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

April 16, 2010

Re: Request for Comment on Consultative Document

Ladies and Gentlemen,

Thank you for the opportunity to respond to the Consultative Document entitled "Strengthening the resilience of the banking sector", released in December, 2009. SunTrust supports the goal of the Basel Committee ("the Committee") of creating transparent and risk sensitive capital rules that ensure adequate capital both in quantity and in composition. We appreciate this chance to offer comment towards this end.

In what follows we offer a series of comments on specifics of the proposal. The nature of the proposal makes it easier and clearer to approach this as a series of discrete points. However, they all point to the overarching concern that in the face of the recent severe financial crisis, the Committee is putting in place a regulatory environment that will overstate the risks faced by financial institutions, and understate these institutions' ability to absorb losses. If these changes are put in place, the result will be a materially smaller financial sector that inefficiently allocates capital in response to incorrectly measured risks. This will not just impact shareholders, but will result in less credit in the economy as a whole which will result in lower economic activity, and will force more of what has traditionally been banking work into other less regulated areas of the financial system. SunTrust hopes the Committee will reconsider the specific proposals in this document (and the companion Liquidity document). If there are any questions we would be happy to discuss them with you.

<u>Raising the quality, consistency and transparency of the capital base</u>

SunTrust agrees with the Committee that it is important that banks' risk exposures are backed by a high quality capital base. System participants should not only have confidence that banks' risks are being effectively captured by the regulatory process, but should also have confidence that any associated losses can be absorbed by the capital base should the identified risks materialize.

To this end, SunTrust supports the Committee's proposals for the additional reporting required to provide a sufficient level of transparency. SunTrust agrees with the importance played by the role of transparency in building market confidence, and supports the Committee's goals of improving the ability of market participants to better understand the loss absorption capacities of the various financial institutions. Though SunTrust believes that the benefits of the proposals should be carefully weighed against fairly measured implementation costs, SunTrust is broadly supportive of this goal.

SunTrust also believes in the importance of high-quality capital, and the critical role it plays in financial crisis, and the conceptual framework of "going concern" and "gone concern". When losses great enough to threaten a bank's ability to function as a going concern occur, its Tier 1 Ratio is less relevant, and liquidity issues can become more important in the minds of clients and investors. SunTrust agrees with this assessment and supports the Committee's objective of focusing on the ability of different capital types to support financial institutions as going concerns, not just in an effort to ensure that debt holders are paid in full. However, SunTrust is concerned that the Committee is being over-restrictive in its attempt to identify what types and components of capital are effective in ensuring that an institution survive as a going concern. SunTrust recommends the following adjustments:

1) **Criteria for inclusion in Tier 1 Additional Going Concern Capital –dividend / coupon discretion:** SunTrust believes this requirement is overly conservative. As opposed to requiring that dividends / coupons be cancelable, the Committee should require that dividends / coupons simply be indefinitely deferrable. Once the institution returns to profitability, payments could continue as planned and agreements to settle any accumulated disbursements could be made. This has the effect of ensuring that these forms of capital can be used to maintain the institution as a going concern. To the extent that the magnitude of the potential deferred dividends is a concern, SunTrust suggests that the Committee consider limiting the total amount of these instruments that can qualify for Tier 1, as opposed to eliminating them altogether.
2) **Goodwill and other intangibles:** SunTrust supports the Committee in its position that the capital base should be adjusted for any balance-sheet assets whose value(s) would be highly uncertain in times of stress or insolvency. However, SunTrust believes that mortgage servicing rights (MSR's) should not be classified as such an asset. Strong MSR markets exist and highly reliable valuation approaches supported by readily available, market-provided inputs are an industry standard. Though the pricing inputs themselves may be above or below historical averages during times of stress (as was the case recently), pricing would still be possible and, furthermore, would be possible to a relatively similar degree of certainty. SunTrust recommends MSR's not be considered in this adjustment. A more appropriate change to the approach to MSR's would be in the application of a simple haircut to values. This adjustment seems an obvious place for national discretion in the United States.

3) **Investments in current shares (treasury stock):** Current U.S. accounting standards already require firms to adjust common equity for treasury stock. SunTrust supports this, but believes the benefits gained from adjusting for index security-based exposure would not justify the associated processing and governance costs. SunTrust recommends index-security holdings not be considered in this adjustment.

While SunTrust believes the quality-related proposals identified here should be reconsidered, the Bank supports the other proposals and, in general, the spirit of the quality, consistency and transparency changes the Committee has outlined in this section of its consultative paper.

Counterparty Credit Risk

SunTrust appreciates the efforts that are being made by the committee to better quantify risks associated with counterparty risk. As counterparty risk makes up only a small portion of our risk exposure, we will not comment on specifics of the proposal. However, we would like to take this opportunity to address a concern we have with the proposed regulations surrounding counterparty risk management. In our judgment capital is not the ideal tool for dealing with counterparty risk management. Of course, we do not mean that capital should not be held to support counterparty risk; it should, and in a manner corresponding with the risk. Our concern is that the focus on capital will result in two things:

1) A misapplication of effort surrounding counterparty risk from the effective management of it at both the bank and system level to the calculation of capital ratios that will be much less effective in actually preventing crisis, and
2) A corresponding tendency to overestimate the risk associated with counterparty risk at the individual bank level to compensate for a system-wide risk, resulting in a misallocation of bank resources.

We will deal with each in turn.

1) Though capital is a necessary component of bank management, it is a poor replacement for both effective risk management and, more important for the issue at question, effective supervision. SunTrust believes that this is particularly the case for counterparty risk. Recent events have made clear that financial institutions needed to strengthen their risk management around counterparty risk. It is necessary that the full exposure to counterparties be both calculated and managed to, and that the possible speed, severity, and correlation with changing exposures of counterparty risk be better understood. At the system and supervisory level, however, improvement is also necessary. Many of the fears of the transmission of risk through counterparty exposure are tied to liquidity and transparency. A "worst-case" crisis would likely involve a general liquidity crisis following a more localized credit- or market-risk related crisis, with counterparty risk the transmission mechanism. To a certain extent, specifically when there are institutions that have substantial exposure to failing institutions that will ultimately be unable to pay, this is unavoidable. However, the actual risks to the system could be much broader than those institutions with exposure to failing firms, as a more generalized panic could occur as

investors have no way to distinguish between institutions with "bad" exposure and those without. This can potentially be mitigated by increased system-wide transparency, which could take many forms. One would be regular and standardized reporting of multiple measures of counterparty risk managed and verified by a regulatory body. This would allow institutions without material exposure to troubled firms to get a "clean bill of health" in case of potential crises, and would potentially allow the regulatory body to identify possible paths of transmission crises could take. A more detailed (and complex) attempt to do something similar would be for a central regulatory agency to make an effort to create a "risk taxonomy" of major financial institutions, capturing (at a high level) broad exposure categories. This would allow for a more forward looking system-wide risk management effort, as the regulatory body could identify concentrations that cross both conventional risk and counterparty risk.

2) We believe that it would be a mistake to intentionally overstate the risks and corresponding capital associated with counterparty risk to attempt to solve (at least partially) a system-wide concern over the transmission of crises through counterparty exposure. It is an obvious point, but losses do not get assigned to specific sources of risk-weighted assets—losses that stem from counterparty risk are no different from the perspective of a capital base than those that stem from more traditional credit losses. Overstating the cost of counterparty risk (by overstating risk-weighted assets) will presumably have a marginal impact on the system-wide level of counterparty risk, but this seems to be a very crude tool if the goal is to manage this level of risk. Other possible approaches (for example, rules surrounding margins) could have a similar impact on this level while having other corresponding positive benefits.

Leverage Ratio, Off-Balance Sheet Items (excluding derivatives)

The consultative document proposes a flat 100% credit conversion factor for commitments (including liquidity facilities), unconditionally cancelable commitments, direct credit substitutes, acceptances, standby letters of credit, trade letters of credit, failed transactions and unsettled securities. SunTrust acknowledges the many challenges associated with effectively measuring the usage given default (UGD) of off-balance sheet items, but believes that defaulting to a 100% credit conversion factor materially overstates the risk associated with some of these items. This will result in higher costs for borrowers as well as distorting the relative risk measures and risk management for the different items. SunTrust recommends that the regulatory agencies work with the banks to do a more detailed quantitative analysis of the question in order to both set levels and differentiate risks between different assets classes and assets within asset classes. It seems outside the spirit of the Basel II effort to simply default to the worse case when data-driven results are feasible.

SunTrust recently completed such an exercise, and would be happy to share detailed results with regulators. Using internal default data from December, 2006 to October, 2009, SunTrust evaluated the UGD for Wholesale and Business Banking clients. The recent economic downturn provided sufficient data to do an internal analysis, which is in the process of being implemented. The average UGD from the internal exercise was materially different then the previously-used

results, as was the risk-differentiation (again, we are happy to share results with our regulators if interested). This points to the possibility that the currently proposed rules will materially overstate the risks associated with off-balance sheet items, which is clearly undesirable both from the perspective of the individual institutions and for the economy as a whole.

Two possible extensions of the work SunTrust has done could be facilitated by the Federal Reserve or similar agency. The simplest would be to use the work of SunTrust and other large financial institutions that have carried out similar projects to develop an improved industry view allowing for a more accurate estimation of the credit conversion factors. This would be relatively straightforward, though differences in quantitative approach, product definition, and other issues would make drawing conclusions problematic. A second, and potentially much more beneficial project for both the Basel regulatory process and bank risk management, would be to work with the large financial institutions to pool credit data to carry out an industry-wide study. This would require meaningful up-front effort both from the regulatory body (in determining data definitions, product definitions, quantitative approach, etc.) and for the banks involved, but the payoff could be substantial. SunTrust would be happy to have the opportunity to leverage such an exercise to better understand this difficult to estimate parameter, which would allow for better risk management and product design. In addition, it would provide the best possible estimates for the Basel Committee in their efforts to create a risk sensitive capital framework.

Forward Looking Provisions

The consultative document promotes stronger provisioning practices through four initiatives: accounting standards aligning closer to an expected loss (EL) provision model, supervisory guidance supporting the expected loss methodology, reducing capital disincentives for strong provision policies, and more transparency on provisioning practices. SunTrust encourages the regulators to work closely to ensure that there is consistency and agreement with the accountants in promoting an EL provision model.

The existing allowance framework can best be described as an incurred loss model for the allowance for loan and lease losses (ALLL). This methodology attempts to align the balance sheet valuation for loans with the ALLL methodology. As such, the ALLL will increase in bad times and decline in good times. An unintended consequence of this is a reduction in banks' ALLL at times immediately prior to downturns when capital is needed the most, and therefore increased capital contraction going into a downturn.

Although the existing incurred loss methodology attempts to ensure an adequate valuation of a bank's balance sheet through the ALLL, it can be in conflict with another accounting standard, the revenue recognition principle, which attempts to align expenses and revenues to when they are incurred. Since an EL-based provision methodology will leverage a bank's PDs and LGDs to each period's provision expense, the proposed methodology will better align to the revenue recognition principle. It should be noted, however, that if the risk rating philosophy used to generate the PDs and LGDs is based on a Point in Time (PIT) ratings philosophy, then the provision expense, in theory, will only lead the actual losses by approximately one year. If,

however, the risk ratings are based on Through the Cycle (TTC) risk ratings, the provisions will be better aligned with a longer-term view of the PDs and Loss Severities and therefore be better aligned with the revenue recognition principle. If this approach is adopted, then the provisions will remain relatively stable (although they will increase modestly in periods of weaker credit environment); however, the ALLL will rise in good times as provisions exceed losses and fall in bad times when losses exceed provisions. It should be noted that if the ALLL is not allowed to drop during the bad periods, when losses exceed provisions, this methodology will not be as effective. There is the concern that regulatory agencies would use a TTC methodology during good times and a PIT methodology during bad times.

SunTrust fully supports a TTC EL-based provision methodology that is aligned with the accounting revenue recognition principle. This, of course, would require agreement between regulatory agencies and the Securities and Exchange Commission in the United States.

Finally, SunTrust fully supports the consultative document recommendation with regard to eliminating the capital incentive to under-provision currently allowing only a 50% deduction of the provision to EL shortfall to be deducted from Tier 1 and Tier 2 Capital. SunTrust encourages the modification to allow a full 100% deduction for Tier 1 and Tier 2 for any provision to EL shortfall.

Building buffers through capital conservation

SunTrust supports the spirit of maintaining capital buffers, as the discussion and objectives are largely consistent with those laid out in current SR 99-18 and Pillar 2 guidance. SunTrust also agrees that prudent management would require a capital plan that outlines capital conservation actions—via reduced ordinary dividends, fewer share buybacks, and lower discretionary bonus payments to staff—when current or expected capital buffers are insufficient to guard against downturn. However, SunTrust believes the existing, principles-based approach laid out in SR 99-18 and Pillar 2 is superior to that which the Committee proposes in its consultative paper.

First, we question what benefits exist from the type of process described in the consultative document versus those that currently exist. The larger financial institutions that would be impacted by the proposed regulations all work closely with multiple supervisory groups. To the extent that one of these groups believed that the institution was not effectively managing its capital base and should carry out some sort of capital action in the interest of safety and soundness, it already has means to enforce this opinion. Putting in place a relatively simplistic set of rules does not seem to improve this situation.

Next, SunTrust respects the Committee's intentions as stated in paragraph 257, but questions whether in practice the market would allow firms to fall below the calibrated buffer, effectively establishing a new minimum capital requirement. It seems likely that capital buffers would continue to be required (internally by prudent management practices and externally by market participants) above these new, higher levels.

Finally, allowing banks to draw down capital buffers to regulatory minimums during downturns is theoretically ideal, but SunTrust believes implementing this on a practical basis is extremely difficult. In order for this framework to operate optimally, banks and their regulators would need a clear picture of a downturn's severity and duration. It is widely acknowledged, especially after this latest crisis, that participants' ability to do this is limited. We believe that in practice this approach would result in banks building higher capital levels during "good" times and being required by both the market and supervisory guidance to further increase them during "bad" times, exacerbating any downturn by further limiting the credit supply. If the Committee is determined to implement an approach such as this, we strongly request that it be made exceedingly clear long before it is tested, so all participants know exactly what will be expected in the face of a downturn. If this is not the case the market signaling effect could be impossible to control and detrimental to both the banks and the economy as a whole.

SunTrust supports the spirit of the proposal and agrees with the role of capital conservation actions in maintaining sufficient buffers, but would suggest removing the proposals from this consultative paper. The current principles-based approach laid out in SR 99-18 and Pillar 2, coupled with sound regulatory oversight, is superior.

Cyclicality of the Minimum Requirement

SunTrust strongly supports this and all further efforts to clarify the definitions and goals of the key inputs used in the estimation of risk-weighted assets under Basel II, and the impact these choices may have on the cyclicality of the approach. Prior to addressing the two specific approaches discussed in the consultative document, SunTrust would like to suggest that the Basel committee explicitly consider a related point: the intention of the aggregate capital ratios that result from the Basel II approach.

It would be beneficial both to ensure correct implementation of the Basel II approach as well as for being able to address issues such as those brought up in this section if the Basel Committee would release a brief paper addressing the intended goal of the capital ratios that will result from the approach. Specifically, if a Bank operating under Basel II had a constant Tier 1 capital ratio throughout a credit cycle, what would that mean? One possible meaning would be that the 1-year, forward looking probability of default of the Bank was constant throughout that year. Another possible interpretation would be that the "through-the-cycle" probability of default for the Bank would be constant, which would imply that the 1-year, forward looking probability of default would fluctuate with the cycle. Addressing this question would go a long way to clearing up some of the basic confusion that exists now and will only grow in importance as the market more fully integrates the results of Basel II Banks. It would also allow a better response to the issues raised in the consultative document. SunTrust is agnostic as to the appropriate answer to this question, but feels strongly that clarity would greatly benefit all institutions operating under Basel II.

Regarding the two approaches in the consultative document, SunTrust will address each in turn.

1) Using the "highest average PD estimate applied by a bank historically to each of its exposure classes as a proxy for downturn PD": The implication of this approach is that Banks would have risk weighted assets driven by the probabilities of default of credits over the past several years, a period with a historically high default rate in the asset class most tied to the lending activities of all banks except for the largest. This approach would lead to a substantially higher cost of capital for loans related to residential mortgages, which would reduce lending activity and increase costs in that sector. It would result in banks reporting risk weighted assets well in excess of the actual risks on their balance sheets in all times except for the highly unlikely repeat of current events. Asset classes that have performed relatively well in the past years would receive a relative capital benefit to those that have not, making interpretation of different institutions' risk weighted assets and resulting capital ratios impossible. SunTrust strongly believes that this approach would be a fundamental mistake, effectively eliminating much of the benefit that would result from the increased risk sensitivity of Basel II. An approach like this would likely be less useful for both the market and supervision than that of Basel I.

2) Using "the average of historic PD estimates for each exposure class". This is closer to the traditional "through the cycle" approach that has been an option throughout the development of Basel II. It avoids many of the problems of the approach discussed above, and certainly is the better of the two. It would benefit from a clearer understanding of the interpretation of capital rules discussed above, however. This approach would result in cyclical fluctuations of the probability of default of a Basel II institution with stable capital ratios across the cycle. This could of course be mitigated by having a fluctuating capital "cushion" throughout the cycle, but doing so would in effect eliminate the "through the cycle" nature of the suggested approach, effectively replacing it with "point in time" measures of risk. The result would be a capital framework increasing the cyclicality of the macro economy, as has been mentioned many times. This highlights the interconnectivity of many of the suggestions made surrounding Basel II, and that an effectively designed system will require a clear initial statement of goals, as discussed above. Again, we request that you provide such a statement.

SunTrust strongly supports the effort to provide greater clarity around the meaning of the variables used in the estimation of capital, and we hope that these efforts are continued going forward. The trade off between risk sensitivity and cyclicality is in many ways insolvable, making it even more critical that all participants fully understand the goals of the Basel II approach. This understanding is critical to ensure that we implement Basel II in a manner consistent across banks to allow for meaningful comparisons both by the regulatory agencies and the market.

Conclusion

SunTrust appreciates that the Committee is trying to tackle the many difficult issues brought up in the recent economic downturn without abandoning the goal of a transparent, risk-sensitive set

of capital rules, and hopes that this continues. The scope of the proposals made and their potential impact, however, are staggering and could result in significant costs to economy as a whole. General estimates of the potential capital required in the United States as a result of these rules are in the hundreds of billions, which could lead to a massive decrease in the supply of lending. SunTrust requests that the Committee re-evaluate the many topics in the consultative document, and give each the attention given to the specifics of the section on the measurement of counterparty credit risk. For each proposal, please consider not just the specific impact on the banking system, but the market reaction both now and in the next economic downturn, the impact on the supply of credit during both good times and bad, and the tendency the proposals may have to push financial activity out of the more regulated banking system into other areas of the financial system. SunTrust further requests that upon completion this work be resubmitted as a consultative document allowing for an additional period of comment from the industry.
If you require any clarification of these comments or would like to discuss our views, please contact me at aleem.gillani@suntrust.com.

Sincerely,

Aleem Gillani
Executive Vice President and Treasurer

cc: Richard Gilbert
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