TOTALBANK

A subsidiary of Banco Popular Español, S.A.

October 18, 2012

The Honorable Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
Regs.comments@occ.treas.gov
Docket ID OCC-2012-0008,-0009 & -0010

The Honorable Ben S. Bernanke, Chairman
Boards of Governors of the Federal Reserve System
Regs.comments@federalreserve.gov
Docket No. 1442

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
comments@FDIC.gov
RIN 3064-AD95, AD96 & -AD97

RE: Basel III Capital Proposals

TotalBank appreciates the opportunity to comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies"). TotalBank is a community bank with nearly $2.4 billion in assets operating in Miami, FL. Like most community banks, we are focused upon serving the financial needs of small businesses and consumers in our community.

After reviewing the Basel III Notice of Proposed Rulemaking (NPR) and the Standardized Approach NPR, we have certain concerns over the impact of these NPRs that we would like to share with you. Specifically, our concerns revolve around the following topics:

- Available for Sale Securities
- Exclusion of Certain Deferred Tax Assets
- Residential Mortgages
- High Volatility Commercial Real Estate (HVCRE)
- Delinquent Loans

This comment letter will detail our specific concerns on these matters.

Available for Sale Securities

One of the most concerning components of the proposal is the inclusion of Accumulated Other Comprehensive Income (AOCI) within the definition of Common Equity Tier 1 (CET1) capital. Therefore, unrealized gains or losses on available for sale (AFS) securities would now be *included* within regulatory capital under the proposed rule, presenting the very real possibility of volatile fluctuations in CET1 capital on quarter-to-quarter basis.

The proposed inclusion of AOCI is most concerning given the current historically low interest rate environment that may lead to sharp reductions in unrealized gains and a potential relatively brisk transition to net unrealized losses once interest rates inevitably increase from the current historically low levels.

This proposed change makes little sense since it only covers one side of the balance sheet, resulting in an asymmetrical affect on capital. As rates rise, the value of securities will decline, but the economic value of financial liabilities, should move in the Bank's favor in a symmetrical fashion. One way for banks to combat this issue is to elect fair value accounting for certain financial liabilities, such as FHLB advances, with the intent of "balancing out" or off-setting fluctuations in the values of AFS securities with changes in values of financial liabilities that should be moving inversely with the AFS portfolio.

The drawback to this approach, however, is that the changes in the value of the liabilities would flow through to capital through the income statement while the changes in the values of the AFS portfolio would bypass the income statement. Therefore, some level of symmetry on the capital computation would result in asymmetry on the income statement, unless the AFS portfolio was classified as a "trading" portfolio, with the changes in market values flowing through the income statement, even though the portfolio isn't being held for "trading" purposes.

Another approach banks will undoubtedly consider to mitigate the impact of this proposed provision is to include a greater number of securities in the Held to Maturity (HTM) bucket. The shortcoming of this strategy, however, is that banks will have a reduced ability to sell securities, limiting the Bank's ability to secure liquidity and react to market conditions, providing banks less flexibility in managing their investment portfolios.

It is true that the inclusion of unrealized gains/losses in CET1 capital will generally benefit banks in the short term given that most banks are currently sitting on unrealized gains in the current low rate environment. TotalBank currently has just under $10MM of unrealized gains in its AFS portfolio, which would provide a short term jolt to the Bank's capital ratios. Specifically, adding this total to the Bank's capital increases the Total and Tier 1 RBC ratios by approximately 70 bps each and increases the leverage ratio by 45 bps.

However, this short term increase in capital could potentially disappear quite quickly once interest rates start to rise. The chart below illustrates the *estimated* effect on TotalBank's unrealized gain/loss position on its AFS portfolio given the indicated *instantaneous* increases in rates.

Rate Shock	Unrealized Gain (Loss)	Leverage Ratio
Unchanged	**$9,976,000**	**10.64%**
+100	**$144,000**	**10.19%**
+200	**($12,445,000)**	**9.62%**
+300	**($26,236,000)**	**8.99%**

To emphasize, the rate shocks illustrated above are instantaneous, effectively estimating the effect of unrealized gains/losses if rates were to increase by the indicated levels on a single day, which is not likely or realistic. However, it is possible for rates to rise *briskly* at some point in the future when rates do in fact start to rise.

As indicated above, the Bank would lose over $36MM in capital if rates were to increase by 300 bps, reducing the leverage ratio by 165 bps. While TotalBank has sufficient capital to absorb such a decline, it is very likely that such a shift in interest rates will have a more profound and tangible effect on many community banks across the country. The sad part about this inevitable truth is that the decline in capital will not be reflective of a decline in the economic value of these institutions.

Regulatory agencies and bankers make it a priority to ensure that the banks they supervise and manage are well positioned for rising or declining interest rate environments by proactively managing interest rate risk. This risk management practice ensures that there is symmetry in the repricing characteristics of financial assets and financial liabilities. Flowing changes in market values of assets on one side of the balance sheet through CET1 capital on the basis of accounting classifications makes little sense and simply serves to reduce capital in the banking industry when interest rates rise, regardless of how the bank has positioned itself for rising rates.

Additionally, we are also concerned that regulators will incorporate the effects of such interest rate shocks on the unrealized gains/losses of AFS portfolio in their assessment of a Bank's capital position, effectively requiring banks to maintain capital "cushions" that would enable them to be "well" capitalized (or meet the capital conservation buffers) after absorbing the effects of such shocks.

For example, a bank that is meeting all capital requirements today, but would fall below "well" capitalized after recording the effects of a 300 bps instantaneous increase in rates on its AFS portfolio would likely face regulatory scrutiny. While we can agree that such shocks in interest rates are not likely from one day to the next, it must be noted that these instantaneous shocks is how banks and regulators measure the effects of interest rate risk, so translating this same concept to assessment of bank capital under the Basel III proposal is not a stretch.

Obviously, this component of the proposal that includes the unrealized gains/losses on AFS securities in CET1 capital is one that has garnered a lot of attention and debate – and deservedly so given the level of volatility that will be introduced to capital levels at financial institutions of all sizes.

Exclusion of Certain Deferred Tax Assets

The next component of the proposal that warrants comment is the exclusion of any deferred tax assets (DTA) related to carryforwards of prior net operating losses. The proposal indicates that any component of a Bank's DTA that is related to carryforwards of prior operating losses much be excluded from CET1, regardless of the number of years in which those carryforwards would expire (which could be up to 20 years).

One must consider that under accounting rules, those carryforwards are only recognized on bank balance sheets if the bank has met the "more likely than not" realization threshold for those assets, a stance that is presumably verified by a bank's independent auditors on an annual basis. The regulators should consider a capital structure that assigns some value to carryforwards for banks that have a recent demonstrated track record of recording taxable earnings. We do agree, however, that overall limitations on the inclusion of DTAs on a Bank's CET1 is a sensible approach.

Residential Mortgages

The proposal assigns risk weights to residential mortgages based on (1) whether the mortgage is a "traditional" category 1 mortgage or a "riskier" category 2 mortgage; and (2) the loan-to-value (LTV) ratio of the mortgage.

Specifically, category 1 loans must meet the following criteria:

- Term of no more than 30 years
- Regular periodic payments
- No increases in principal, deferments, or balloons
- Underwriting and repayment ability based upon (a) principal, interest, taxes and insurance; (b) maximum interest rate allowed in first five years; and (c) documented income
- Interest changes limited to 2% per year and 6% over the life of the loan
- HELOC qualification includes principal and interest on maximum exposure
- Loans that are not 90 days past due, nonaccrual or certain junior liens

Category 2 loans, on the other hand, include all other residential mortgage exposures, including junior liens and nontraditional mortgage products.

The risk weights are based on the LTV table below for category 1 and 2 loans:

LTV % (excludes PMI)	Risk Weight Category 1	Risk Weight Category 2
Less than or equal to 60	**35%**	**100%**
>60 to ≤ 80	**50%**	**100%**
>80 to ≤ 90	**75%**	**150%**
>90	**100%**	**200%**

The LTV is computed by taking the current balance of the loan divided by the value of the collateral at the last formal underwriting.

There are concerns with this component of the proposal. First, the proposal rule does not recognize private mortgage insurance (PMI) at all. Mortgages are therefore subject to the high risk weights even if PMI reduces the risk of loss on such loans. To the extent that PMI is in place and is verifiable and valid, its existence should be acknowledged within the scope of the NPR.

Second, a bank is required to re-assess a mortgage after a loan restructuring or modification, unless the modification is made under the federal Home Affordable Mortgage Program (HAMP). Thus, a category 1 mortgage might become a category 2 mortgage after modification if the bank does not modify the loan under HAMP. This aspect requires clarification, as there are valid reasons that a loan could be modified outside of HAMP without increasing the credit risk to the bank.

The third and most important concern with this aspect of the proposal is the fact that the proposal classifies all junior liens, such as HELOCs, as category 2 exposures with risk weights ranging from 100% to 200%, serving as a significant deterrent to originating these types of loans that provide liquidity to consumers across the country for viable reasons. In addition, a bank that holds two or more mortgages on the same property would be required to treat *all* the mortgages on the property – *even the first lien mortgage* – as category 2 exposures.

Thus, if TotalBank cross-sells a HELOC to a customer that has a first lien residential mortgage with the Bank, the junior lien may "taint" the first lien into a category 2 mortgage, resulting in a higher risk weight for the first lien mortgage. By contrast, if one bank makes the first loan and a separate bank makes the junior lien, then the junior lien does *not* change the risk weight of the first lien. This makes little sense to us. We urge the Agencies to consider decoupling the mortgage from the HELOC so as not to taint the first mortgage. At the very least, existing mortgages and HELOCs to the same consumers at banks should be grandfathered under the current approach and should not be tainted.

Besides the obvious impact of "tainting" first mortgages with HELOCs, this proposal will also serve to increase the rates that banks charge on HELOCs in order to achieve a commensurate risk adjusted return on capital (RAROC), adversely affecting consumers.

High Volatility Commercial Real Estate

The NPR would assign high volatility commercial real estate (HVCRE) a risk weighting of 150% as opposed to the current 100% risk weighting. HVCRE means acquisition, development, or construction financing except:

- 1-4 family residential projects
- Projects in which:
    1. The LTV ≤ maximum supervisory LTV, and
    2. Borrower contributed at least 15% of "as completed" appraised value, and

3. Borrower contributed the capital before the bank advances funds, and the capital is contractually required to remain through the project life.

Like the proposed changes to the residential mortgage risk-weighting approach, HVCRE currently included on the Bank's loan portfolio are *not* grandfathered in to the current risk weighting methodology.

Also like the affect on HELOCs, the 150% risk-weighting will serve to increase the rate that banks charge on such loans in order to achieve a commensurate RAROC, making development projects more challenging for developers. Needless to say, such an unintended consequence could prolong the economic recovery period.

We urge the Agencies to also consider the amount of non-performing HVCRE loans and OREOs held by banks and the effect this part of the proposal will have on those properties. Since pricing on loans financing HVCRE will undoubtedly increase as a result of the proposal, the economic viability of development projects that will get these properties moving again will plunge, prolonging the holding period of these types of assets by the banking industry. We need to encourage prudent development, not discourage it.

Delinquent Loans

Under existing rules, the risk-weight of a loan does not change when the loan becomes delinquent. Instead, the additional risk is addressed through the ALLL. The proposal would change this approach significantly by assigning nonresidential loans over 90 days past due a risk-weight of 150%.

Therefore, a delinquent loan will now adversely affect both the numerator and denominator of capital ratios by reducing CET1 capital (and possibly Tier 2 capital if the ALLL has already reached the 1.25% of RWA maximum) while also simultaneously increasing a bank's risk weighted assets.

Conclusion

TotalBank respectfully submits these comments for consideration by the Agencies. We believe that there are opportunities to improve the proposal in order to ensure that the capital framework adopted by the Agencies enhances the quality and quantity of capital without unnecessary negative impacts on profitability and operating efficiency – and without creating undue concern about the viability of healthy financial institutions that could be negatively impacted under the proposal in normal fluctuations in their AFS portfolios.

Sincerely,

Jose Marina

Jose Marina, C.P.A.
Executive Vice President & C.F.O.