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October 22, 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 the opportunity to provide comment on the Basel III proposals[1] that were issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Unrealized Gains/Losses on Investment Securities Available-for-Sale as a Component of Regulatory Capital

I appreciate the comprehensive effort to harmonize capital standards among internationally active banks and bank holding companies, and to restructure the risk-based capital calculation methodology to more clearly incorporate risks arising from the most recent financial crisis. I am, however, particularly concerned about the inclusion of accumulated other comprehensive income (AOCI)—more specifically, unrealized gains/losses on investment securities available-for-sale (AFS)—as a component of both Common Equity Tier 1 (CET1) Capital and Tier 1 Capital. Under the proposed calculation, Tier 1 Capital builds upon CET1 Capital and is then used to derive Leverage Ratio. Unrealized gains/losses on investment securities AFS is an extremely volatile and generally significant balance on most community bank, thrift and regional bank balance sheets.

Incorporating unrealized gains/losses on investment securities AFS as a component of CET1 Capital and Tier 1 Capital in arriving at the Leverage Ratio under the proposed regulatory capital rules appears counterproductive, except in cases where a bank or thrift does not have the intent or ability to hold the financial instrument to avoid realizing any currently unrealized losses (i.e., portfolio liquidation is imminent). According to Appendix D to Part 225 of the Bank Holding Company Act, "the principal objectives of [the Leverage Ratio] is to place a constraint on the maximum degree to which a banking organization can leverage its equity capital base." Because the volatility of AOCI in community bank, thrift and regional bank balance sheets is significant, it will, in and of itself, materially increase or decrease the Leverage Ratio from reporting period to reporting period. A large unrealized gain position will erroneously suggest a higher "degree to which a

[1] *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.*

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banking organization can leverage its equity capital base". Conversely, a large unrealized loss position will erroneously suggest a lower "degree to which a banking organization can leverage its equity capital base". These are erroneous indications because the unrealized gain and loss positions can and historically have reversed very quickly. The result is a Leverage Ratio that becomes nearly meaningless in its intent as a clear measure of leverage for current and long-term capital planning purposes.

The significance of this can be clearly seen when applied to balance sheets of banks and thrifts with assets under $1 billion. The nearly 6,600 banks and thrifts under $1 billion in assets represent $1.4 trillion in total assets and hold $318 million in debt securities.[2] Because the majority of these debt securities are municipal and mortgage-backed securities, over half the $318 million reprice longer than five years from now. The impact on Leverage Ratio solely from incorporating unrealized gains/losses on investment securities AFS was modeled using portfolio composition and repricing data from the FDIC's Statistics on Depository Institutions and price volatility data from Bloomberg. The average Leverage Ratio for the 6,600 banks and thrifts with fewer than $1 billion in assets was 10.24%. Under the proposed calculation of CET1 Capital and Tier 1 Capital, an instantaneous 400 basis point increase in the Treasury yield curve[3], would drive the Leverage Ratio down to 7.79%, solely from the resulting unrealized losses on investment securities AFS. Banks with $1 billion to $10 billion in assets similarly would be impacted under this scenario, with a decline in average Leverage Ratio from the currently reported 10.27% down to 8.26% were unrealized losses on investment securities AFS included in CET1 Capital and Tier 1 Capital.

Incorporating the impact of fluctuations in unrealized gains/losses on securities AFS into regulatory capital is historically consistent with risk-based capital measures. It should continue to be treated as such—included solely in Tier 2 Capital and Total Capital, and as a component of the Total Capital Ratio. Please eliminate unrealized gains/losses on investment securities AFS from the determination of CET1 Capital and Tier 1 Capital or, at a minimum, provide an exemption of such for banks and thrifts who do not operate banking offices in other countries or conduct significant cross-border transactions.

Should you wish to follow up with me on comments included herein or any other matters, please do not hesitate to contact me.

Sincerely,

Trey C. Maust
Co-President/CEO and Board Member

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[2] All institution data is derived from June 30, 2012 Call Reports.
[3] 400 basis point shock was used as it brings the Treasury yield curve up to an approximate 25-year average.