James R. Biery
President, CEO & Treasurer
717.255.6911 (ph)
717.233.6362 (Fax)
jbiery@pabanker.com

October 22, 2012

The Honorable Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
Docket ID OCC-2012-0008 and OCC-2012-0009 RIN 1557-AD46

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Docket R-1430 and R-1442 RIN No. 7100-AD 87

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
comments@fdic.gov
RIN 3064-AD95 and RIN 3064-AD96

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (the "Basel III Proposal") and Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (the "Standardized Approach Proposal")

Dear Federal Bank Regulatory Agencies:

The Pennsylvania Bankers Association (PBA) represents over 150 institutions and their affiliates in the Commonwealth of Pennsylvania. Our Association's federal government relations policy-makers believe this letter to be generally reflective of the PA banking industry's collective views on these Proposals. We will not offer comments on the "advanced approaches."

I. Summary of PBA's Position

The PBA understands that the banking industry must maintain adequate, quality capital. We simply do not believe that the Proposals named *above* would achieve that goal without substantial harm to the U.S. banking industry and the customers and communities it serves.

We respectfully request the withdrawal of these Proposals with the pledge that we and others representing the banking industry under the American Bankers Association/State Bankers Association Alliance will work with you to develop workable bank capital regulations reflective of the largely community-based banking system in this country.

II. Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (the "Basel III Proposal")

A. Profitability, Investment, Management Recruitment & Retention

We believe the Proposals would significantly reduce bank profitability and thus increase the risk of bank failures rather than reduce it. Adequate returns on equity are necessary in order to attract investment. Good management is required in order to operate safe and sound institutions. Maintaining the required capital conservation buffer would impose capital distribution and compensation restrictions that are simply not necessary in light of the already adequate regulatory authority to restrict dividends and executive compensation. The Proposals have the potential to reduce profitability, investment and human resources at a time when they are already difficult to maintain.

B. Bank Balance Sheet and Market Stability

Regulatory capital levels would become unnecessarily volatile by including Accumulated Other Comprehensive Income ("AOCI") in the calculation of Common Equity Tier 1 Capital. Unrealized gains or losses may never be realized and thus are not reflective of changes in value. Banks are already examined for their ability to effectively manage interest rate sensitivity. Measuring capital on the proposed basis would restrict loan availability to no good supervisory end. Our members also see a potential negative impact on the already-stressed municipal bond market.

C. Restricted Core Capital Elements

We believe the legislative intent of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") was to exclude institutions with less than $15 billion in assets from the phase-out of trust preferred securities proceeds from Tier 1 capital eligibility. The vast majority of institutions that issued trust preferred securities have not experienced problems. Institutions of this size also have less access to capital markets. The DFA's grandfathering provision is justified. We request that it be respected.

D. Deferred Tax Assets

Financial institution tax planning is complex and strategic. The ability to realize future tax benefits in bank capital calculations is vital. We suggest using U.S. Generally Accepted Accounting Principles which allow a greater variety of factors to be considered in evaluating these assets' quality.

E. ALLL

The Proposals result in "double-counting" of numerous credit risk elements. Some relief could be obtained by eliminating the limit on an institution's Allowance for Loan and Lease Losses includable in Tier 2 capital.

F. Mortgage Servicing Assets

Institutions which originate, sell and service mortgages should be supported, not penalized, by the Proposals. Limiting the inclusion of the value of mortgage servicing assets in capital, combined with other aspects of these Proposals, could reduce bank mortgage lending and servicing at a time when the housing market is struggling to regain its role in the economy of Pennsylvania and our nation. Our housing market needs more bank participation, not less.

III. Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (the "Standardized Approach Proposal")

A. Residential Mortgage Risk Weights

The highest level of concern expressed to PBA regarding these Proposals has centered on the risk-weighting of residential mortgages.

1. Balloon features

Balloon features are a simple interest rate risk management tool accessible to community banks which largely lack complex interest rate hedge capabilities. They allow direct management of a loan's duration and interest rate risk. They also serve a variety of specialized customer needs. They are not by nature more risky. We request elimination of the balloon structure exclusion.

2. LTV and appraisals

The Proposal would rely too heavily on loan-to-value ratios and appraisals in measuring risk. Collateral is only one lending consideration. Why a mortgage secured by collateral would be viewed as more risky than an unsecured consumer loan makes no sense to us. No residential mortgage loan should be weighted higher than 100%. Rural Pennsylvania home buyers and sellers have limited access to experienced appraisers. As a result, PBA and other trade associations in Pennsylvania are concerned that appraised values do not reflect actual property values as evidenced by the withdrawal of a sizeable number of home purchase contracts when appraised values do not match the offer price. The Standardized Approach

over-relies on appraisals at a time when their utility in measuring value is questionable.

3. Commercial Real Estate

   The concerns enumerated *above* also apply to "High Volatility Commercial Real Estate (HVCRE) risk weighting. We understand the potential risks posed by over-concentration in CRE and the additional management oversight that acquisition, development and construction (ADC) projects require. We simply believe that the proposed HVCRE definition over-relies on project equity as a risk determinant when other available forms of collateral can serve as appropriate equity and other management tools can mitigate risk.

4. Past Due Exposure

   Risk weighting at 150% for assets 90 days or more past due or on nonaccrual status ignores existing processes for risk management and imposes increased operational burden without a proven benefit. Current accounting rules require appropriate valuation allowances for an impaired loan. This risk weighting double-counts the exposure unnecessarily.

5. Off-balance sheet items

   a. Unfunded loan commitments

      We do not believe the proposed risk-weighting change for this category is merited. Further, we believe that decreasing short-term lending will impact small businesses negatively.

   b. Credit-enhancing representations and warranties for mortgage loans sold

      As noted *above*, many community banks do not want to invest in long-term loans due to the impact on their interest rate risk, so they originate mortgages and sell them in the secondary market. Certain representations and warranties regarding the value of the collateral apply in those transactions. If banks must apply a 100% risk weight for the duration of mortgages sold, they are likely to substantially reduce their mortgage lending in response. Less mortgage availability at this point in our fragile state and national economic recovery would be counter-productive public policy. Granted, certain mortgage lending practices contributed to the downturn, but we believe those practices to have occurred largely outside regulated bank originators.

6. Federal Home Loan Banks

   a. Repurchase Agreements

Repurchase agreements are a key part of the financial management of the FHLBank system. The proposed rule will increase the capital charge for banks that sell securities to a Federal Home Loan Bank with the obligation to repurchase these securities at a later date. When the FHLBank is a counterparty there is essentially no risk to the selling bank that the Federal Home Loan Bank will not be able to comply with its obligation to return the securities to the counterparty. We urge the regulators to provide an exemption from this new capital requirement for off-balance sheet positions held as part of a repo transaction.

b. Swaps

FHLBanks, as well as other financial institutions holding interest rate sensitive assets, engage in derivative transactions to protect against changes in prevailing interest rates. The proposed rule requires banking organizations to hold capital with respect to such derivative agreements, with the amount of the capital charge dependent upon the counterparty, the collateral, and the remaining maturity on the contract. The proposal would not require a capital charge for derivatives cleared through a central clearinghouse. The FHLBanks use a wide variety of swap agreements to hedge the various types of funding that our member banks require, and therefore the use of a clearinghouse is not practicable for all swaps transactions. Further, when the FHLBank is a counterparty there is essentially no credit risk to the counterparty. We believe that capital should not be charged when the counterparty is an FHLBank, even if a clearinghouse is not used.

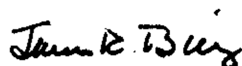
IV. Conclusion

The Basel Accords were not developed for the U.S. banking system which like no other enjoys the availability of thousands of institutions of all sizes with community banks pre-dominating in numbers but not size. U.S. bank regulation needs to be scaled accordingly while preserving bankers' ability to apply judgment and experience applicable to their communities and customers' unique needs.

For the reasons briefly summarized *above*, PBA strongly urges your agencies to withdraw these Proposals completely pending further research and analysis with the goal of re-proposing a simpler regulatory capital framework.

We look forward to working with you toward that end.

Respectfully submitted,



cc: PA's US Senators and Members of its House Delegation
The Honorable Glenn Moyer, Secretary of Banking and Securities

3897 North Front Street • Harrisburg, PA 17110 • Tel. (717) 255-6911 • FAX: (717) 233-6362 • www.pabanker.com

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