Oak Bank

You can't be the best, if you're only the same.

October 12, 2012

VIA ELECTRONIC DELIVERY
Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal
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:

Oak Bank is a $210 million community bank with one office in Fitchburg, Wisconsin. As President of Oak Bank, I am very concerned with the Notice of Proposed Rulemaking that would revise the general risk-based capital rules and the measurement of risk-weighted assets for all banks by implementing changes made by the Basel Committee on Banking Supervision for all banks. These changes are being proposed for all banks despite the fact that the Basel III proposals were intended only for the very large, complex international institutions.

These changes, as proposed, will excessively tighten regulatory capital requirements for community banks like Oak Bank thereby reducing the amount of credit that is available to support families and small businesses in our communities. Our preliminary analysis indicates that our own risk based capital ratio will decline from 14.55% using current risk based capital calculations to 13.28% under the new rules being proposed.

The formulas being proposed to calculate risk based assets are very complicated and will prove to be overly burdensome to Oak Bank. We simply do not have the resources to make these calculations and acquiring the necessary resources will come at great expense.

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 concerned about the cumulative burden these rules will have on Oak Bank.**

For these reasons and for the concerns outlined below, I respectively request that the regulatory agencies 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. **It is imperative that the regulatory agencies recognize that there are many differences between community banks like Oak Bank and large, complex international institutions. The regulatory agencies must not force a community bank into the same capital calculation as a sophisticated international institution.**

If the regulatory 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 you 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 you 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.** It is generally our intent and our practice to hold these securities until maturity. Therefore, unrealized gains and losses attributable to fluctuations in interest rates are generally temporary and should not be reflected in common equity tier 1 capital.

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 will put significant downward pressure on our bank's capital levels thereby reducing our ability to support economic growth in our community.

For this reason, I oppose this proposed treatment. The regulatory agencies should remove this treatment from the proposals.

Treatment of Trust Preferred Securities (TruPS)

The regulatory agencies' treatment of trust preferred securities (TruPS) under the proposals must not be finalized as proposed. Presumably out of concern for such a debt instrument being treated as "capital", Congress, as part of the Dodd-Frank Act (DFA), prohibited any new issuances of TruPS; however, under the Collins amendment in DFA, TruPS are grandfathered for institutions between $500 million and $15 billion. Nonetheless, the regulatory agencies' proposals ignore the Collins amendment by requiring a complete phase-out of TruPS beginning in 2013.

Many Wisconsin community banks hold TruPS as capital on their books. The proposed complete phase-out of TruPS creates a significant problem for community banks that are privately held as they will have little access to additional sources of capital.

I oppose the regulatory agencies' treatment of TruPS beyond that which Congress intended under DFA. The regulators should preserve the full intent of the Collins amendment to DFA by *permanently* grandfathering outstanding TruPS for institutions between $500 million and $15 billion.

Capital Risk-Weights for Residential Mortgages and Related Matters and Home-Equity Lines of Credit (HELOCs)

The regulatory agencies' proposals place new and 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 risk weight could rise to 200%. These higher risk weights appear to be arbitrarily set as there is no empirical data presented by the regulatory agencies to support this extraordinary increase in risk weights for certain types of mortgages.

Oak Bank makes many on-balance sheet home loans that are written as 3 or 5 year balloon mortgages with payments amortized over 30 years. We provide these loans to good clients that, for varying reasons, are unable to obtain a fixed rate secondary market loan. Examples include clients that have substantial recurring income but an insufficient down payment, or clients that own a home that is located in a rural setting (where secondary market appraisal requirements are hard to satisfy), or clients that are successfully self employed but don't have the predictable W-2 income that the secondary market desires. Because we know our clients and our community, we are able to competently assess credit risk and prudently underwrite these loans. However, we lack the tools necessary to manage the interest rate risk associated with a fixed rate loan product and, therefore, choose to originate these loans as balloon loans. If regulatory agencies make it unattractive for community banks to originate balloon loans (by increasing the capital risk weight from the current rule of 50% to 150% as proposed for a 5 year balloon loan with a LTV of 81-90%) small business owners, young professionals (that have recently graduated and have good jobs but little down payment), rural property owners and many others will be unable to secure the mortgage financing they need and achieve the American dream of home ownership.

I challenge the assumption that a residential mortgage loan has a higher degree of risk simply because the loan has a balloon payment, an adjustable rate, or an interest-only payment. In fact, over the past 5 years, our portfolio of balloon loans has experienced minimum losses with an average annual default rate of only .28%. The regulatory agencies' proposed capital treatment far outweighs the reality of risk that we have experienced for these types of loans.

The regulatory agencies must not finalize the proposed rules with such severe and unwarranted risk weighted treatment of residential mortgage exposures.

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 many borrowers, particularly first time home buyers, to come up with a 10% down payment, much less an amount higher than that. Therefore, PMI continues to be a product purchased to protect against repayment default risks. I recognize the concerns expressed by the regulatory 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.

The Agencies' proposals should recognize that PMI reduces the risk of loss and should, therefore, provide for the recognition of PMI when determining a loan's LTV ratio.

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 regulatory 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 with consideration given to both the value of the home and the borrower's creditworthiness. At Oak Bank, many HELOCs are underwritten with a very low LTV ratio. In some cases, we even have a first mortgage securing our HELOCs. Over the past 5 years, we have incurred an average annual loss of .26% on our HELOC portfolio providing evidence that HELOCs are prudently and thoughtfully underwritten.

The Agencies should remove the provision that all HELOCs are an automatic Category 2 classification.

Off-Balance Sheet Items

The proposal states that a commitment with an original maturity of one year or less that is not unconditionally cancelable by the bank, must carry a 20 percent credit conversion factor. This will force banks to allocate risk based capital to consumer and business lines of credit even when these credit facilities are being "rested". As a result, banks will be forced to charge annual fees to consumers who wish to maintain access to HELOCs. As you know, banks are being demonized by the media and consumer advocacy groups for increasing consumer banking fees.

The agencies should remove the provision that all commitments with an original maturity of one year or less carry a 20 percent credit conversion factor. Banks should only be required to hold capital against funded balances.

Conclusion

Because of the concerns outlined above, I urge you to 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 regulatory agencies must recognize that there are many differences between community banks and large, complex international institutions and should not force a community bank into the same capital calculation as a complex international institution.

I appreciate the opportunity to comment on these proposals.

Sincerely,

Terry D. Taylor
President