Black River Country Bank

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September 27, 2012

VIA ELECTRONIC DELIVERY
Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.,
Washington, DC 20429
comments@FDIC.gov
RIN 3064-AD95 and RIN 3064-AD96

RE: Regulatory Capital Rules: (1) Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Correction Act: RIN 3064-AD95; and (2) Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements: RIN 3064-AD96

Dear Mr. Feldman:

Black River Country Bank is a $70,000,000 community institution in Jackson County, Wisconsin. As a community banker with Black River Country Bank, I am gravely concerned over the broad approach taken by the Federal Deposit Insurance Corporation (FDIC), together with Board of Governors of the Federal Reserve System (FRB) and Office of the Comptroller of the Currency (OCC), (collectively, the Agencies) to impose a “one-size-fits-all” regulatory capital scheme despite the fact that the industry believed the Basel III proposals were intended for the very large, complex international institutions.

Black River Country Bank has been in operation for over 100 years. We have survived difficult economic times more than once. Typically during these difficult times more regulatory burdens are place on the community banks and we typically find ways to survive and adjust the new climate, but it is frustrating when the regulatory changes continue to take place because of practices of institutions that are not community banks. I as a community banker want you to consider what we have done for our communities, our economy and banking industry as a whole. While we may not be the big players, when all put together, the community bank is the cornerstone of each of these. We are diligent in work to be a good community member, provide for our customers and shareholders and protect the integrity of the banking system. We do this regardless of the regulatory environment and our past performance proofs that. It is time for there to be clear differences made in the regulatory community and not to be presented rules that will discourage community banks from continuing to be that cornerstone.

Respectfully, I believe this approach excessively tightens regulatory capital requirements on community banks which is unwarranted, beyond Congressional intent in many respects, and will likely cause a disruption in available credit in our marketplace.

I wish to remind the Agencies that, in addition to the proposed Basel III rules, there are currently at least ten major mortgage related rulemakings in various stages of development (HOEPA, MLO compensation, TILA/RESPA integration, two appraisal rules, ability-to-repay, risk retention, escrow requirements, and mortgage servicing rules under both TILA and RESPA). This, in turn, builds upon at least seven major final rulemakings in the previous 36 months (RESPA reform, HPML requirements, two MDIA implementation rules, appraisal reforms, appraisal guidelines, and MLO compensation).

I am very much concerned about the cumulative burden these rules will have on my institution. It is vitally important that the proposed regulatory capital rules be analyzed together in the context of other rulemakings and regulatory reforms—and be prospective in approach. The Agencies must not create capital requirements that are based upon occurrences in the past, under a different regulatory environment, and without consideration of other rulemakings and reforms.

For these reasons and for the concerns outlined below, the Agencies must withdraw the proposed regulatory capital rules, conduct additional study and analysis, and only propose capital rules which take into consideration the impact other regulatory proposals and reforms will have on risk. The Agencies must recognize that there are many differences between community banks and large, complex international institutions—and must, therefore, not force a community bank into the same capital calculation "peg-hole" as a sophisticated international institution.
If the Agencies do not withdraw the proposals to further study the drastic impact they will have on community banks and on the U.S. financial industry as a whole, I urge the Agencies to take into consideration the specific concerns and recommended changes noted below.

Accumulated Other Comprehensive Income (AOCI)

As proposed, all unrealized gains and losses on available for sale securities (AFS) must "flow through" to common equity tier 1 capital. Therefore, if there is a change in the value of an AFS security (which can occur daily in some circumstances), that change must immediately be accounted for in regulatory capital. I wish to remind the Agencies that unrealized gains and losses occur in AFS portfolios primarily as a result of movements in interest rates—and *not* as a result of credit risk.

If the rules are finalized as proposed, with the inclusion of unrealized losses of AFS securities in common equity tier 1 capital, rising interest rates would put downward pressure on banking organizations' capital levels. This will potentially cause my bank to reduce our growth or shrink our securities portfolios considerably in order to maintain capital ratios at the desired or required levels.

Additionally, as a community bank, we have been an investor in our local government entities. However, as proposed, the rules would discourage my bank from holding municipal securities, including holding U.S. Treasuries, because of the interest rate impact on such long-duration assets. This, in turn, could lead to a lower return on assets for my bank and less funding for the housing market and national and local governments, collectively.

For these reasons, I greatly oppose this proposed treatment. <u>The Agencies must remove this treatment from the proposals.</u>

Capital Risk-Weights for Residential Mortgages and Related Matters, High Volatility Commercial Real Estate (HVCRE), and Home-Equity Lines of Credit (HELOCs)

The Agencies' proposals place new significantly higher capital risk weights in several categories of real property-secured loans despite having neither empirical evidence to substantiate the need for such heightened capital levels, nor a mandate under law. The proposals raise several significant concerns, including the following.

Residential Mortgage Exposures Risk Weights

The proposals assign risk weights to residential mortgage exposures based on whether the loan is a "traditional" mortgage (Category 1) or a "riskier" mortgage (Category 2) *and* the loan-to-value (LTV) ratio of the mortgage. The current risk weight for a real estate mortgage is generally 50%; however, depending upon the Category and LTV ratio of a particular residential mortgage, the capital risk could rise to 200%. These higher risk weights appear to be arbitrarily set as there is no empirical data presented by the Agencies to support this extraordinary increase in risk weights for certain types of mortgages.

Respectfully, I challenge the Agencies' assumption that a residential mortgage has a higher degree of risk based exclusively upon the loan having a balloon payment, an adjustable rate, or an interest-only payment, to warrant the substantial increases in capital risk weights that are proposed. In fact, our portfolio of balloon loans has experienced minimum losses with a default rate of less than ½ percent. The Agencies' proposed capital treatment far outweighs the reality of risk that we have experienced for these types of loans.

In addition, the substantial increase in risk weights will discourage my bank from making these types of loans even though we have experienced minimal losses and they have been the backbone of the business model we have developed. As a community bank, we make loans that are 3- or 5-year balloon mortgages with payments amortized up to 30 years. We provide such loan products in order to offer loans to good borrowers and to protect against interest-rate risk. This type of lending has been the cornerstone to our community bank for the last century. However, the new risk weights will discourage us from making such loans. For example, if we make a 5-year balloon loan with a LTV of 81-90%, the capital risk weight skyrockets from the current rule of 50% to 150% under the proposals. We have made many of these types of loans in the last 15 years and continue to do so today. We make these loans based on sound underwriting decisions, knowledge of our customers and of our community. We these sound practices we have continued to be a strong community bank, but this type of treatment will detrimentally impact just how many loans I can offer my community and customers, will reduce or eliminate a traditional credit product that customers seek, and will also reduce our ability to protect against interest rate risk. This proposal and everything else that the government has done to move mortgage lending into 30 year fixed rate lending has been a travesty on community banks. You are forcing these well securing, solid loans that are the livelihood of our bank off our books and if we decide to keep them on our books we are subject to lack of control of our interest rate risk and criticism from you our regulator because of it. At the current time approximately 25% of our lending could be affected in a negative way by these proposals and I do not foresee a way for us to replace that.

<u>The Agencies must not finalize the proposed rules with such severe and unwarranted risk weighted treatment of residential mortgage exposures</u>.

Reclassification to Category 2 for the Restructure or Modification of Mortgages Unless Made Under HAMP

The proposals would also require a financial institution to re-assess a mortgage after a loan restructuring or modification, unless the modification is made under the federal Home Affordable Mortgage Program (HAMP). Thus, a Category 1 mortgage may become a Category 2 mortgage after modification if the bank does not modify the loan under HAMP. I believe this treatment will, in essence, limit my ability to provide an option to restructure or modify a loan except under HAMP. Given today's economy and its impact on any particular borrower, it is imperative banks be given flexibility to restructure or modify *any* given mortgage loan to the particular needs of both the bank and the borrower—including not under HAMP. The bank should not be penalized by assigning a Category 2 risk weight to a loan that is modified or restructured in a manner that is not under HAMP. Again, we the community bankers know our customers and know our bank. For years we have worked out solutions with our customers that need the help in a fashion that was satisfactory for the customer and the bank. These customers are our neighbors, our community and our friends, thus we are not here to not help them when possible and this proposal only makes it more difficult to review the differences that every single restricting or modification may need.

<u>The Agencies must allow for the same capital treatment of restructuring or modification for any mortgage as they would permit a loan restructure or modification under HAMP.</u>

Removal of PMI Recognition When Determining Loan LTV

The bank's residential mortgage portfolio would also be negatively impacted by the proposed change in treatment of private mortgage insurance (PMI). The proposed rules do not recognize PMI when determining an LTV for a particular loan. Therefore, mortgages would be subject to high risk weights even if PMI reduced the risk of loss for such loans. It is difficult in today's challenging economy for borrowers to come up with 10% downpayment, much less an amount higher than that, thus, PMI continues to be a product purchased to protect against repayment default risks. I recognize the concerns expressed by the Agencies within the proposed rules regarding less financially-sound PMI providers; however, where a bank can demonstrate that a particular PMI provider is financially sound, the bank should be permitted to recognize PMI when determining the particular loan's LTV ratio for capital risk weight purposes.

<u>The Agencies' proposals must recognize that PMI reduces the risk of loss for such loans, and must, therefore, provide for the recognition of PMI when determining a loan's LTV ratio.</u>

Capital Requirements for Loans with Credit-Enhancing Representations and Warranties

Under the proposed rules, if a bank provides a credit-enhancing representation or warranty on assets it sold or otherwise transferred to third parties, the bank would be required to treat such an arrangement as an off-balance sheet guaranty and apply a 100% credit conversion factor to the transferred loans while the credit-enhancing representations and warranties are in place. This new requirement would affect any mortgage sold with a representation or warranty that contains (1) an early default clause, and/or (2) certain premium refund classes that cover assets guaranteed, in whole or in part, by the U.S. government or a government-sponsored entity. Currently, the risk-based capital charges do not apply to mortgages once they are sold to third parties, even where the seller provides representations and warranties to take back mortgages that experience a very early payment default—such as within 120-days of the sale of the mortgage.

The proposal would result in substantial additional capital charges for the mortgages we sell and will limit the amount of credit I can make available to potential borrowers. I believe there is little evidence that the temporary representations and warranties associated with these mortgages have resulted in significant losses for a regulated financial institution—even during the financial crisis.

<u>As a result, the Agencies must retain the 120-day safe harbor under the current risk weight rules and not impose this additional capital charge.</u>

Home-equity Lines of Credit (HELOCs)

The proposal classifies all junior liens, such as home-equity lines of credit (HELOCs), as Category 2 exposures with risk weights ranging from 100 to 200%. In addition, a bank that holds two or more mortgages on the same property would be required to treat *all* the mortgages on the property—even the first lien mortgage—as Category 2 exposures. Thus, if a bank that made the first lien also makes the junior lien, the junior lien may "taint" the first lien thereby causing the first lien to be placed in Category 2, and resulting in a higher risk weight for the first lien. By contrast, if one bank makes the first lien and a different bank makes the junior lien, then the junior lien does not change the risk weight of the first lien. There is one exception to this general treatment; however, that exception is very narrow and thus, most junior lien mortgages will likely be deemed Category 2 mortgages.

Again, this is another area within the proposals for which the Agencies have provided no data to support their assertion that all HELOCs are risky and warrant such severe treatment. In reality, HELOCs are carefully underwritten—based not only on the value of the home, but upon the borrower's creditworthiness and with some of the strongest LTV ratios. Historically are home-equity loans have performed the same as our 1st mortgage loans. Where we have seen a difference in performance is when we have had the 2nd mortgage loan, but not the 1st mortgage. Typically this customer has presented more risk, mostly due to the fact that the original lender probably was not interested in making the loan. This entire thought process appears to be backwards to me. We should be encouraging the borrowers to keep the equity lending needs with the existing lending that knows them best and the property best. We work so hard to develop these customers and provisions like this that would have us suggesting to our customers to look elsewhere for the equity loans so our capital position is not harmed just doesn't make sense.

<u>The Agencies must remove the treatment that all HELOCs are an automatic Category 2 classification.</u>

No Grandfather Treatment for Existing Mortgage Loans

Finally, the proposed rules do not include any type of grandfather provision. Thus, *all* mortgage loans currently on the bank's books will be subject to the new capital requirements. This will require bank staff to examine old mortgage underwriting files to determine the appropriate category and LTV ratio for each mortgage. This is a daunting task and comes at a time when the industry is also implementing numerous other *substantial* regulatory revisions and reforms previously mentioned. We simply do not have resources necessary to gather all of the information required to properly determine the revised risk weights for existing mortgage loans. We have developed the model our bank operates on with a lean staff that is well trained and loyal. It is difficult to find qualified new staff and if found to keep them and train them. Our staff is already overburdened with work that doesn't add to the bottom line and I do not see how this additional burden would add any safety nets but instead just increase costs, which ultimately will be passed on to the customers.

The Agencies must grandfather all existing mortgage exposures by assigning them the current general capital risk-based weights.

Conclusion

For the concerns outlined above, the Agencies must withdraw the proposed regulatory capital rules, conduct additional study and analysis, and only propose capital rules which take into consideration the impact other regulatory proposals and reforms have on risk.

The Agencies must recognize that there are many differences between community banks and large, complex international institutions—and must, therefore, not force a community bank into the same capital calculation "peg-hole" as a complex international institution.

I appreciate the opportunity to comment on the Agencies' proposals.

Sincerely,

Robert Becker
President