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AMSOUTH

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

Re: Docket Number OP-1227

We have reviewed the proposal to institute a dual risk rating system, and appreciate the chance to comment. Such dialogue between the industry and its regulatory bodies can only make for a better final product.

While we are in general agreement with the concept of dual risk ratings, we did note some uncertainties that we felt warranted clarification. We also noted a few points on which we felt an alternative treatment might deliver a better final product, especially in the application of the proposal at the Relationship Manager level.

Again, we appreciate the opportunity to comment on a proposal of this magnitude, and would welcome the chance to respond to any questions.

Suggestions for Clarifications

We would suggest clarification on several points, followed by circulation of the revisions for further comment.

The definition of "Remote Risk of Loss" (RRL) is not as clear as it could be.
As written, the proposal specifies that loans secured by cash or cash equivalents can qualify for "Remote Risk of Loss." It doesn't specifically permit or preclude other collateral. But by not mentioning alternative reliable collateral assets – prudently margined real estate, for example – it leaves the definition of RRL open to wide-ranging interpretation.

On a secondary point, the definition appears to equate the stability of commodity and livestock values with that of cash and its equivalents. On its face, this would appear to be inconsistent with the realities of the marketplace. Some expansion on this point would be helpful.

Depending on the resolution of the collateral question above, a second question could arise: Does RRL status qualify a credit for a Pass rating?

- The issue is often applicable in bankruptcy situations. If an institution is barred by a bankruptcy order from executing on collateral, there could be a material length of time (a year or more) between default and liquidation of the pledged asset.

  Under current practice, such a credit would qualify not only for a Classified risk rating, but in all likelihood, non-accrual status. This would hold *even if* documented collateral value, appropriately margined, would indicate no realistic expectation of any loss of either principal or legally accrued interest.

  How would the proposal treat this situation?

- The proposal allows a risk rating based on a guarantor to substitute for that of the borrower. We agree that the provision is a good one. But as currently written, it could create some confusion in circumstances where the loan would qualify as impaired, but the guarantor is sound.

  Some clarification on whether a guarantor can raise the rating of an otherwise impaired borrower to a Pass risk rating would be helpful.

The effect of limited guarantors is uncertain.
We agree that, in certain instances, a risk rating based on a guarantor's wherewithal may be substituted for one based on the borrower alone.

But how would the proposal treat limited guaranties? Consider a limited guaranty, properly documented and imminently collectable. It bridges the difference between a 90% advance on real estate and a more conservative 70% exposure on the real estate alone. Would that qualify for RRL treatment?

The definition of an Asset Based Lending (ABL) collateral "valuation" is ambiguous.
While we agree that diligent monitoring of working assets can significantly mitigate credit risk, the proposal leaves open the definition of a "valuation." It would be helpful to provide guidance on whether a "valuation" is an ABL audit, executed to industry standard, an audited financial statement or a third-party appraisal, for example.

The proposal would include undrawn commitments in the calculation of classified *assets*.

- We are unclear as to why an unfunded commitment would be off-balance sheet when the borrower is sound, but effectively on-balance sheet when the borrower is troubled.
- We are unclear as to whether this contemplates the unfunded portions of committed lines of credit, Letters of Credit, or both.
- In either case, we are unclear as to why regulatory accounting requirements would diverge from GAAP on such a material point.

Suggestions For Alternative Treatment

In addition to the points of clarification summarized above, we would also suggest some treatments different from the provisions of the proposal as it is currently written.

The proposal specifies that, "The existence of adverse economic or market conditions that *are likely to* affect the borrower's *future* [emphasis added] capacity may support a "marginal borrower rating."

Established practice is that we assign risk ratings based on the financial condition of the borrower at any given point in time. Future prospects for improved or deteriorating cash flows are treated as irrelevant for risk rating purposes unless and until they actually materialize.

Related to the risk rating issue, GAAP allows for allowance allocations based on only those losses that have occurred at the balance sheet date. The disparate treatment of untroubled off-balance sheet items versus ones under distress could lead to an unwarranted divergence of GAAP and regulatory accounting requirements.

We would suggest maintaining the existing treatment of expected future events.

After writing down an exposure, the proposal prescribes a 6-month period of performance before upgrading out of the Default rating.

We understand and agree with the necessity for documented performance, especially after a writedown.

But if, at the date of writedown, the borrower has demonstrated the ability to service the new lower recorded debt amount in the six month time frame immediately preceding that writedown, we would suggest that ability to perform is sufficiently proven.

We would therefore offer an alternative to the proposal: If the borrower can demonstrate *either* (1) documented ability to service the new lower debt amount at a market interest rate for the six months immediately preceding the date of the writedown, *or* (2) six months of actual performance after the writedown, the credit qualifies for a return to performing status.

While sound in concept, some aspects of the proposal are complex and could prove difficult to implement at the line Relationship Manager level.

- The mixture of grids, new terminology, and ranges of loss exposure figuring into a final transaction rating separate and apart from the borrower rating is confusing, even to credit professionals possessing broad and deep experience. Implementation by less experienced relationship managers dealing with regulators who themselves would have varying degrees of experience, would be at best a daunting task.
- The current OLEM / Substandard / Doubtful / Loss rating system is well-known and understood by customer contact, credit and regulatory personnel. We would suggest that the dual rating system be presented in the form of a modification of the current system.
- Use of *ranges* of loss severity to drive Loan Loss Reserve allocations and risk ratings would be a complex, theoretical process vulnerable to conflicting interpretation from

institution to institution from one regulatory agency to another and among regulators in the same agency.

We would recommend the alternative of determining an institution's LGD for various collateral classes (e.g. OOCRE, NOOCRE, working assets, etc.) and using this modifier to determine the transactional risk rating.

Sincerely,

Michael J. Willoughby

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