FinSer

106 S. St. Mary's Street ◆ Suite 600
San Antonio, Texas 78205-3607

(210) 224-5492 ◆ Fax (210) 224-8787
www.finser.com

October 19, 2012

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

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

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

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

As you may be aware, FinSer Corporation has provided various services to the community banking industry since 1980. Our role has provided a great vantage point to see the positive impact on local communities and local economies provided by many of the community banks we work with. Unquestionably, the health of our national economy is dependent on having a strong banking system at all levels. While national and international banks may take center stage, with regional banks also playing a key role, the importance of the community bank must not be overlooked as we work to rebuild our national economy. In this light, we wish to express our concerns regarding the added volume and complexity of regulation that the Basel III proposals will place on community banks if implemented in current form. Not only does added volume and complexity of regulation make it increasingly difficult to operate at a smaller size, but also will make it more difficult for community banks to both retain capital and attract new capital. Without adequate sources of capital, there can be little question that the industry will suffer and the number of banks will shrink. Should this occur, more communities will inevitably lose access to the services available through community banks focused on their unique needs. Therefore, we urge some broad rethinking as to how the Basel III international standards may best be applied to community banks.

While not meant to represent the total sum of our concerns as noted above, we would like to address two specific points in proposals that we believe are highly problematic for community banks. First, we are very concerned about the proposed "flow through" of the gain or loss in the

Available for Sale (AFS) securities account to Tier 1 capital. Currently, this would increase Tier 1 capital in most community banks, allowing more capital to potentially be returned to shareholders in the form of dividends or other payments. In periods of rising interest rates, however, additional capital may be required. This uneven demand for capital has the potential to be quite unsettling to shareholders and may tend to encourage capital to seek other investment opportunities. From a bank management standpoint, having the impact from the relative level of interest rates flow through to capital on one segment of the balance sheet potentially runs counter to effective strategies for management of the balance sheet as a whole. Effective interest rate risk and other management strategies require an understanding of how interest rate and other factors will impact the entire balance sheet, allowing for appropriate trade-offs and mitigation between different parts of the balance sheet. While estimation of the impact on certain segments of the balance sheet (e.g. loans and deposits) are sufficiently subjective that they would <u>not</u> form a reasonable basis for "flow through" to capital, they are important to making effective management decisions. Thus, the "flow through" on this one segment of the balance sheet has the very real potential of confounding effective balance sheet management. If elimination of this "flow through" provision for community banks is not deemed otherwise acceptable, we would at a minimum encourage consideration of provisions that would accommodate some reasonable volatility threshold for high quality credits, within which the "flow through" would not be required. We believe that the continually changing impact on capital as currently proposed could be quite disruptive, often forcing management to focus on short-term issues related to capital fluctuations and redirecting their attention away from development and execution of optimal long-term strategic plans.

A second concern that we would like to specifically address is the risk weightings for 1-4 Family Mortgages. Observing loss ratios on 1-4 Family Mortgages in community banks with strong underwriting standards, the proposed risk weightings appear somewhat punitive. Additionally, we find that many community banks have included balloon features to their 1-4 Family Mortgages as a key element in their interest rate risk management strategies. Pushing these mortgages, otherwise underwritten to high standards, into the higher risk weightings associated with the proposed category 2 simply because of a balloon feature appears counter productive to the overall risk management process. We are very concerned that these risk weightings, coupled with additional record keeping requirements, will deter community banks from engaging in 1-4 Family Mortgage lending, thus making these loans less available to local borrowers and eliminating another opportunity for community banks to produce earnings while serving their communities.

Again, while the aforementioned parts of the proposal are especially troubling to us, we urge broad rethinking as to how the Basel III international standards may best be applied to community banks in an effort to strengthen banking at all levels. We thank you again for the opportunity to comment on this important matter.

Sincerely,

Fred J. Schwarz, CFA
President

FJS/bm