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September 25, 2017

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
Eccles Board Building
20th and C Street, NW
Washington, DC 20219

Mr. Keith Noreika
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Re: Retaining existing transition provisions for certain elements of the regulatory capital rules [RIN 3064-AE 63]

Dear Chairman Gruenberg, Chair Yellen, and Acting Comptroller Noreika:

This letter is submitted in response to the notice published in the *Federal Register* of August 25, 2017 (82 Fed. Reg. 40495) on behalf of a coalition of community banks adversely affected by the Basel III capital rules requiring the deduction of Trust Preferred Securities (TruPS) from Tier I capital if those securities represent more than ten-percent of total capital.

Approximately 25-30 community banks are covered by this particular provision. They are located in numerous states but especially in Illinois, Mississippi and Wisconsin. Many of these institutions operate in rural areas. Several have assets of less than $100 million, and, in many instances, are banks which have been in business over 100 years and have never been less than well-capitalized until Basel III took effect.

The extent of the capital deduction, were it to be fully implemented, could be as high as 20-percent for some of these companies. For this reason, we commend the federal supervisory agencies for the proposal to pause the fourth and final year of the Basel III transition period while a review of the TruPS and other regulatory capital instruments issued by financial institutions is conducted.

Over 300 FDIC-insured institutions invested in TruPS CDOs since their issuance was initially authorized under a 1996 interpretation of the Federal Reserve Board. As issued, they were highly-rated and diversified bank obligations. When some issues became impaired during the financial crisis, these securities were properly and accordingly written down as required by accounting rules. In our view, the combination of the accounting requirements for banks to write down their investment in TruPS based on the expected performance when combined with existing risk-based capital rules constituted a more than adequate underpinning from the standpoint of safety and soundness.

Inasmuch as no additional TruPS have been issued since 2007, and that the health of the issuing banks has now stabilized, it was never necessary in our view for existing TruPS held by banking institutions to become subject to a capital deduction imposed by Basel III. Indeed, these securities, consisting of long-term investments with adjustable interest rates, now represent a quality asset on the books of many institutions.

On the other hand, the Basel III deduction has been onerous and counterproductive to the communities served by the adversely affected institutions. In the aggregate, the amount of the capital deduction attributable to the Basel III TruPS provision is estimated to be approximately $250 million. A bank’s lending capacity is directly tied to its capital levels, and, as a general rule, every dollar of capital in a bank can be leveraged on a multiple of twelve. Thus, in the specific context of the Basel III TruPS provision, the result has been a lending capacity loss in excess of $2.5 billion.

Moreover, a very large number of the affected banks are in rural or other underserved communities. Many are or could be designated as Community Development Financial Institutions serving low- to moderate-income areas. For these companies, there is no realistic way to raise new capital and their only option has been to shrink the bank or find a merger partner, which has, in several instances, already occurred.

The adoption of the proposed rule and the revocation of capital deductions mandated by the prior requirements would immediately allow these institutions to increase their lending for residential and commercial mortgages, apartment lending, small business support and other areas of capital deployment including municipal financing needs in the communities they serve.

Thank you for taking these recommendations under consideration.

Respectfully submitted,

James J. Butera
Ryan D. Israel