Community Bank
1ST
Las Vegas

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 recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Basel III was obviously designed to apply to the largest, internationally active banks and not community banks. Community banks did not engage in the highly leveraged activities that severely depleted capital levels of the largest banks and created panic in the financial markets. The 19 largest banks in the country have been, and continue to be, the focus of media and the public for what is wrong with banking. Unfortunately, community banks get the broad-brush treatment in this spectacle.

[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.*

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Community banks operate on a relationship-based business model that is specifically designed to serve customers in their respective communities on a long-term basis. This model contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. It may be that certain people who have never seen the more rural areas of the country and assume that their worlds are defined by concrete, asphalt, and skyscrapers may be out of touch with the reality of what a community bank truly does other than what a textbook or junior analyst says is occurring.

It is unfortunate that the banking environment that community banks are being pushed into today were neither of our making or our desire. Quite frankly, if these pending regulations are applied to Small Community Banks, the goals of everyone from the President on down to grow small businesses as a major part of restoring our economy, will at the very least, be prolonged in time.

Community Banks are already severely limited in their ability serve the local small businesses, due to the current economic conditions, and the severe new regulations being imposed on them by the many regulatory agencies

Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will only penalize the community banks who offer these loan products to their customers and deprive customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. Many community banks will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE, thereby losing what a community bank does – work with our customers in the good times and bad..

It is almost impossible to predict the total impact on Community Banks of the above risk weights into any model due to the uncertainties of what the future economic picture will look like. What is extremely clear, is when interest rates begin to rise, the demand for Capital will far outdistance the ability of Community Banks to raise it.

In the real world, community banks do not have ready access to capital that the larger banks have through the capital markets. The only way for community banks to increase capital is through the accumulation of retained earnings over time. Due to the current ultra low interest rate environment, community bank profitability has diminished, further hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) to allow those banks that need the additional capital, to retain and accumulate earnings accordingly.

The proposed risk weight framework under Basel III is too complicated. It will be an onerous regulatory burden that will penalize community banks by the additional costs of monitoring, reporting, and time spent explaining to our boards the intricacies of Basel III.

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Further, imposing distribution prohibitions on community banks with a Subchapter S corporate structure conflicts with the requirement that shareholders pay income taxes on earned income. Banks like mine with a Subchapter S capital structure would need to be exempt from the capital conservation buffers to ensure that their shareholders do not violate the provisions of the Internal Revenue Code. We recommend that the capital conservation buffers be suspended during those periods where the bank generates taxable income for the shareholder.

As a community banker, there are circumstances when we see how the outcome will actually negatively affect our customers and this is one of them. Certainly I understand that a small community bank CEO in a rural area of New Mexico will not carry as much influence as one of those bank presidents we all see testifying before congressional bodies, but do not think that bigger is better in this case. The knowledge levels of small community bankers, because we are so involved in our banks, so intimate with regulatory rules, and so willing to share that information with one another, may sometimes be greater than that of the 19 larger bank presidents. We believe the levels of our common sense certainly are.

I would concede that there are bad community banks for which additional regulatory oversight is necessary. That is what your organizations do. However, all community banks should be allowed to continue using the current Basel I framework for computing their capital requirements and not be forced to operate under Basel III.

Thank you for your time.

Sincerely,

Ray Litherland

Ray Litherland
CEO

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