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April 16, 2010

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CH-4002, Basel
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Introduction

We appreciate the opportunity to comment on the Consultative Document, *Strengthening the Resilience of the Banking Sector* dated December 2009. We believe we are all better served by a capital framework which effectively supports the industry during periods of stress and is less pro-cyclical. There are certain provisions of the proposal, however, which we believe would not achieve the stated objectives and/or would have unintended negative consequences. Below we offer several observations and recommendations that we hope will improve the final document.

About BOK Financial

We are a full service commercial bank with $23 billion in assets, 197 banking locations, and serve markets in 8 states including: Oklahoma, Texas, New Mexico, Colorado, Arkansas, Missouri, Arizona, and Kansas. Our lines of business include middle market commercial banking, consumer banking, and wealth management. We serve the consumers and businesses of main street middle-America.

From a financial perspective, we entered the credit cycle with very high tier 1 common equity ratios, and have remained profitable throughout the credit cycle. Our markets have experienced economic stress, but our consistent underwriting standards, conservative limits on certain types of commercial real estate exposure, and avoidance of subprime supported the continuation of our strong financial performance. We elected to not take TARP capital investments, and have supported the banking needs of the communities we serve throughout the financial crisis as we and our predecessors have for decades.

Comments on proposals

1. Unrealized losses should not be deducted from regulatory capital on the basis of changes other than credit risk

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The Consultative Document in paragraph 96 states "the proposal addresses concerns that the existing policy adopted in certain jurisdictions of filtering out certain unrealized losses has undermined confidence in Tier 1 capital. It helps ensure that the common equity component of Tier 1 is fully available to absorb losses"

We feel very strongly that this proposal should be eliminated for several reasons. a) It is bad regulatory policy because it would be highly pro-cyclical. b) FAS115r effectively dealt with any issue of confidence in Tier 1. c) It does not reflect the interest rate risk management practices of our industry. d) It would increase liquidity risk, and negatively impact banks already constrained ability to efficiently manage interest rate risk. e) The impact would be magnified by the Deferred Tax Asset disallowance from Tier 1, and make the impact of securities portfolio market value changes on Tier 1 capital greater than the impact to Tangible Common Equity. Each of these impacts is further described below:

a. Such a proposal would be highly pro-cyclical. Under periods of stress the liquidity premiums of even high quality assets can widen resulting in market value declines where there is no credit deterioration. These declines would erode capital in the banking system, force further sales of assets (see the leverage ratio requirement) and cause further capital erosion which would also reduce the ability of the financial system to support the economy with sufficient lending capacity. From a regulatory policy perspective this must be avoided.

b. Implementation of FAS 115r addressed any lack of confidence in Tier 1 capital. The pro-cyclical impact of mark-to-market accounting in the US resulted in the 2009 solution of FAS 115r under US GAAP. This results in the credit component of losses running through income and impacting both accounting capital and regulatory capital. Non-credit components of valuation do not impact regulatory capital. This FAS 115r process allows legitimate credit related losses to impact capital without causing a pro-cyclical spiral in valuations to impact the real economy.

c. Most banks practice sound asset liability management. Fixed rate assets are funded with fixed rate liabilities. For most US banks, including BOK Financial, the vast majority of market value changes in the available-for-sale securities portfolio are driven by changes in interest rates. Consider a hypothetical bank with 30 year maturity AAA rated sovereign debt funded by 30 year fixed rate non-prepayable liabilities and a 7% leverage ratio (adequate capital). Should a 300 basis point increase in interest rates really require this entity to raise capital by 2+ times its market capitalization? We feel strongly that the answer is no, however, that is what this proposal would do.

d. It would result in inconsistent treatment of like assets, and have negative unintended consequences. When interest rates rise, fixed rate loans (i.e. held-to-maturity assets) fall in value, fixed rate bonds (i.e. available-for-sale assets) also fall in value, however fixed or stable rate liabilities gain in value. The goal of asset-liability

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management is to ensure that all those three changes net out to a relatively small impact. To choose just one of those three balance sheet items and run its impact through regulatory capital is illogical. It is in conflict with all the regulatory guidance about asset-liability management including that of the Bank for International Settlements. A large part of BOK Financial's success (and that of many other regional and community banks) has been attributed to sticking to very basic banking practices such as making variable rate working capital loans tied to Prime or LIBOR and funding them with stable core deposits. To offset this asset-sensitive book of business we buy high quality fixed rate securities and fund them with variable rate liabilities. Commercial banks have operated this way prudently for a century. Running market value losses on fixed rate assets but NOT the market value gain on stable rate liabilities through regulatory capital will distort the capital adequacy of the company and have significant consequences. The threat of very expensive highly dilutive capital raises would certainly change behaviors. Banks would have several alternatives including:

i. Chose held-to-maturity accounting treatment instead of available-for-sale for much of the securities portfolio. This would take away yet another tool to implement prudent asset-liability management. Having fewer assets available-for-sale would put more liquidity risk in the banking system.
ii. Encourage loan customers to use fixed rate loans. This would expose banks to greater interest rate risk from prepayments and funding draws on fixed rate term loans which is essentially unhedgable. This would **increase** unhedgable forms of interest rate risk in the banking system.
iii. Shorten the maturities of our term liabilities, but that would have the consequence of materially increasing liquidity risk.
iv. Very small community banks may turn to derivatives to manage their rate risk positions and get themselves into a level of complexity that they are not prepared to manage properly.

Note that US regulators have recently sent out notices to remind banks to be diligent in managing interest rate risk. This proposal would make that much more difficult.

e. The impact of deducting unrealized losses from Tier 1 would be made even larger by the proposed Deferred Tax Asset deduction from tier 1 capital. These would be pre-tax variances hitting Tier 1 in many cases. The negative impact to Tier 1 would be larger than the impact to Tangible Common Equity which seems unlikely to increase confidence in either capital measure.

From our perspective, this proposal simply must be removed. It does not align increased capital with increased risk, and it increases the volatility of measured capital. This may not be as material of an issue for the internationally active banks, but for the regional banks and community banks which serve the consumers and businesses of the heart of the country this is very important. This group of banks is less likely to have the resources to submit response letters, and as such this topic may not get the attention it deserves. We urge the committee to take the foregoing into consideration and eliminate this proposal.

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2. Mortgage Servicing Rights (MSRs) should not be deducted from Tier 1

Paragraph 97 of the Consultative Document states "The proposed deduction addresses the high degree of uncertainty that intangible assets would have a positive realizable value in periods of stress of insolvency...."

We fully agree that goodwill and other certain intangible assets should be eliminated from Tier 1 capital as they have no realizable value under stress or in liquidation. In contrast to Goodwill, there is no similarly logical reason to exclude MSRs from Tier 1 capital. MSRs retain value under stress, and in liquidation. In fact we think deducting MSRs from Tier 1 capital as is proposed is bad from a policy perspective. A dramatic increase in capital requirement on MSRs in US banks would simply increase the cost of mortgages to consumers, negatively impact housing values to some degree.

MSRs are, from a financial perspective, very similar to an Interest Only security. Unlike other intangible assets, MSRs have a clearly identifiable underlying stream of cash-flows to support their value. While accounted for as an intangible asset, they are more like a financial asset in practice. There is financially little difference between MSRs and Interest Only securities, purchase premium on mortgage related securities, and unamortized capitalized acquisition costs on mortgage loans. All pose similar interest rate risk and all are captured in market risk measures and hedging activity. All should receive the same treatment. We believe that mortgage servicing rights should be carved out of this deduction from Tier 1 capital.

This appears to be an issue affecting only the US and a few other countries. European Banks do not appear to have MSRs due to differing accounting standards.

3. Expected Losses (EL) vs Loan Loss Reserve

Paragraph 246 of the proposal contains the following: "...the committee is proposing that any shortfall in the stock of provisions to expected loss be deducted fully from the common equity component of Tier 1capital..."

The result of this proposal seems to be that capital will be impacted by the greater of calculated loan loss reserve or Expected Losses as determined by a Basel II approach. Non-Basel banks do not have the infrastructure in place necessary to calculate a Basel-II-type Expected Loss. The proposal suggests that this will be less pro-cyclical. Our view is that it will clip the peaks a little, but not support the troughs in any way. The need to manage essentially two loan loss reserve processes would be very inefficient for mid-size and smaller institutions and not seem to have much impact on economic cyclicality. We believe non-internationally active banks should be exempt from this requirement.

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4. Include Trust Preferred Securities in Tier 1 capital

Paragraphs 88 and 89 of the proposal outline criteria for inclusion in Tier 1 additional going concern capital, and effectively exclude the trust preferred security from this category.

We at BOK Financial compete directly in our footprint with foreign owned banks. This proposal would give those banks a permanent competitive advantage in the form of a lower cost of capital. European and other foreign banks would still be able to issue tax deductible forms of Tier 1 capital based on favorable tax treatment of non-cumulative preferred securities in European countries, but the US banks could not, as the Trust Preferred structure would not qualify as Tier 1 under this proposal. In the US, non-cumulative securities are not tax deductable. We believe that when issued on a stand alone basis, trust preferred securities meet the overall goals of Tier 1 capital. These structures have been highly effective as loss absorbing high quality capital through dividend deferral (when issued at the holding company), through exchange for common stock, and in liquidation. Most importantly we recommend that the cost-of-capital playing field should remain level, and secondarily we believe trust preferred securities based on their performance through the cycle have earned the right to qualify as a component of Tier 1.

If capital requirements are increased, and the volatility of measured capital is increased, while at the same time access to capital is reduced by eliminating the trust preferred security, the cost of capital will be maximized and that cost of capital will ultimately be borne by the real economy through the price and availability of credit. We believe there is a need for a non-dilutive Tier 1 capital instrument that mid-size and smaller banks have access to, similar to the role the trust preferred security has fulfilled.

5. Treatment of off balance sheet items and netting of derivatives in Leverage Ratio

Paragraphs 202 through 238 discuss various aspects of the leverage ratio

We support the goal of a globally consistent Leverage Ratio. The treatment of derivatives and other off balance sheet items in the Leverage Ratio is, however, very important. The range of risks within derivatives varies dramatically and some important inconsistencies can result depending on how this standard is applied. We think this standard as constructed would have some unintended negative consequences and adjustments should be made. A risk based approach should be taken with each of the various off balance sheet items. Netting should be allowed in the derivatives exposures and unfunded commitments should be reflected only to the extent that history demonstrates draws could be anticipated.

a. Netting agreements are valid contracts. The actual counterparty exposure for a firm with a valid netting agreement is the net amount, not the gross amount. These agreements hold-up in bankruptcy. Ignoring the netting agreement would

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be as illogical as ignoring the security agreement of a secured loan in the determination of its credit exposure. Derivative exposures should be reflected on a net basis, by counterparty or by exchange.

b. Cash collateral held against derivative exposure actually does reduce the exposure and derivative exposures should be reflected net of the cash collateral held in conjunction with right of set-off.

c. Many US regional and community banks offer customer derivatives. Generally these are simple structures with reasonable maturities indexed to interest rates or commodity prices. We offset the market risk of each customer transaction with a matching transaction with a swap-dealer counterparty. Both sides of the derivative are underwritten to our credit standards and require collateral to be posted against the counterparty credit exposure. This is an important service we provide to our middle market commercial customers. Without this they would be unable to manage an important risk in their businesses. Without this reduction in risk to those businesses, we would not be able to prudently extend them as much credit. If this customer derivative business were rendered dis-economic due to unreasonably high regulatory capital requirements, banks would need to reduce lending to these otherwise highly credit-worthy borrowers which would negatively impact the real economy.

d. Important inconsistencies would result from this standard as proposed which would provide incentives for banks to actually increase risk. Take the example of fixed rate lending compared to floating rate lending combined with a customer interest rate swap. Many US regional banks currently offer customer interest rate derivatives to swap floating rate loans to fixed for their customers. Then to eliminate the market risk exposure to the bank, prudently execute an offsetting mirror-image swap with a swap dealer. Both swaps require collateral to cover any market value which minimizes the already small credit exposure to a level generally less than 1% of the notional amount. The fixed rate loan has the same market risk to the bank as does a variable rate loan plus a floating-to-fixed interest rate swap. The pre-payment risk to the bank is actually lower with the floating rate loan-plus-swap combination for reasons best described by behavioral finance. So, while the floating rate loan plus swap combination is slightly lower risk to the bank than the fixed rate loan, the capital required would be higher. The capital required would be even higher if the bank prudently offset all the market risk with a mirror swap with a dealer. An undue capital burden would therefore make all these swaps dis-economic so banks will do much fewer of them which will result in higher market risk and prepayment risk in the banking system.

e. Unfunded commitments are also proposed to be included in the leverage ratio denominator. Unfunded credit commitments are remarkably stable over time and have exhibited very little volatility during periods of stress in the US over multiple historical stress cycles. Unfunded commitments should be only be

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included on a factored basis where a history-based drawdown factor is applied. The evidence of the last and previous periods of financial market stress show the following:

- Consumers, small business and middle market companies have historically not in aggregate drawn on their credit facilities during periods of stress or financial crisis. The opposite is true, they hunker down and shrink their balance sheets causing loan balances to remain flat or shrink slightly.
- Large corporate borrowers who have multiple sources of liquidity (i.e. commercial paper, medium term notes, etc) will exhibit some drawn-downs on their bank lines to the extent that those alternative funding sources are disrupted. Otherwise they are also prone to reducing investment activity in their own businesses and reducing debt.

The historical experience of the industry should be the basis of inclusion in the leverage ratio. Those banks with large corporate exposure should include a reasonable history-based percentage of those unfunded amounts in their leverage ratio denominator. Consumer, small business, and middle market credit facilities should have a de-minimis factor.

Conclusion

We hope these comments will be helpful in crafting the best possible outcome for this regulatory policy. Please contact me if we can be of any assistance in clarifying our comments or providing additional background information

Sincerely,

Martin E. Grunst
Treasurer