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Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

October 18, 2012

Mr. Feldman:

This letter is in response to the FDIC's proposed rules RIN 3064-AD95 (BASEL III NPR) and RIN 3064-AD96 (Standardized Approach NPR). Ballston Spa National Bank is a 174 year old banking institution located in Ballston Spa, NY. We operate 10 branches located throughout Saratoga County. Our assets total approximately $400 million and are primarily comprised of Residential Mortgage and Small Business Loans, and investments to fund the needs of local municipalities. Like most Community Banks, our success over the years is a result of a relationship based business model that is designed to serve our customer base and community over the long term. This long term approach relies upon a common sense risk management effort to achieve steady growth, not designed to maximize earnings for short term stock appreciation or executive compensation plans.

Capital Recognition of Securities Unrealized Gains and Losses

The inclusion of accumulated other comprehensive income (AOCI) which includes unrealized gains and losses on investments in the proposed regulations will create volatile swings in capital and could mask potential issues. Historical trending information will be impossible to analyze utilizing a new type of calculation and additional analytics would be required quarterly to extract the impact of the market value adjustments.

Utilizing changes in market values of securities as a source or reduction of regulatory capital, completely discounts the fact that there are also offsetting swings in the market values of liabilities which fund these securities which are not accounted for under the proposed rules, nor under current GAAP. In addition, each bank is required by its regulators to estimate the volatility of swings in market value of its entire balance sheet, not just one part of the balance sheet. As a result, an argument could be made that banks are already evaluating the impact of market value swings on its capital, and that requiring the use of these market value swings in determining regulatory capital is dangerous and ill-advised.

Community banks typically hold securities for a few specific reasons: primarily to maintain liquidity or provide collateral for municipal deposit relationships, and to a lesser extent, to generate income when lending opportunities subside. Current interest rates are at historically low levels and have generally resulted in significant unrealized gains on securities held by community banks. As interest rates rise, fair values will fall and immediately affect capital levels under the BASEL III rules. For Ballston Spa National Bank, we estimate that if interest rates increase by 300 basis points, our fair values of securities will decline by approximately $5 million and our AOCI will decline by $1.9 million, or 6% of our Tier I Capital.

If the BASEL III rules become effective, we believe that many community banks will manage their balance sheets differently to mitigate the risk of interest rates fluctuations on their regulatory capital. Strategies could include:

- Shortening the duration of our investment portfolios – this will reduce price volatility, however, long term capital growth would be compromised;
- Utilize held-to-maturity portfolios – this reduces the impact of price volatility on regulatory capital, however, balance sheet flexibility, liquidity, and interest rate risk management would be severely compromised, and possibly subject the bank to other more significant risks;
- Stretch for yield on higher risk securities – to replace lost income because durations would be shorter, banks may employ higher risk investments to meet income expectations;
- Reduce acceptance of municipal deposits, or increase fees charged to maintain these deposits – as a result, our community focused mission to serve our communities over the long term would be compromised.
- In order to maintain capital against possible price volatility of securities, banks may need to restrict or limit lending to its communities, therefore compromising our basic mission to support our communities.

Larger banking institutions have always been able to employ advanced hedging instruments to mitigate the impact of interest rate changes on their income statements, as well as determining the economic value of their equity. Unfortunately, most community banks do not have the expertise to employ such instruments, and even if they did, the cost of these instruments generally are far more significant to the smaller community bank than they are to large "TBF" banks.

As a result, we strongly encourage the exclusion of AOCI from capital measures under the proposed BASEL III regulations.

Capital Conservation Buffers

Implementation of the capital conservation buffers for community banks will be difficult to incorporate. Unlike "TBF" institutions, community banks do not have ready access to capital market instruments without incurring significant additional expense and may be forced to reduce dividends to accelerate the accumulation of retained earnings. Many of the shareholders of Ballston Spa National Bank are local community members, business owners, or BSNB employees. We have been fortunate to maintain a healthy dividend payment averaging 39% of our net earnings over the last five years. If necessary, reducing these dividends in order to maintain or create a capital conservation buffer would impact our direct community and could incent our investors to seek better investment opportunities elsewhere.

Revised Risk Weighting Methodology

The proposed risk weight methodology under Basel III is complex and may inadvertently penalize community banks for offering additional mortgage products which meet the needs of its communities such as second lien home equity loans, higher loan to value loans, interest only loans and residential balloon loans. This could, and would, limit choices for our communities we serve. Some banks may exit the residential loan market entirely, or quite possibly, originate only those loans that can be sold to investors such as Fannie Mae, Freddie Mac or FHLB. And let's not even discuss what would happen if those entities are allowed to fail!

In addition, the imposition of the higher risk weighting on a retroactive basis to all loans currently outstanding could cause the devaluation of existing residential mortgage portfolios and a substantial increase in risk-based capital requirements involved in residential mortgage lending – generally a staple of all community banks.

For Ballston Spa National Bank, over 53% of our entire loan portfolio is in residential lending. A significant piece of our residential portfolio is currently risk-weighted at 50%. Under the BASEL III proposed rules, it is conceivable that many of these loans could be weighted at levels ranging from 75% to 200%. How that would impact our bank and our ability to lend to our customer base, remains to be seen – however, it is very probable that the cost of obtaining financing would certainly increase.

Proposed Phase-out of Trust Preferred Securities

The phase-out of TRUPS over any period of time would eliminate an important source of capital for many privately-held banks and bank holding companies such as Ballston Spa National Bank and further reduce our alternatives to raising the capital that could be required under other BASEL III proposals. Ballston Spa National Bank utilized TRUPS for additional capital during the early part of the last decade. This came at a troubled time in the bank's history and allowed management the time and capital to improve its products, services and personnel and continue to be a very positive influence on our community. Ballston Spa National Bank has served the local community for over 170 years. In addition to providing traditional banking services to our customers, we are committed to working, supporting and volunteering in the communities we serve. In 2011 alone, our employees volunteered over 5000 hours to support other community organizations or benefit programs in the arts, social and human services, education and youth, and many others. Without the benefit of utilizing TRUPS 10 years ago as a significant source of capital, it is uncertain whether we would be such an important member of our community today. If the goal of BASEL III is to consolidate thriving community banks into the TBF model that generally drove our current economic woes, this would certainly help to achieve that objective.

Administrative Burden

The BASEL III capital rules are largely consistent with the guidelines ratified by the G20 countries in late 2010. By having the rules apply to all insured depository institutions, the agencies have leveled the playing field among various types of charters, and various sizes of banks. The complexity of calculating and tracking the capital calculations will, without a doubt, add to the already excessive administrative burden for smaller banking organizations to implement these rules. The costs of these administrative burdens, when compounded by the new consumer protection regulations which are generally attributed to the apparent greed of "TBF" institutions but are borne by the community banks, will result in higher costs to our consumers, or, more tragically, continued consolidation among mid-size and smaller banks in the US, therefore, fewer choices for our communities.

Conclusion

We appreciate the opportunity to provide these comments on behalf of Ballston Spa National Bank. We acknowledge the difficulty of conforming the BASEL III rules to the US banking market, and the further difficulty to conform the rules to the Dodd-Frank framework enacted by Congress. However, the "one size fits all" approach of BASEL III needs to be reevaluated – not many community banks are considered "TBF" and unfortunately, they are the ones that will be most significantly, and negatively, impacted by the current proposed rules under BASEL III.

Very Truly Yours,

Christopher R. Dowd
President and CEO
Ballston Spa National Bank