State of North Carolina

OFFICE OF THE COMMISSIONER OF BANKS

BEVERLY E. PERDUE
GOVERNOR

JOSEPH A. SMITH, JR.
COMMISSIONER OF BANKS

October 18, 2012

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
RIN 3064-AD95

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. R-1430
RIN No. 7100-AD87

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, D.C. 20219
Docket ID OCC-2012-0008

Dear Sir or Madam:

The North Carolina Office of the Commissioner of Banks appreciates the opportunity to comment on the joint Notice of Proposed Rulemaking ("NPR") issued by the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency ("Federal Regulators") entitled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action."

It is beyond question that capital adequacy is a critical determinant of the health and viability of each individual bank and of the banking industry generally. It is therefore clear that adoption of capital rules and regulations that will foster sufficient capitalization of our banks is a public policy matter of great importance, both specifically to the industry and more broadly to our nation's economy. We applaud the intent of the Federal Regulators in taking up this issue and drafting a proposed rule. However, we are very concerned that the form and substance of this NPR will not bring about the intended goals, and may indeed wreak serious if unintended harm on the banking industry, especially smaller banks that serve many of our communities.

Specifically, we believe the rule is unnecessarily complex and burdensome, particularly to community banks. Further, its extension to community banks is neither intended nor necessary

under the terms of the Basel III Accords on which the proposals are presumably based and the intent of which is to target those very large, complex institutions covered by Basel II.

It is certainly not surprising that the provisions of this NPR will increase the level of capital banks are required to maintain, especially in light of the recent banking crisis. Increased capital, though a seductive idea when cast against the backdrop of widespread bank failures, should not be reflexively used as a substitute for thoughtful, attentive regulatory supervision. In considering the lessons learned from this cycle, our agency looked at the best-capitalized 10% of our banks going into the fourth quarter of 2007, and tracked their performance trajectory through the second quarter of 2012. Our conclusion is that capital adequacy, even abundance, was not a reliable predictor of viability. Rather, the common characteristic of banks that weathered the storm well, allowing for geographic footprint problems and such, was the quality of management.

This should come as no surprise; we believe this has always been the case. Over many years it has become quite clear that, *ceteris paribus*, good management can manage with less capital than their peers, while weak management has demonstrated a remarkable ability to squander abundant capital.

This agency is firmly committed to ensuring that our banks operate safely and soundly with strong capital, and we would be supportive of a clear, more comprehensible capital rule aimed at increasing minimum required capital levels and improving the quality of capital. We are of the opinion the Federal Regulators should consider a separate rule carving out an exemption for this NPR for smaller, less complex, so-called "community banks."

In arriving at appropriate levels of capital for such a rule, moreover, we think it critical to set robust minimum capital requirements that nevertheless give reasonable deference to the ability of banks under that capital regime to maintain the required levels while also being able to achieve reasonable returns on equity and assets. To do otherwise is to do harm to the banking model generally, and to community banks especially. Regulators must be concerned not only about the ability of existing banks to maintain sufficient capital; they must also be concerned about the industry's ability to attract additional capital. Excessive capital requirements are destructive of this end.

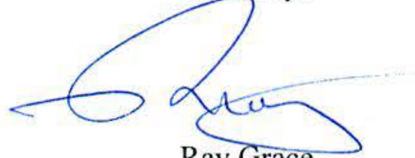
The Basel III NPR has obviously generated great interest and a commensurately broad response, much of it diving deeply into the details of the proposal. Others have accomplished that, and we generally endorse and support the positions expressed by the Conference of State Bank Supervisors in their response to this NPR as well as their letter regarding the risk-based capital NPR. Instead, we wish to voice our general concern over what we view as the unnecessary and burdensome complexity of the proposal, and our fears that, coming as it does on the heels of an as-yet not fully implemented Dodd-Frank statute, and a crushing and lingering recession, many banks, but especially community banks, will find compliance with the resultant rule difficult if not impossible to attain.

With respect to community banks, some would say that increased capital standards must come at all costs, and the loss of some more community banks is acceptable "collateral damage." There is far more concern over the large, "systemically significant" institutions. We submit this view is incorrect. Community banks hold only 10% of U.S. banking assets, yet account for some 40% of small business loans. Moreover, they serve many communities that, but for those banks, would not be well-served, if at all, by those large banks. We believe community banks should be viewed in the aggregate, as a segment of the industry that, as such, constitute a separate "systemically significant" institution.

Not all banks are alike, even those that outwardly appear quite similar. The riskiness of each category of assets varies greatly from one bank's balance sheet to another's, from geographic region to region, and over the passage of time. Different business plans, different management, different markets, and many other factors play into how well a given bank can perform and survive at any given capital level. For this reason, while it may not provide the (deceptive) comfort of discrete, established ratios or risk weightings, capital adequacy is, in our view, best determined by management, by investors, and by regulators, on a case-by-case basis, and in the case of regulators, informed by thoughtful, careful and competent supervision. As difficult as this is, we think it is the only reliable methodology.

In summary, we are skeptical of the proposed Basel III rule as unnecessarily complex and burdensome for all banks. We think this is most certainly true in the case of community banks, already struggling with the weight of complex regulation, a flat yield curve and a weak economy. We would support and urge that, at the very least, an exemption from the Basel III accord should be carved out, and in its place, we believe a clearer, more concise rule incorporating higher minimum capital requirements and more reliance on Tier 1 Leverage Capital, would be helpful and appropriate.

Sincerely,



Ray Grace
Acting Commissioner of Banks

cc: The Honorable Ben Bernanke, Chairman, The Federal Reserve System
Thomas Curry, Comptroller, Office of the Comptroller of the Currency
Martin Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation
North Carolina State Banking Commission
Thad Woodard, President & CEO, North Carolina Bankers Association