

May 16, 2011

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
Attn: Comments

RE: Consolidated Reports of Condition and Income
3064-0052

12 CFR Part 327
Federal Register / Vol. 76, No. 51, March 16, 2011 / Notices
Proposed Agency Information Collection Activities
Comment Request

12 CFR Part 327
Federal Register / Vol. 76, No. 38, February 25, 2011 / Rules and Regulations
Assessments, Large Bank Pricing
Final Rule: Risk-Based Assessment System for Large Insured Depository Institutions

Ladies and Gentlemen:

The Northern Trust Company ("Northern Trust") supports the concept of applying risk-based evaluation tools in the determination of FDIC assessment fees. We are concerned, however, that the definitions of "leveraged loans" and "subprime loans," as they appear in the Final Rule, contribute to a concentration measure that does not accurately represent the risk incurred. Moreover, compliance with these definitions will present significant challenges to Northern Trust in reporting its position, especially if required to do so beginning June 30, 2011. Therefore, we respectfully request the FDIC reexamine both the content and timing of implementation of the Final Rule containing the definitions of these two terms.

Our comments are specifically directed toward the definitions of two components of the higher-risk asset ratio: (a) leveraged lending, and (b) subprime loans. This ratio is one element of the concentration measure used in the new scorecard, under the larger category of ability to withstand asset-related stress. It is applicable to both highly complex institutions and large insured depository institutions. Additionally we have provided comment on the challenges in complying with the reporting requirements set forth in the Final Rule beginning as of June 30, 2011.

Leveraged Lending

In defining leveraged lending the Final Rule does not recognize distinctions created by several important lending criteria, including type of transaction, composition of collateral/guaranty, and industry of the borrower. Without recognition of these distinct components, the current definition will not sufficiently differentiate leveraged lending risk among insured banks. The focus on a single ratio as a proxy for this risk is inconsistent with regulatory practices and will likely produce an undesirable level of volatility throughout an economic cycle.

More critically, gathering the required data will be very difficult, especially for initial reporting required

as of June 30, 2011. As defined in the Final Rule, this will require evaluation of total debt/EBITDA and senior debt/EBITDA for every commercial loan with original commitment greater than \$1 million. Northern Trust does not have all of the required data in electronic form, and locating it will require a substantial manual research effort. Building out a fully automated solution for future tracking of this data will take several quarters and be quite costly.

The industry accepted definition of leveraged lending contained in the *2008 OCC Comptroller's Handbook* would be a reasonable alternative and could be implemented more easily, while still achieving the FDIC's risk measurement objective.

"Numerous definitions of leveraged lending exist throughout the financial services industry. Depending upon the source, definitions commonly contain one or more of the following conditions:

- *Proceeds used for buyouts, acquisition, and recapitalization.*
- *Transaction results in a substantial increase in borrower's leverage ratio. Industry benchmarks include a twofold increase in the borrower's liabilities, resulting in a balance sheet leverage ratio (total liabilities/total assets) higher than 50 percent, or an increase in the balance sheet leverage ratio more than 75 percent. Other benchmarks include increasing the borrower's operating leverage ratios [total debt/ EBITDA (earnings before interest, taxes, depreciation, and amortization) or senior debt/EBITDA] above defined levels such as above 4.0X EBITDA or 3.0X EBITDA, respectively.*
- *Transactions designated as a highly leveraged transaction (HLT) by the syndication agent.*
- *Borrower rated as a non-investment-grade company with a high debt to net worth ratio.*
- *Loan pricing indicates a non-investment-grade company. This generally consists of some spread over LIBOR (London Interbank Offered Rate) that fluctuates as a function of market conditions.*

The OCC broadly considers a leveraged loan to be a transaction where the borrower's post-financing leverage, when measured by debt-to-assets, debt-to-equity, cash flow-to-total debt, or other such standards unique to particular industries, significantly exceeds industry norms for leverage.

Banks engaging in this type of activity should define leveraged lending within their lending policy. Examiners should expect the bank's definition to clearly describe the purpose and financial characteristics common in these transactions."

This definition would allow banks to identify leveraged lending relative to a clearly defined policy, based on the substance of underlying transactions, as opposed to a largely formulaic interpretation of one ratio. Automated tracking would be simpler going forward, as the bank would only have to implement and monitor a comprehensive "leveraged lending indicator" on its loan system.

Subprime Loans

The definition of subprime loans in the Final Rule does not consider several factors that are indicative of a subprime risk, such as size or type of delinquency/financing/judgment, and whether the credit characteristics reflect deterioration of a prime borrower or participation in a formal sub-prime program.

Gathering data to support this reporting will also be difficult for Northern Trust, especially for initial implementation. One specific concern is collecting relevant characteristics on existing loans where several of these factors are not retained post-origination.

The less prescriptive definition contained in the 2001 interagency guidance on subprime lending could be implemented more easily, while achieving the FDIC's risk measurement objective.

***"Exclusions** - For purposes of this guidance, subprime lending does not refer to individual subprime loans originated and managed, in the ordinary course of business, as exceptions to prime risk selection standards. The Agencies recognize that many prime loan portfolios will contain such accounts. Additionally, this guidance will generally not apply to: prime loans that develop credit problems after acquisition; loans initially extended in subprime programs that are later upgraded, as a result of their performance, to programs targeted to prime borrowers; and community development loans as defined in the CRA regulations that may have some higher risk characteristics, but are otherwise mitigated by guarantees from government programs, private credit enhancements, or other appropriate risk mitigation techniques.*

*The term "**subprime**" refers to the credit characteristics of individual borrowers. Subprime borrowers typically have weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers. Generally, subprime borrowers will display a range of credit risk characteristics that may include one or more of the following:*

- Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months;*
- Judgment, foreclosure, repossession, or charge-off in the prior 24 months;*
- Bankruptcy in the last 5 years;*
- Relatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood; and/or*
- Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.*

This list is illustrative rather than exhaustive and is not meant to define specific parameters for all subprime borrowers. Additionally, this definition may not match all market or institution specific subprime definitions, but should be viewed as a starting point from which the Agencies will expand examination efforts."

Similar to leveraged lending, adopting this definition would allow banks to identify subprime loans relative to a clearly defined program/policy based on the substance of the underlying transaction, as opposed to a formulaic interpretation of a handful of characteristics. Including FICO as a factor would also make initial implementation more realistic for many banks including Northern Trust.

In conclusion, Northern Trust believes both the definitions of leveraged lending and subprime loans and the timeline for reporting implementation, as set forth in the Final Rule, bear further consideration.

Sincerely,

Thomas E. Bernhardt
Senior Vice President