August 22, 2012

Mr. Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Proposed Rulemaking on Minimum Capital Requirements for Banks

Dear Federal Deposit Insurance Corporation:

As a community banker and former regulator with over twenty-five years experience in the banking industry, I find the potential impact of the proposed Basel III capital rules on community banks to be very disturbing. The ultimate losers will be consumers and small businesses who will face higher borrowing costs and diminished availability of credit and banking services. The introduction of the Basel III regulatory changes at this time seems especially counter-productive given the tenuous state of the economic recovery. For community banks, the complex and cumbersome proposals will add significantly to an already untenable and ever increasing level of regulatory burden and cost. Community bankers tend to be a resilient lot, but for the first time in my career I have heard fellow bankers talk of capitulation – selling banks they've spent generations building rather than face the regulatory burden which is ballooning out of control.

We all recognize the importance of adequate capital in our financial institutions. We all pay FDIC insurance premiums. We know it benefits us to have a strong industry with minimal failures. I can agree that existing Tier 1 capital requirements are too low, but I do not see the wisdom in replacing the existing guidelines with a more complex and cumbersome set of rules that subject community banks to far greater volatility in capital adequacy ratios. We have become such a nation of rule-makers and community banks are getting crushed by the weight of the endless stream of new regulations. Subjecting community banks to Basel III proposals seems akin to having a bad day at work and coming home to kick the dog. Community banks were not the source of the problems in the recent and on-going financial crisis. By and large, community banks did not engage in sub-prime lending or invest in speculative derivative investment products. We did not create the mess nor do we have the luxury of being too big to fail.

I have several concerns regarding specific provisions of the newly proposed Basel III capital rules, as they impact community banks, as enumerated below:

1) The most potentially devastating provision of Basel III to community banks is the inclusion of unrealized gains and losses on AFS securities in the new Common Equity Tier 1 (CET I) capital. This couldn't come at a worse time. With slack loan demand, many community banks are forced to accumulate large investment portfolios in a record low interest rate environment, in an effort to maintain a positive bottom line. There is only one way for bond valuations to move. It feels like regulators waited until the cards were stacked against us to implement this provision. This could wipe out a significant portion of capital overnight due to market rate movements. And these fluctuations could very well only be temporary. This will discourage community banks from holding longer-term municipal bonds for fear of interest rate swings, resulting in lower earnings for banks and higher borrowing costs for already financially strapped municipalities. Most community banks generally hold their investment securities to maturity. They are only put in the AFS category to get the liquidity credit and to preclude being accused of gains-trading if a prudent opportunity presents itself. Large banks have the ability to hedge their interest rate exposure on their securities portfolio. Community banks don't have this luxury.

2) The nauseating break-down of risk-weighting assets by loan-to-value ratios, past due status, and loan type will add considerable expense to the community bank compliance burden, and seems to be more of a way for the government to allocate credit. To be a true measure of a bank's risk profile, it would seem risk weightings would need to be adjusted as LtV's changed over the life of the loan. For example, if a mortgage loan starts out at an 85% LtV, but the borrower soon after makes an unanticipated lump-sum payment that reduces the LtV to less than 60%, the bank's risk has clearly been reduced. Yet there doesn't seem to be a provision for moving this loan from the 75% risk weight category to the 35% category. Likewise, what if an updated appraisal reveals a significant change in LtV? It would be absurd to require updated appraisals on all performing real estate loans in the portfolio just for the sake of assigning a risk weight classification, but this is precisely what the Basel III provisions attempt to measure. But if you aren't going to measure LtV except at origination, it is not a true representation of a bank's risk profile, so why implement something that is flawed from the on-set?

(5) The risk weighting of certain residential mortgage and commercial real estate loans at 150% and 200% makes no sense at all. These risk weightings are excessive and again

smack of governmental credit allocation. How could a loan expose a bank to more risk than a complete and total 100% loss? Risk for most nonperforming loans is already addressed in the loan loss reserve, yet the Basel III proposals seem to ignore this completely. Current capital regulations already limit the amount of the loan loss reserve that can be counted in Tier I capital, which seems a disincentive to encourage a bank to maintain an ample reserve. These excessive risk-weighted loan categories will break the backs of the home-town community bank as our loan portfolios consist primarily of commercial real estate loans. The big banks took the mortgage loan business away from us with their securitization packaging, the car dealers have their own financing arms, and there are pay-day loan stores on every corner for small consumer credit. There isn't much else left for community banks but commercial real estate, and now Basel III is going to take that away from us. There is no way we can capitalize a commercial real estate portfolio at 150% risk weighting and an increased equity capital requirement. The Basel III provisions seem to be aimed at forcing privately-owned community banks to raise more capital. That is not going to happen. Indeed, most community banks will respond by shrinking asset size and avoiding loans in the higher-weighted categories, with the ultimate result of restricting consumer and small business credit in an already challenging market.

I know fellow bankers that have already stopped making residential mortgage loans due to the almost-impossible-to-comply-with regulatory burden on escrow requirements, balloon note limitations, appraisal standards, additional disclosures, zero tolerance rules on good faith estimates, etc. This mountain of disclosures is counter-productive. It doesn't protect the consumer. It has become so voluminous and complex that few consumers even attempt to read it. All this to fix problems that we community bankers didn't contribute to in the first place.

3) Phasing out the inclusion of Trust Preferred securities for community banks seems to be an unfair changing of the rules in the middle of the game. Again, because of no access to capital markets it would be practically impossible to replace this capital any other way than to earn it out. This would place a huge burden on earnings in a fragile economic climate. Most of us took on these obligations in the first place because it was supposed to be a perpetual source of capital. Again, this is pulling the rug out from under us at the most inopportune time, even with the 10+ year phase out.

4) The buffer rules just seem to be an unnecessary additional layer of complexity to the proposed capital rules. Why don't you just say CET I has to be 7.00% and leave it at that. In reality, that is what the buffer rules are going to do anyway. There are a lot of

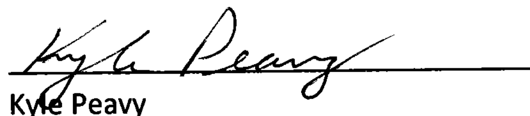
subchapter-s community banks that will have no choice but to meet the buffer rules so they can distribute enough income to their shareholders so that the shareholders can pay their individual income tax liabilities.

The real culprit in this financial mess was the repeal of Glass Stegal. If you want to enact meaningful legislation that would truly address the current problems, revive Glass Stegal and curb the unabashed risk-taking by the large multi-national banks that have nothing to lose because they know they are too big to fail. Swing for the bleachers and if it doesn't work out, big bank executives only have to survive a year or two and they can retire to an island in the Caribbean, compliments of their multi-million dollar annual salaries and bonuses. There has always been a disconnect between the capital levels required of community banks and large regional and money-center banks and the relative risk of their business activities.

The regulatory burden for community banks has grown so large that we can't afford to hire enough people to perform all the non-revenue-generating compliance functions. This burden will eventually force smaller banks to sell or merge, and the industry will begin to consolidate into fewer and larger institutions, which are the ones responsible for our current problems in the first place. Besides, the time to implement such sweeping capitalization changes is in a period of strong economic growth, where banks can withstand such challenges. With the US economy presently teetering on the brink of a double dip recession, a national debt that is out of control with no one in Washington seemingly willing to do the right thing, and Europe poised to lead the world into a global depression, it just feels like lawmakers waited until community bankers were balancing a unicycle on a basketball to give us a shove in the back with these Basel III proposals.

Community banks are the primary source of credit to small business borrowers, and those businesses create the bulk of new employment opportunities and economic activity in this country. It seems a perverse and tragic consequence to cripple community banks with legislation aimed at solving problems caused by others in the financial services industry.

Respectfully yours,



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