and "international GAAP", the differences in shareholders' equity should become fewer and fewer over time.

Other forms of long-term capital should also be allowable for inclusion, even though not considered shareholder's equity under GAAP.

Community banks in the U.S. frequently use trust preferred and subordinated debt as components of their capital structure. Trust preferred securities are issued through the banks' bank holding company with the proceeds most often downstreamed into the subsidiary banks as common equity. Subordinated debt is issued by both the holding companies and the banks themselves, and when issued by the holding companies is also customarily downstreamed into the subsidiary banks as common equity. While theses capital sources are not restricted to privately-held companies, they each are a valuable source of capital available to privately-held companies who do not have access to public capital markets.

Trust preferred is structured to provide long-term capital with terms that can approach economic perpetuity and provide for long-term deferral of dividends that approaches economically indefinite deferral. Trust preferred is available to absorb losses throughout the consolidated company. As such, it provides many of the same benefits as common equity and therefore should continue to be reorganized as capital in the banking system.

Subordinated debt is also structured to provide long-term capital that is junior in priority to all other bank liabilities.

Limitations on the portion of total capital these instruments may represent should not be excessive. Loss of these capital sources to privately-owned banks would be quite detrimental to safety and soundness.

3. <u>Deductions from Capital</u>

Particular concerns we have with certain proposed deductions from capital are as follows:

A. <u>Deferred tax assets</u>. To exclude these assets on a dollar-for-dollar basis from capital reflects an underlying assumption that the bank is not a going concern and will not generate future profits to recover the deferred taxes. This seems very extreme for the vast majority of banks and leads to essentially a worst case scenario approach. Any haircut for deferred tax assets should be more reflective of likely future results, not the worst case;

B. <u>Investments in other financial firms</u>. It should be clear that investments in consolidated subsidiaries of the bank or holding company are not subject to this deduction. Furthermore, investment in government-sponsored enterprises that may meet the definition of "financial firm" should not be a deduction;

C. <u>Goodwill</u>. Since goodwill is subject to ongoing impairment analysis and represents the future earning power of the underlying business unit, it has always seemed odd and overly conservative to deduct 100% of goodwill from capital. Again, a 100% deduction implies an assumed complete impairment in the future which is highly unlikely for most banks. A more meaningful approach would be a partial deduction reflecting the probability of future impairment and not an extreme assumption. This could be accomplished by applying an amortization of the goodwill balance as was the case historically under GAAP;

D. <u>Mortgage servicing rights (MSRs)</u>. While MSRs are technically classified as intangible assets, they are directly related to profit producing contracts with actual value in the marketplace. There is far more

similarity of MSRs to other earning assets, such as loans, than to other intangible assets, such as a copyright on a patented process. MSRs generate specific cash flows and are subject to ongoing assessment for impairment. To exclude MSRs from capital is extraordinarily extreme and assumes there must be dollar-for-dollar capital to support MSRs to provide for a catastrophic loss. To treat MSRs as needing 100% capital essentially destroys the private involvement in mortgage servicing. While the MSR business is profitable, often times very profitable for skilled operators, profits available will not be sufficient to justify a 100% capital requirement.

Requiring a 100% deduction for MSRs will be devastating to the mortgage servicing business. It would be more meaningful to deduct what would be considered appropriate capital for the servicing business (maybe in the 10-15% range) AND subtract the MSR balance from the denominator of the bank's capital ratio to avoid double-dipping.

E. Other intangibles. To exclude 100% of other intangibles belies the nature of the specific intangibles. Most intangibles that we encounter are core deposit intangibles (CDI), intellectual property rights and mortgage servicing rights. CDI is directly associated with customer accounts and relationships that are at the heart of a bank's funding. CDI is amortized over the estimated life of the account and is a direct reflection of the estimated value of the accounts. To deduct 100% of CDI implies there is no value in the accounts or relationships, yet another extreme assumption. Intellectual property rights may relate to specific earning assets, such as copyrighted materials while others, such as trademarks, are connected to profit production less directly. A full deduction for all types seems an extreme adjustment.

4. Adjustments to Total Assets

A. Assets related to capital deductions. When capital is reduced by certain assets, such as goodwill, then the same deduction should be made from the capital ratio's denominator. Therefore, if capital is reduced for goodwill, so should total assets. To not do so effectively results in another layer of capital on the asset;

B. Off-balance sheet exposures. Off-balance sheet exposures come in many shapes and sizes. Some are commitments highly likely to be funded while others rarely result in funding. Furthermore, some commitments to loan money result in replacement of an existing loan with a new loan for no increase funding.

Additions to Total Assets for off-balance sheet risks should reflect the likelihood of the risk actually resulting in a future asset (or increase in assets) and not an across-the-board 100% conversion factor.

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