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503 Airport Road, Suite 101 · Medford, OR 97504 · Tel 541.618.6003 · Fax 541.618.6001

October 3, 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

Re: **Basel III Capital Proposals**

Ladies and Gentlemen:

Thank you for considering my observations on the on the Basel III proposals[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I have spent over 30 years in the financial institutions industry. Over this span of time, I have gone through numerous business cycles. I have experienced first-hand the negative impact of economic downturns on our nation, communities and banking institutions. As such, I appreciate the motivation to improve the management of business risk as the intent behind these proposals.

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[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

However, I would ask you to consider the negative impact these proposals will have the ability of the nation to recover from the very anemic economic conditions currently present in the country. This is especially true of those proposals that mandate levels of capital based on assigning various risk-weightings to different types and quality of loans. This aspect of the proposals will stifle the ability of community banks to supply credit to support the economic activity of the communities they serve. The dampening effect this proposal will have on the supply of credit will cause the cost of credit to increase. The burden of such increase will be overwhelmingly borne by small businesses, the life-blood of our national economy. Given the continued sluggishness of the economy, imposing regulations that restrict expansion of credit could not be more ill-timed.

In addition, these proposals are in direct conflict with initiatives currently underway by the Financial Accounting Standards Board (FASB). As you are aware, the FASB is in the process of developing new standards pertaining to the accounting for financial instruments, a portion of which deals with credit impairment. An exposure draft regarding this proposal is scheduled for release for public comment in fourth quarter 2012. The central element of the credit impairment portion of this proposal is the notion of "current expected credit loss" or CECL. Imbedded in such a model are key concepts, such as expected credit loss and the current recognition of the effects of credit deterioration on collectability as estimated by the probability of default and the loss given default.

I would submit for your consideration that a model such as CECL has a much stronger analytical and experiential basis for assessing projected credit risk, and thus risk to capital, than the arbitrary and static approach envisioned by the subject regulatory proposal. As credit risk changes based on observable facts, rather than on artificial realignments of asset mix, the levels of capital needed to support such credit risk would modify via the changing levels of the allowance for loan and lease losses (ALLL). The level of the ALLL would be adjusted via charges to earnings, and thus to capital. In reality, the ALLL has always been a segregated "pool of capital" set aside to cushion against credit losses. The emphasis on addressing credit risk should focus on improved expected credit loss analytic segmentation, not the imposition of a "one-size-fits-all" methodology based on capital levels derived from subjective risk weightings.

In addition, the logic behind assigning static risk-weightings to various loan types as a proxy for risk has significant shortcomings. For example, this approach does not allow for variances in risk based on:

- differences in cash flow generated by commercial real estate collateral
- differences in the financial strength of guarantors
- changes in collateral values or cash flow coverage since the inception of the loan
- equity invested by the borrower in the business or real estate project

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Given the above referenced initiative by FASB regarding credit impairment, I am concerned that the additional imposition of this regulatory proposal will potentially burden the industry with too much required capital. Such a result will cause economic returns to be depressed, inhibiting the ability of financial institutions, primarily community banks, to raise needed capital in times of economic growth or downturn.

Therefore, I strongly encourage you to remove this component of the proposal altogether. If there is a need to hold higher levels of capital for credit risk on the balance sheet, that need should be addressed through an appropriate provisions to the ALLL, as described in my comments above. In a related matter, the limit on the amount of ALLL that may be included in capital (the excess over 1.25% of risk weighted assets for Tier II) is an outdated concept and should be eliminated. Since charges to earnings provide the predominate source of enhancements to the ALLL, the entire amount of the ALLL should be included in common equity.

Thank you for taking these comments under serious consideration regarding this very important matter.

Respectfully,

Doug Biddle

Douglas N. Biddle
Executive Vice President
Chief Financial Officer

Cc: Linda Navarro, President & CEO – Oregon Bankers Association
James M. Ford, President & CEO – PremierWest Bancorp
Greg Walden, Member – United States House of Representatives