October 10, 2012

Via E-mail: regs.comments@occ.treas.gov
Office of the Comptroller of the Currency
250 E Street, Southwest
Mail Stop 2-3
Washington, DC 20219

Via E-Mail: regs.comments@federalreserve.gov
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, Northwest
Washington, DC 20551

Via E-Mail: comments@FDIC.gov
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, Northwest
Washington, DC 20429

Re: (1) Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, Basel III OCC Docket ID OCC-2012-0008; Basel III Federal Reserve Docket No. R-1442; Basel III FDIC RIN 3064-AD95 (the "**Basel III NPR**"), and (2) Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, Standardized Approach OCC Docket ID OCC-2012-0009 and 0010; Standardized Approach FDIC Docket No. RIN 3064-AD96 and RIN 3064-D97 (the "**Standardized Approach NPR**") (the Basel III NPR and the Standardized Approach NPR being collectively, the "**NPR's**")

Dear Ladies and Gentlemen:

Background and Overview

As President and CEO of Fox Chase Bank, I appreciate this opportunity to respond to the Basel III NPR and the Standardized Approach NPR, each dated June 7, 2012, that were recently approved by the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (collectively the "agencies"), which together outline broad principles to be used by banking organizations in capital planning.

Fox Chase Bank is a 145-year old, $1 billion asset, well-capitalized federal thrift headquartered in Hatboro, PA, that did not participate in the TARP or SBLF programs. We have played a vital role in providing loans to area businesses, especially in the wake of the Great Recession of 2008-2009. During

the last five years we expanded our business lending at a 40 percent 5-year compounded growth rate. Serving businesses and consumers in our local markets is our specialty and our local roots and long history of serving local markets differentiates the bank from national and international banks, which dominate the market.

As a community banker I fail to comprehend the rationale for applying the Basel III standards, which have been formulated for large, complex, systemically important international banking organizations, to community banks (which for statutory and regulatory purposes have recently been defined as those banks having less than $10 billion in assets). Community banks do not engage in many of the business activities of these larger and more complex financial firms and, as a result, typically are subject to fewer and less complex risks. The NPRs are not required under the Dodd-Frank Act or any other U.S. law, and they exceed the intended scope of Basel II and Basel III. On this basis alone, I would urge the regulatory agencies to exclude from coverage banks under $10 billion in total assets.

There are many troubling and impractical consequences of the NPRs to Fox Chase Bank and other community banks that will collectively limit our ability to meet the credit needs of borrowers in our communities, and are likely to (i) substantially limit the availability of credit for certain types of borrowers and/or (ii) significantly increase the borrowing costs to certain business owners and consumers.

The NPRs treat mega-banks and community banks as being identical business models with identical risk profiles. This does not take into consideration the more simplified balance sheets and customary lending practices of community banks. And while it is true that many community banks have failed through the recent cycle, those failures generally relate to loan concentrations in ADC and higher-risk residential mortgage loans that the agencies had existing rules and enforcement powers at hand to deal with effectively.

I will amplify these concerns and demonstrate how the interaction of various regulatory proposals (including but not limited to the anticipated definitions of "Qualified Mortgage" and "Qualified Residential Mortgage") will forcefully coalesce in such a way as to significantly reduce the capacity of community banks, including that of Fox Chase Bank, to make credit available to our customers.

I urge you to exempt community banks from the NPRs.

Harmful Effects of Flowing Unrealized Gains and Losses through Capital

The NPRs propose that unrealized gains and losses on Available-for-Sale (AFS) securities "flow through" to common equity tier 1 ("CET1"). Under the current risk-based capital rules, unrealized gains and losses that exist in accumulated other comprehensive income on AFS debt instruments are not included in regulatory capital. By including unrealized losses of AFS securities in CET1, rising interest rates will exert substantial downward pressure on bank capital levels. As a consequence, banks will have to reduce lending, negatively impacting the ability of the banking sector to contribute to economic recovery in a rising interest rate environment and raising the risk of liquidity crunches during times of economic expansion.

AFS investment securities provide a vital source of liquidity for community banks. Because of the volatile nature of interest rates over longer time frames and the unpredictable nature of interest rate movements, the NPRs introduce substantial volatility into CET1 and Tier I capital. This will require banks of all sizes to maintain ratios of both CET1 to risk-weighted assets and Tier 1 capital to risk-weighted

assets that substantially exceed levels that would otherwise apply in order to avoid the sanctions applicable to banks that fall below the proposed capital conservation buffer. Alternately, it could provide incentive for bank management to reduce AFS securities, which would affect its liquidity and could become a safety and soundness issue.

Because rising interest rates will be experienced by all banks simultaneously, the impact of the NPR as proposed will stress the capital levels of all banking organizations coincidental to a rise in interest rates. This is likely to place immense pressure on regulatory bodies without the benefit of reducing risk on bank balance sheets. To the contrary, the NPRs will increase balance sheet risk without economic or social benefit.

The NPR should be revised by the agencies such that unrealized gains and losses on AFS securities that reside in accumulated other comprehensive income do not flow through capital. This would allow unrealized losses related to credit impairment to be reflected in capital, but would exclude the impact of interest rate fluctuations.

At a minimum, gains and losses on U.S. government and agency debt obligations, including U.S. GSE debt obligations should be excluded from the revised capital treatment under the NPRs.

Harmful Systemic Effects of TAG Expiration in combination with NPRs

At present, the FDIC's TAG program extension is in jeopardy. Since the inception of the TAG program, transaction deposits guaranteed by the FDIC above the typical insured deposit limit of $250,000 increased $266 billion to an industry-wide total of $1.507 trillion at March 31, 2012. Many market watchers expect a significant exodus of low-cost transaction deposits from insured depositories as a result of the expiration of the TAG program. In order to retain a portion of these deposits upon the expiration of the TAG program, banks may be required to offer collateralized deposit guarantees similar to those mandated for municipal deposits. This will require the industry to acquire and hold more high quality investment securities to collateralize deposits at a time when interest rates are at all-time record lows and the Federal Reserve has announced, but not commenced, QE3. When interest rates inevitably rise, these securities will likely result in future unrealized losses, and will deplete bank capital under the NPRs.

Alternately, the industry could see these deposits flow from bank deposit accounts to money market mutual funds or other vehicles, requiring banks to reduce lending and shrink balance sheets, or further compress besieged net interest margins by seeking more expensive funding alternatives. The first option hampers economic recovery by reducing lending capacity. The second option reduces bank safety and soundness.

Harmful Effects of Cash Flow Hedge Treatment

The NPRs propose that banks deduct any unrealized gain and add any unrealized loss on cash flow hedges included in accumulated other comprehensive income to CET1, net of applicable tax effects, which relate to the hedging of items that are not recognized at fair value on the balance sheet. The proposed deduction will have a particularly negative impact in light of the proposed treatment of unrealized gains and losses on AFS securities described above. Cash flow hedges are a proven and reliable tool that bankers have used successfully to prudently manage interest-rate risk exposures in a safe and sound manner. In some situations, it is the only tool that can be used to mitigate certain

interest-rate exposures. Since cash flow hedges present little or no economic risk to community banks and are, both in fact and in practice, used to decrease economic risk to banks, which is an essential aim of bank safety and soundness, this aspect of the NPR should be eliminated in the final rule or, in the alternative, the NPR should be modified to exclude community banks from this harmful treatment of cash flow hedges.

Harmful Effects of NPRs on First-time Home buyers and the Move-up Market

The NPRs propose to separate 1-4 family residential mortgage loans into two risk categories: "category 1 residential mortgage exposures" and "category 2 residential mortgage exposures" based on certain loan-to-value ("LTV") and underwriting characteristics. The NPR does not recognize private mortgage insurance ("PMI") for the purposes of calculating the LTV. The proposed definition of category 1 residential mortgage exposures would generally include traditional first-lien, prudently underwritten mortgage loans and first-lien home equity loans. Risk weights for category 1 residential mortgage exposures increase with rising LTVs that range from: 35 percent weight for LTVs less than or equal to 60 percent; 50 percent weight up to an LTV of 80 percent; 75 percent weight for LTVs up to 90 percent; and 100 percent weight for LTVs over 90 percent. This departs sharply from the 50 percent risk-weighting applicable to all first-lien residential mortgages in effect today.

Category 2 residential mortgage exposures would generally include all junior-liens and so-called "non-traditional" first-lien mortgage loans, which are those that do not meet the definition applicable to category 1. This would include loans with an amortization longer than 30 years, have a balloon feature, or do not meet the full underwriting document support required to qualify for treatment as category 1. Risk weights for category 2 residential mortgage exposures also increase with rising LTVs that range from 100 percent weight for LTVs less than or equal to 80 percent; 150 percent weight for LTVs up to 90 percent; and 200 percent weight for LTVs over 90 percent. This departs sharply from the 50 percent risk-weighting applicable to residential mortgages that would fall into category 2 in effect today.

The use of LTVs is at best arbitrary since LTVs are based on appraisal values, which vary widely with market conditions and can change dramatically over time. Appraisals are a "best guess" of value at any point in time.

The proposed burdensome and unnecessary risk-weightings for residential mortgage loans will either (i) reduce availability of credit for first-time home buyers who do not quality for VA or FHA residential mortgage loans, or (ii) substantially increase the cost of home ownership for first-time home buyers. In my 31-years as a banker, the vast majority of first-time home owners are unable to put 20 percent down on their first home. The NPRs will substantially curb lending to first-time home owners and will harm the housing recovery.

Residential mortgage loans with balloon features are not only prudent interest-rate risk instruments for community banks, there are situations where this product is a wise and prudent choice for the borrower. Second mortgage or home equity loan risk-weights of 150 to 200 percent will be harmful to our clients who depend on this source of funding to pay for the costs of college education for their children. When combined with restrictions associated with qualifying for federal or school-based student aid, it will have large repercussions on the ability of many families to pay for their children's education.

Finally, the complexity of the scheme of risk weights based on LTV ratios and categories will create an unnecessary burden on community banks. This scheme clearly seeks to address some characteristics associated with contributing factors to the financial crisis, however, it fails to recognize that for each soured loan with the characteristics mapped out in the NPR, there were many others that have and continue to perform well, and have contributed to low-cost home ownership in the U.S. Furthermore, the characteristics themselves do not make for a more or less risky loan, and evidence from the housing market melt-down point to a few "bad actors" using riskier types of products as a driving force, and not the products themselves, each with a prudent and practical application in a given situation.

For these reasons, I urge the agencies to greatly simplify the risk-weighting scheme for residential mortgage loans.

Harmful Effects of NPRs in Combination with Dodd-Frank Definitions of Qualified Mortgage and Qualified Residential Mortgage

The NPRs proposed risk weighting for 1-4 family residential mortgage exposures (see above), when combined with the widely anticipated final definitions of "Qualified Mortgage" ("QM") and "Qualified Residential Mortgage" ("QRM") pursuant to the Dodd-Frank Act will coalesce in such a way as to harshly limit credit availability and affordability for first-time home buyers.

Although not finalized, the Consumer Financial Protection Bureau's ("CFPB") draft rules relating to Qualified Mortgages and Qualified Residential Mortgages will drive the industry towards traditional 80% LTV residential mortgages because of anticipated safe-harbor provisions expected in the final rule. The NPRs strongly reinforces this regulatory intent by introducing risk-weightings for residential mortgages with higher LTVs as described above. As most mortgage loans originated with higher LTVs are granted to first-time home buyers, the interaction of the CFPB's QM and QRM rules with the NPRs will have the effect of severely reducing the availability of financing for first-time home buyers or substantially increasing the cost of it, making home ownership less affordable. This will not only delay the recovery in the U.S. housing market, it will likely create massive and permanent shifts in U.S. housing, including driving down the rate of home ownership.

A second compounding impact on first-time buyers is the proposed treatment for home equity loans. Many first time home buyers, unable to afford the standard 20 percent cash down payment required to qualify for a QM or QRM will use a home equity loan in order to buy a home with as little as 5% down. The impact of the NPR will be to raise the cost of capital for banks offering this very common type of loan for first-time home buyers by as much as 300 to 400 percent, depending on LTV. The impact of the proposed rule will be to drive up the cost of financing for first-time home buyers, while limiting credit availability.

The NPRs should be revised so as to not be punitive on first-time home buyers.

Harmful Effects of Derivative Contracts Treatment on Small Business

The NPRs provide a new method for determining the risk-based capital requirements for over-the-counter ("OTC") derivative contracts that is similar to the risk-based capital rules. Under the proposed rule, banks would determine the exposure amount and then assign a risk weight based on the counterparty or collateral. The exposure amount is the sum of current exposure plus potential future credit exposure ("PFE"). This is in contrast to the general risk-based capital rules in effect presently,

which place a 50 percent risk cap on derivatives. The NPRs make use of a specific credit conversion "multiplier" for determining the "effective notional amount" to which a risk-based weighting will be applied for determining capital allocations. These factors generally range from 1.0 percent, applicable to foreign exchange contracts ("FX") with remaining maturity of one year or less, to 10.0 percent for non-investment grade credit default swaps, to 15 percent for commodities contracts.

Interest rate swaps and foreign exchange derivatives are commonly used by small businesses to prudently and effectively manage their exposures and are a common and accepted risk mitigation technique. Small businesses with customers, suppliers or operating entities outside the U.S. typically deal in various currencies and are exposed to FX rate risk. These companies assess the types and levels of their exposure to FX rate fluctuations and volatility for the specific currencies in which they operate. Banks provide interest rate swaps and FX hedging services to small businesses either directly, or through an up-stream correspondent bank. In some cases, to simplify recordkeeping and accounting requirements, community banks enter into a risk participation agreements ("RPA's"), which are a simplified form credit default swap, with an upstream correspondent bank, who then enters into the swap or FX transaction directly with the community bank's client. This arrangement makes it cost effective and operationally efficient way for community bank clients to effectively hedge operational risks.

The conversion factors used for very common interest rate, FX derivative contracts and RPA's, combined with the elimination of the 50 percent cap, will drive up the cost of capital associated with offering these fairly routine transactions, and will result in much higher transaction costs for small businesses. This is unwarranted based on actual experience with these contracts and will add unnecessary costs to small businesses seeking to compete in an increasingly global economy.

This NPR should be eliminated. It is not sufficient to exempt community banks since most offer these services through a larger correspondent (above the $10 billion asset threshold used to distinguish community banks). For small businesses the risk of default is nominal and the corresponding capital weightings do not reflect the risk of default.

Concluding Comments

Taken together, and when considered in concert with other regulatory proposals and newly issued rules, the NPRs disproportionately affect community banks, will limit credit to many credit-worthy consumers and businesses and will result in disruptions to the nascent recovery that is struggling to gain traction in the U.S.

The combination of rising compliance costs, rising regulatory capital burdens, and shrinking net interest margins, will drive capital from the banking sector making it more difficult for the industry to attract capital and ultimately will drive consolidation within the industry. Such consolidation risks the formation of more and new mega-banks, which were the intended targets of the Basel accords.

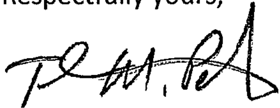
Community banks do not have the same access to capital markets in good times, and have a more difficult, if not impossible, ability to raise capital when times are bad. The volatility to capital introduced by the NPRs will place community banks at increased risk of encountering the sanctions applicable to banks that fall into the proposed capital conservation buffer.

The NPRs treat mega-banks and community banks as being identical business models with identical risk profiles. This does not take into consideration the more simplified balance sheets and customary

lending practices of community banks. And while it is true that many community banks have failed through the recent cycle, those failures generally relate to loan concentrations in ADC and higher-risk residential mortgage loans that the agencies had existing rules and enforcement powers at hand to deal with effectively.

For all these reasons, I urge you to exempt community banks from the NPRs.

Respectfully yours,



Thomas M. Petro
President and CEO
Fox Chase Bank

CC: The Honorable Robert P. Casey, Jr.
The Honorable Patrick J. Toomey
The Honorable Patrick Meehan
The Honorable Jim Gerlach
The Honorable Michael G. Fitzpatrick
The Honorable Allyson Y. Schwartz
The Honorable Glenn Moyer, Pennsylvania Secretary of Banking
Mr. Wayne Abernathy, American Bankers Association
Mr. James R. Biery, Pennsylvania Bankers Association