EMPRISE BANK®

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October 18, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W. Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, D.C. 20219

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

We appreciate the opportunity to comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Emprise Bank is a privately held $1.5 billion community institution with 42 offices in 24 communities throughout the state of Kansas.

Several aspects of Basel III will have a significant negative impact on community banking and ultimately the customers and communities Emprise has served for over a century. The Basel III capital requirements were crafted for larger and more complex institutions. They do not make sense for community banks. Following are aspects of the regulations that will most adversely affect our bank.

1. Inclusion of accumulated other comprehensive income (AOCI) from securities in regulatory capital.

Changes in AOCI on securities held by most banks are primarily driven by changes in the interest rate market, not fundamental changes in the underlying securities. Changes in credit quality can also affect AOCI on some securities held by banks, but most banks hold a majority of their securities portfolios in U.S. Government guaranteed securities. Most banks, including Emprise, have had soft loan demand and a significant influx of deposits, resulting in securities portfolio growth.

Credit-related impairments on securities are already deducted from capital as current accounting rules require these losses to be included on the income statement.

Including AOCI in regulatory capital will cause banks to make decisions that are necessary for capital management, but may not be in the best interest of the institution, consumers, and the industry as a whole:

- Banks will move securities portfolios from available-for-sale (AFS) to held-to-maturity (HTM), which reduces liquidity and limits the ability of a bank to actively manage its portfolio to adjust its interest rate risk position and make investment decisions that make sense as bank's balance sheet shifts over time.
- Banks will reduce the size of their investment portfolios and likely their deposit base. This will further reduce competition for deposits and erode a historically key component of the earning power of community banks.
- Banks will move to shorter term assets. In doing this, banks will give up substantial earnings, which results in the growth of capital and surrendering the natural rate hedge from core deposits in order to avoid a potential arbitrary capital penalty from rising rates.

Asset and liability management is required in order to mitigate interest rate risk, and this requires that banks have flexibility in structuring their balance sheet such that this risk is adequately managed while not compromising their ability to generate a fair return. AFS portfolios have this flexibility and our Bank has been able to adjust its risk position while, at the same time, generating returns that would have been unavailable in an HTM portfolio. Ultimately, this move will create more interest rate risk and less profitability (lower capital creation capacity) in the industry.

AOCI moves primarily with changes in interest rate. All regulated institutions are required to manage the interest rate sensitivity of their entire balance sheet, but AOCI is only reported on one part of the balance sheet. This part of the regulation is slated to phase in starting in 2014. Rates are expected to remain low through 2014 or 2015. If rates start to increase as the capital requirements are phasing in, banks will need to have capital to cover AOCI caused by changes in interest rate plus changes related to other capital consuming provisions in the proposed regulations. This “doubling down” on capital will create significant and unnecessary stress on bank capital and create a scenario in which banks are unable to provide as much credit to their customers.

The portions of the balance sheet which offset the change in the securities portfolio, such as a strong base of core deposits, are not accounted for in AOCI. Investment portfolios are reviewed by examiners during the course of safety and soundness exams. If a bank’s securities portfolio is inappropriate, examiners make recommendations for changes.

This provision should be removed from proposed regulations before they are finalized. At a minimum, AOCI on securities backed implicitly or explicitly by the federal government and investment grade municipal securities should be excluded. This change does not enhance the soundness of institutions and will cause them to make decisions that are necessary under this situation, but may not be the most prudent for managing the whole balance sheet of the institution.

2. Elimination of trust preferred securities (TRUPs) from tier one capital.

Financial institutions under $15 billion in total assets were granted the ability to retain their existing TRUPs under the Dodd-Frank Act as approved by Congress and signed by the President. These instruments provide a stable source of capital for institutions such as Emprise. Our institution has $18 million in TRUPs and, as these instruments phase out, the bank will need to retain capital to cover these assets that could be used to grow. Ultimately, this provision will limit Emprise’s growth by over $200 million.

This limited growth will result in Emprise not being able to provide as many loans in the markets it serves and it will result in a lower return on equity. This lower return is a concern of Emprise’s shareholders. It should be of significant concern to regulators. As the earning power of banks diminishes, the ability of banks to grow their capital base diminishes in at least two ways. Banks will occasionally incur loan losses as part of their business. The ability to generate income allows banks to incur these losses and continue to have a strong capital structure. As returns in an industry, such as banking, diminish, it becomes more difficult to retain, let alone attract capital, to the industry.

This provision should be removed from the proposed regulations. This provision creates a situation in which community banks cannot grow, or may even have to shrink. This provision goes far beyond what was recently enacted legislatively.

3. Revisions to asset risk-weightings

a. Mortgages

The move from two mortgage risk weight categories to eight risk weight categories will add granularity to the risk weighting process, but it will reduce the ability of banks such as ours to originate and retain mortgages in our communities. A significant portion of our Bank's loan portfolio is in 1-4 family residential mortgages. Many of these mortgages do not make sense to sell into the secondary market because of the small loan size, type of collateral, prior borrower credit issues or borrower preference. Historically, our Bank has suffered very few losses on these loans, even through our nation's most recent economic issues.

Under the new regulatory scheme, many of these loans will not provide an adequate return on the equity required to hold them. If implemented as proposed, our Bank may reduce its exposure to these historically safe loan assets, limiting our ability to serve a broad portion of our communities. For reporting purposes, we will need to go through a significant information gathering exercise in order to properly report on our current loan portfolio. This exercise will change our regulatory capital ratios, but it will not provide significantly better information related to the safety and soundness of our institution.

We would like for this provision to be removed from the final regulations. If it is partially implemented, it would make sense to allow banks to roll mortgages down through the loan-to-value categories. For example, as the regulations are proposed, a loan with a 91% LTV would have a 100% risk weight. As that loan amortizes, it will retain its risk weighting unless it is restructured or modified. So if that loan is paid down to 50% LTV, it will retain its 100% risk weighting. It would make sense to allow this loan to be categorized based on its current principal balance. We acknowledge that home values do not always increase; however, the current market is not representative either. Typically, as a loan amortizes, it demonstrates borrower commitment and it reduces the amount of exposure relative to the value of the asset, reducing the risk level of the asset. At a minimum, the capital calculations should reflect this reality. Regulations that will likely last a decade or more should make sense going forward and not simply be a reaction to what has happened in the past.

b. Mortgage credit enhancing representations

If banks are required to hold capital for credit enhancing representations on mortgages, it will create a situation for some banks that make the secondary market no longer make sense. When combined with the risk weighting issues around holding these mortgages, more of the mortgage business will be driven from regulated financial institutions back to the shadow banking world of independent brokers and other providers. In order for this to make sense for banks, they will need to earn more fees in originating mortgages, which drives up costs for consumers.

The ultimate outcome of these changes for consumers will be higher costs, less choice, and a move to less reputable providers. Like many pieces of regulation, the real outcome will be the opposite of the desired outcome.

c. High volatility commercial real estate (HVCRE)

Risk weighting loans on development projects at 150% will drive banks out of this type of lending. We acknowledge that this lending, if not underwritten correctly, can expose financial institutions to additional risk. This risk can be managed adequately with experience, expertise, and robust policies and procedures.

The proposed changes to risk-weighting will result in higher credit costs and fewer credit options for borrowers and add expenses to institutions by creating additional burdensome tracking and reporting requirements. They should be removed or tempered in the final regulations.

4. Capital Buffers and their interaction with subchapter S corporation financial institutions.

Subchapter S financial institutions should have parity with tax payment parity with C corporation financial institutions. Income taxes on S corporation banks are paid at the shareholder level instead of at the corporate level. If an S corporation institution is limited in paying dividends to its shareholders because of capital constraints under the capital conservation buffer, it is treated differently than a C corporation bank which pays its tax at the corporate level. We are not aware of any circumstance under which a C corporation bank would need to make a special request to its regulators to pay income taxes under the proposed regulations or under current regulations. S corporation institutions that fall below the capital conservation targets as proposed would be limited from paying dividends - even dividends to pay income taxes.

If capital conservation buffers are implemented, please include provisions that allow S corporation institutions to pay dividends sufficient to cover income taxes on taxable income generated by the financial institution.

In conclusion, the Basel III proposals set out very complex regulatory plans that were designed for very large and complex institutions. We are not convinced that these regulations truly mitigate the risk found in these institutions. We do believe that by adding additional layers of regulatory requirements to community financial institutions, the banking industry will not be enhanced. In order to comply, community banks will have to make decisions that are not in the best interest of the long term stability of their banks and ultimately their communities. This will reduce the number of community banks, which we understand may be a regulatory goal. We believe, however, that a significant reduction in the number of viable institutions will negatively impact smaller communities throughout the country.

Applying these regulations to community banks will result in lower amounts available to loan to customers, a reduction of the types of products we can offer, and an increase in operating and compliance costs. Furthermore, it will have no material effect on the safety and soundness of institutions such as ours. These regulations were written as a reaction to our recent economic crisis. If applied, we do not believe these regulations would have had a significant impact on the losses suffered by the deposit insurance fund.

In this letter we have presented the issues in the proposed regulations that will have the largest negative impact on our institution. However, the best solution for community banks and their stakeholders, including our regulators, is to go back to the drawing board and take a common sense approach to drafting capital regulations for community banks. This view is not only shared by fellow bankers, but also by FDIC Board Member and former President of the Federal Reserve Bank of Kansas City, Thomas Hoenig and by the Conference of State Bank Supervisors, among others.

Sincerely,

Aaron K. Veatch

Aaron K. Veatch
Senior Vice President and Chief Financial Officer

cc:

The Honorable Pat Roberts
United States Senate

The Honorable Jerry Moran
United States Senate

The Honorable Mike Pompeo
United States House of Representatives

The Honorable Tim Huelskamp
United States House of Representatives

The Honorable Lynn Jenkins
United States House of Representatives

The Honorable Kevin Yoder
United States House of Representatives

Mr. Ross Crouch
Federal Reserve Bank of Kansas City