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October 18, 2012

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, DC 20551

Office of the Comptroller of the Currency
250 E Street S.W.
Mail Stop 2-3
Washington DC 20219

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

On behalf of the New Hampshire Bankers Association, which represents 36 banking organizations that have branches in the State of New Hampshire, I am writing to point out serious shortcomings in the proposed Basel III standards being considered for American banks.

After review and discussion of these proposals with our members, we have concluded that imposition of the Basel III standards as now written will mean unnecessary consolidation of smaller banks, far fewer product choices at banks that remain in business, and less tolerance for delinquencies or product design in the home mortgage market.

In short, the standards will mean fewer loans being made by fewer banks, at a higher cost to more select groups of borrowers. Small banks will be forced to hold more capital in reserve, see resultant declines in return on equity, and struggle to raise new capital in a low-reward environment for investors.

We urge that the Basel III standards be withdrawn and revised in order to avoid the unintended consequences of placing capital pressure on the nation's smaller well-run banks to the point that they will be forced to limit lending, restructure their business model, or consolidate with other institutions.

Among the more problematic aspects of Basel III standards now proposed are the new limits on qualified capital, including rules on:

- Trust preferred securities;
- Limits on mortgage servicing assets in Common Equity Capital Tier One (CET I); and
- Unrealized gains/losses on AFS securities.

Congress expressly allowed smaller banks to use current levels of trust preferred securities as qualified capital. Why would we deny them that option under the new rules?

Requiring deduction from CET 1, those mortgage servicing assets in excess of 10 percent of a bank's CET 1, will impact current lending practices at many institutions. This requirement, and the prescriptive nature of category designations, may discourage banks from remaining in the residential mortgage business. Banks that continue to lend in the residential market will be less likely to service mortgage loans they originate, creating a serious disconnect between banks and their customers.

The proposed treatment of AFS securities will distort capital ratio strategies, forcing banks to maintain capital ratios above required levels in order to ensure compliance with capital conservation buffer standards. The unrealized gains or losses on these securities are highly sensitive to interest rate movements. With rates at historically low levels, forcing banks to recognize unrealized securities losses at this point can only damage their capital position. This rule will have several unintended consequences. Some banks will simply shrink their securities portfolio. Others will reclassify some of their holdings to "Hold to Maturity" status, making them more difficult to manage should they be downgraded. Adjustments will add volatility to the calculation of CET 1 and Tier 1 capital ratios, forcing banks to boost capital ratios. In the current environment where it is difficult for banks to raise capital, this will have a clear and detrimental effect on lending activity.

The Basel III standards do not simply raise capital requirements - they change the entire business model of the entire industry and force radical change on capital formulas. The standards as presented were drafted for large international institutions, and will cause extreme distress among the small banks in every American community, which are already scrambling to keep up with new regulations and proposed rules put in place under the federal Dodd-Frank Act, as well as those that continue to emanate from the Consumer Finance Protection Bureau.

It is important that any standards eventually put into place recognize that the main business of community banks is not complex securities trading and international financial transactions. It is making loans to consumers and small businesses in their local markets, and working with borrowers in relationships that boost long-term prospects of success for both parties. Without revision, Basel III will see banks literally having to turn their backs on important segments of their local markets.

Risk-weighted asset proposals, too, are severely problematic for community banks in the areas that include:

- Residential mortgage lending;
- Delinquent loans and workouts;
- Lack of any grandfathering provisions; and
- Lack of credit enhancement provisions.

Without significant modification of these proposed rules, mortgages will no longer be the low-risk part of a bank portfolio. Banks will have to hold additional capital because of higher risk weighting for any non-conforming mortgages, despite their years of successful lending in that area. Our members will also need to devote significant resources and incur new overhead to develop data on their portfolios of existing loans as they calculate new risk-weighted assets. No new revenue will be produced as an offset to these

higher compliance costs, placing more pressure on earnings. At the same time, higher reserves for loans sold to the secondary market creates a squeeze on banks that have to choose between locking up capital in mortgages they hold, or boosting reserves for those they sell.

When a loan becomes delinquent, the proposed standards incentivize banks to foreclose quickly, rather than modify a loan and face the task of re-rating the loan risk to determine new loss projections. Banks will be required both to reserve under traditional allowance for loan and lease losses and also to have additional capital due to higher risk-weighting for past due loans. This is opposite of the kind of behavior that Congress and regulators alike have been urging banks to follow over the last several years.

NHBA opposes implementation of the proposed Basel III standards. Sweeping changes such as those in the proposed Basel III standards will cause serious disruption of the nation's banking markets. We urge a thorough revision, and measured implementation of any rules that emerge. While there may be a need to address capital cushions at institutions that routinely engage in complex derivatives trading and international lending, the imposition of a single set of restrictive formulas across the industry will cause irreversible harm for smaller banks. The revision process should be undertaken with an eye toward making sure that new rules do not raise the stress levels that other rule-making has already created for community banks. Any capital rules should be designed for fairness and simplicity of administration, in a form far less disruptive to the health of the banking industry, which is a critical component of a successful economy.

Thank you for consideration of our comments.

Sincerely,

Christiana Thornton
President