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October 19, 2012

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 S. 17th Street, NW
Washington, DC 20429
Via email at comments@fdic.gov

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Via email at regs.comments@occ.treas.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20429
Via email at regs.comments@federalreserve.gov

Re: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96 and RIN 3064-D97

Ladies and Gentlemen:

About West Gate Bank

West Gate Bank ("WGB") is a $325 million community bank with seven branches in Lincoln, Nebraska. We have 151 employees. We have been family owned since 1968 and are regulated by the Nebraska Department of Banking and the FDIC. WGB is a traditional community bank that focuses on lending and deposit services. WGB does not have a trust or investment department nor are we engaged in any non-banking business line. Two years ago, WGB started a correspondent mortgage division that purchases mortgages from Nebraska community banks. We sell the mortgages to Fannie Mae and retain the servicing. WGB currently services $600 million in mortgages and is adding approximately $50 million per month. There are only a couple of banks offering this service in Nebraska.

Deduction of Mortgage Servicing Assets that Exceed 10% of CET 1

The proposed limitation on mortgage servicing assets ("MSA") to 10% of Common Equity Tier 1 ("CET") coupled with the punitive risk weighting (250% in 2018) will render it impossible for WGB to maintain our correspondent mortgage division. Even after only two years in this business line, our MSA exceeds this unreasonably low 10% limit. There is no way in which a community bank can engage in this underserved area given such punitive capital treatment. Local community banks throughout Nebraska—including many in towns under 5,000 people—depend on WGB to purchase their mortgage originations. The handful of large national banks that dominate the U.S. mortgage market do not want to deal with a rural state like Nebraska where the mortgage amounts are small and the volume low. Without WGB, bankers throughout the state have told us they would be forced to abandon offering mortgages.

Forcing Additional Concentration in Mortgage Servicing is Bad Public Policy

Federal bank regulators should promulgate rules based on a policy that fosters a diverse landscape for mortgage servicing. Having small community banks like WGB in the mortgage servicing business is a good thing for our dual banking system. We are close to our customers, know their local markets, and offer customized personal service. In a market where numerous banks (large and small) offer mortgage purchase and servicing, competition will lead to enhanced service, multiple product offerings and more competitive pricing.

The extremely high level of concentration in the mortgage industry contributed to the mortgage meltdown and is the source of significant abuses and scandals in the banking industry over the past five years. Only the largest publicly traded national banks have the capital needed to continue in the face of the Basel III capital treatment of MSA. However, even these banks will increase pricing, reduce product offerings, redline rural states like Nebraska and further slash servicing resources—all to the detriment of the consumer.

Regulators Can Review the Independent Valuation of MSA During Exams

WGB has an independent company value our MSA on a regular basis, and we mark the value to the lower of cost or market accordingly. We provide the valuation to our regulators and ensure that the value on our books is consistent with fair value. Despite its "intangible" label, MSA is very real, steady and provide a predictable income stream that is just as dependable as payments on a loan. If a bank's MSA is overstated, regulators can require a write down just as they do on other assets during exams. There is nothing peculiar about MSA other than the unfortunate label accountants have given it. Moreover, WGB maintains an MSA reserve that operates in the same manner as the loan loss reserve. We make a monthly provision to the MSA reserve that reflects the prepayment speeds in our servicing portfolio.

The regular examination cycle provides ample opportunity for regulators to review and adjust MSA values. Banks should be required to do regular MSA valuations and provide analytical support for the fair market valuation on their books. There is no need for a "one size fits all" haircut that punishes banks like WGB that are being conservative and doing everything the right way.

MSA are Readily Marketable at their Fair Market Value

The proposed punitive capital treatment of MSA appears grounded in the perception that MSA are illiquid and so amorphous that they cannot be fairly marked to market. Both of these perceptions are false. MSA are readily marketable and are purchased and sold regularly by financial institutions. Indeed, these actual buy/sell transactions in the market form the basis of the independent valuation and the ensuing mark to market process. MSA are much more marketable and liquid that the loans that banks regularly make and hold at full value on the balance sheet.

The risk weighting of MSA (250% in 2018) would effectively require banks to hold more than 25% of their MSA value in capital while only receiving capital treatment for 10%. The remaining 15% gap would have to be covered by excess capital held by the institution. No other asset class is treated in such a punitive manner, and such an onerous requirement will force banks to abandon the servicing of mortgages.

Requested Treatment of MSA for Basel III Final Rule

In lieu of the proposed MSA treatment, we would respectfully request consideration of the following alternatives:

- Subject to regular third party valuation and regulatory review and approval, include 100% of the fair market value of MSA in CET.
- Grandfather all existing MSA from any change in treatment. Changing the rules after the game has begun is a matter of fundamental fairness.
- Exempt community banks under some asset size (say, $1 billion) from this portion of Basel III
- Promulgate rules that encourage and make it easier for smaller community banks to engage in mortgage servicing

<u>Increase in the Risk Weighting for Residential Mortgages</u>

Basel III would impose new methodologies for risk weighting mortgages that are heavily dependent on data and can increase risk weights up to 200% for all new *and existing* mortgages.

Regarding the retroactive applicability of these new rules, once again this represents changing the rules in midstream which is unfair. WGB holds approximately 10% of our assets in residential mortgages. This is excellent diversification for us relative to CRE and other loan types, and our experience with residential mortgages is they have the lowest default rate of any loan on our books. We elected to hold these mortgages based on our underwriting and the 50% risk weighting rules that are currently in place. Much of the data needed under the proposed rule that would be necessary to prove that these loans are of Category 1 quality would be difficult or impossible to obtain.

On a go forward basis, increasing the risk weighting (particularly beyond 100%) will limit a bank's ability make many solid loans and curb home ownership in America. Banks frequently choose to make these loans and hold them on their books because they do not meet the GSE guidelines but are still excellent loans to worthy borrowers who deserve the opportunity to get a loan from their local community bank. Like most community banks, WGB does not engage in the business of originating subprime mortgage loans. We are talking about limiting a bank's ability to make and hold good solid mortgage loans.

Requiring Unrealized Gains and Losses Flowing Through Capital

Basel III proposes that unrealized gains and losses on available-for-sale ("AFS") securities to flow through to CET. Currently, unrealized gains and losses are not included in regulatory capital.

Inclusion of such gains and losses in CET would introduce **substantial volatility** into the capital structure of community banks like WGB. Such a rule would force WGB to hold excess capital to avoid the sanctions applicable to banks that are not well capitalized.

In a rising rate environment (which is likely in the coming years), the inclusion of unrealized losses of AFS securities will put downward pressure on capital and cause banks to reduce growth and shrink their securities portfolio. AFS securities provide an important source of liquidity for banks and are critical to asset-liability management. Regulators should encourage AFS portfolios, not enact policies that discourage them.

AFS portfolios provide a flexible tool for community banks to manage their liquidity and maintain profitability in weak loan demand markets. Banks like WGB maintain a portion of their portfolio in longer term municipal bonds that we will no longer be able to hold given the significant impact interest rate changes have on long term bonds. Bond durations will decrease in response to Basel III which will take away an important asset class that is safe, sound and profitable. As a result, rates on such securities will rise which will damage housing, state and local government financing and dampen economic growth.

Unrealized gains and losses that stem solely from interest rate changes should be carved out and NOT flow through to CET. If a credit impairment exists, such an unrealized loss can and should be accounted for in capital as is the case with loan write downs.

Conclusion

Basel III is reactionary in nature and seeks to increase capital requirements based on problems the too-big-to-fail banks encountered over the past five years. While requiring banks to hold more capital is generally a good thing, Basel III will make a bank's capital structure overly complicated and subject to significant change each quarter. Indeed, we would need to hire a special CFO whose sole responsibility would be to forecast and calculate our capital levels each quarter.

Basel III ignores the dual banking system in the U.S. and replaces it with a "one size fits all" regulation. Basel III attempts to micro-manage the entire institution through its capital account. Community banks did not have anything to do with the problems of the past five years that Basel III is designed to address and should be exempt from most of its provisions.

We respectfully request that bank regulators step back and implement a simple and predictable capital model that is not subject to significant quarterly variations. Basel III will have adverse affects and unintended consequences on our economy and banking system that have not been fully studied or understood. Additional work is necessary.

Sincerely,

Carl J. Sjulin
Chairman, President and CEO
csjulin@westgatebank.com

Cc: Matt Williams
George Beattie
The Honorable Jeff Fortenberry
The Honorable Mike Johanns
John Munn, Director of Banking, State of Nebraska
West Gate Bank Board of Directors