



First Interstate BancSystem, Inc.  
401 N. 31st St.  
P.O. Box 30918  
Billings, MT 59116-0918  
406-255-5390  
Fax: 406-255-5350  
www.firstinterstatebank.com

October 22, 2012

Federal Reserve Board  
20<sup>th</sup> Street and Constitution Avenue N.W.  
Washington, D.C. 20551

**Delivered via email [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)**

Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

**Delivered via email [comments@FDIC.gov](mailto:comments@FDIC.gov)**

Re: Basel III Capital Proposals

Ladies and Gentlemen,

Thank you for the opportunity to provide comment on the Basel III Notices of Proposed Rulemaking (NPR) issued in June 2012 which requires all banking organizations to comply with Basel III pronouncements and standardized approach NPR.

First Interstate BancSystem, Inc. is a financial services holding company, headquartered in Billings, Montana, with \$7.3 billion in assets. It is the parent company of First Interstate Bank, a community bank operating 72 offices throughout Montana, Wyoming, and South Dakota. First Interstate is a family business whose culture is driven by strong family and corporate values, as well as a commitment to long-term organic growth, exemplary customer service, exceeding customer expectations through its products and services and supporting, with leadership and resources, the communities it serves. We take our role as a community bank seriously, lending to consumers and all types of business customers within our footprint.

We are in agreement with efforts to ensure banking institutions have a strong and viable capital base and are able to absorb unexpected losses. However, the capital requirements of Basel III are not appropriate or necessary for community banks.

First, the inclusion of gains and losses on the available-for-sale debt securities in the common equity tier 1 capital calculation is a significant area of concern. Introducing this additional volatility into the capital management process would likely result in adjusting investment strategies to shorten the duration of investments in order to reduce the risk of large market

swings. This would result in less yield and lower earnings capacity. If the increasing interest rate environment is a result of an economic recovery, typically there would be increased loan demand, requiring a need for higher level of bank capital. This proposed adjustment to capital for the gains and losses imbedded in the investment portfolio could result in the unintended consequence where community banks would necessarily have to reduce lending activity, which could hamper economic growth in the communities we serve. Additionally, it could result in banks retaining far more capital than being proposed in order to be able to withstand the capital stress of rising rates.

Second, the proposed methodology for risk weighting mortgages is unreasonable and also results in unintended consequences. The proposal addresses not only new mortgages, but existing mortgages currently on the balance sheet that have been underwritten and priced under current capital standards. The proposed mortgage categories are heavily dependent on data that may not have been captured when the mortgage was originated. It would be onerous, if not impossible, for the bank to accurately determine characteristics in place at the time an existing mortgage was originated. This would make it very difficult to assign the appropriate risk rating, which may result in an undue number of mortgages assigned a category 2 status. The retroactive impact could result in substantially increased capital requirements, which would be punitive to the bank.

The proposed risk weights on secured performing mortgages could result in higher capital requirements than unsecured or delinquent loans. The risk weights of up to 200% will increase both the cost of credit to the consumer and have the impact of restricting the availability of consumer credit brought on by increased capital requirements. This could also result in banks reducing their holdings in residential mortgages or only extending credit to the most creditworthy. The unintended consequences could be a substantial reduction in home equity lending, which in our part of the country has **not** resulted in substantial losses, and a negative impact on a barely-recovering housing market.

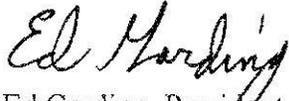
Third, the increased risk weighting on “high volatility commercial real estate loans” is unnecessary. Banks already factor both internal and external risk factors when calculating the allowance for loan loss (ALL) on this type of loan. The ALL is funded through charges to earnings via the provision for loan losses, which already negatively impacts capital as the ALL increases. In addition, the methodology for calculating the ALL is under regular scrutiny from our regulators and subject to severe criticism if we are not adequately defining the risk associated with loans. The increased risk weight assigned to these loans is redundant in the capital calculation.

Fourth, the proposed rules do not grandfather Trust Preferred Securities (TRUP’s) for community banks (those institutions between \$500 million and \$15 billion), which is inconsistent with the intent of the Collins amendment. Eliminating TRUP’s in the calculation of Tier 2 capital is needless, as it does not lead to a higher level of safety and soundness for banks. Replacing TRUP’s will result in higher capital costs to community banks. TRUP’s should remain in place for smaller institutions.

The challenges being placed on community banks in the new regulatory environment are already burdensome and expensive. Demanding more capital from community banks during slow

economic times will make it difficult for a bank to partner with its community to create the optimal environment for growth and success. Further restrictions, as proposed under the Basel III rules, will only serve to further hamper a community bank's ability to meet consumer and business needs. While we understand capital is crucial in providing strength to our financial system, we respectfully request you consider these issues and their impact on the viability of community banks.

Sincerely,



Ed Garding, President

cc Rep Dennis Rehberg  
Senator John Tester  
Senator Max Baucus