From: Donna Johnson <donna@prvb.com>
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To: Comments
Subject: FDIC RIN 3064-AD95 and RIN 3064-AD96

Community banks across Colorado, like Pine River Valley Bank, have strong concerns with proposed rules by the federal banking regulators to implement Basel III capital standards.

Community banks are common-sense institutions that maintain the highest capital levels in the banking industry—they should not be subject to the same complex standards required of larger and riskier financial firms. The federal banking regulators' proposed rules to implement Basel III capital standards would impose undue regulatory burdens on community banks. We support a tiered approach that properly recognizes the difference between Main Street community banks and Wall Street megabanks.

Basel III was conceived as an international standard that would apply only to the largest, internationally active banks. However, the proposed rule issued by federal regulators would impose Basel III standards on banks of all sizes—not just on the large and complex financial institutions that caused the recent Wall Street financial crisis. Community banks did not engage in the reckless behavior that contributed to the crisis and subsequent economic downturn. Imposing excessive regulatory standards on community banks would only threaten the nation's economic recovery.

Community banks have expressed strong concerns with our federal regulators about the proposed new risk weights, particularly on mortgages, certain types of commercial loans, and nonperforming loans. Community banks should have the option to continue using Basel I risk weights.

Also:

- accumulated other comprehensive income, or AOCI, should not be included in regulatory capital;
- trust preferred securities previously issued by institutions with less than $15 billion in assets should be grandfathered and not phased out;
- mortgage-servicing rights should continue to be included as Tier 1 capital; and
- the current cap on the inclusion of allowance for loan and lease losses, or ALLL, as capital should be raised.

While we are concerned about the damaging effects of this proposal on community banks, the ultimate losers in this draconian change are consumers, small businesses and local government entities who will face higher borrowing costs and diminished availability of both credit and bank services. There is never a "good time" for public policy to result in such outcomes, but given the tenuous state of the economic recovery, the application of Basel III to community banks is especially counter-intuitive.

This is a remarkably complex and cumbersome proposal, and the requirements for compliance and adherence will significantly add to an already untenable level of regulatory burden and cost for community banks. We all recognize the importance of adequate capital in our financial institutions. As community banks pay FDIC premiums, it behooves us to have a strong industry with minimal failures. Capital levels are currently at record levels in community banks. The regulatory requirements for community bank capital continue to increase and are generally well in excess of the levels contemplated in the proposal for common equity and Tier 1 capital.

The risk weightings, especially in the mortgage loan category, are excessive, and will further chill an already challenging market. Rules already in effect and proposed, including escrow requirements, balloon note limitations, appraisal standards, additional disclosures, "QM" and "QRM," and new "zero tolerance" on the "Good Faith Estimate," among others, have significantly curtailed mortgage lending among community banks in our state, especially the "in-portfolio" loans. A number of community banks have simply stopped making mortgage loans to their customers, thanks to regulatory and legislative "overkill" in an attempt to fix problems that we didn't contribute to nor participate in. Higher risk weightings for commercial real estate lending will also limit credit availability and raise costs for borrowers in this struggling market.

Further, the proposal appears to ignore the existence of the Allowance for Loan and Lease Losses in providing for a buffer for both identifiable and anticipated exposure in the loan portfolio. If additional risk weights are applied to "problem" loans, does that negate the necessity of specific reserve allocations? The proposal contemplates reflecting market valuation swings of a bank's AFS portfolio in Tier 1 capital. This is now referred to as "Accumulated Other Comprehensive Income" (AOCI), and will require community banks to hold additional capital to compensate for volatility in interest rates. Penalties for falling below mandated regulatory capital levels are severe, and banks will likely move to shorter maturities, sacrifice liquidity and/or forgo expansion or growth based upon inevitable swings and market uncertainty. Short term interest rate swings should not be included in the regulatory capital calculations. The current artificially low interest rate environment that has been a windfall for the larger institutions and a curse to most of the small players, the only movement in rates will be upward, which will negatively impact all community banks.

Large banks have the ability to hedge the interest rate risk exposure on their securities portfolios. Community banks do not have that luxury and are unable to do so in an economically feasible manner. Further, the cost of borrowing for already strapped municipalities and other government entities will increase as banks will be loath to hold longer maturity securities for fear of interest rate swings and capital degradation. One of the hard fought victories in the Dodd-Frank debate was the ability for banks under $15 billion to continue to count Trust Preferred Securities (TrUPS) as Tier 1 Capital. A significant number of community banks utilized this regulator-approved hybrid capital vehicle, and this proposal not only reverses that treatment, but appears to directly contradict the will of Congress.

The proposal has a disparate impact on community banks *vis-à-vis* the too-big-to-fail banking conglomerates:

- Community banks are struggling mightily to keep up with the costly and burdensome tsunami of regulations and edicts coming from Washington, D.C. Large banks have the ability to absorb these compliance costs more efficiently.
- Access to the capital markets is limited in many cases for community banks. With additional regulatory costs, legislative and regulatory mandates impacting revenue opportunities (mortgage lending restrictions, overdraft limitations, interchange price fixing), more risk and lower loan demand in the marketplace due to the economic slowdown and the low interest rate environment, earnings are understandably under stress. Higher capital requirements and additional expenses will only exacerbate these problems, making the attraction of new capital with the promise of more risk and a lower return on equity a difficult proposition.
- Even under existing capital rules, there has been an historic "disconnect" between the capital levels required of community banks and what the large banks have been required to keep. Regulatory requirements for small banks have always been higher, and there is no reason to believe that this disparity will not continue under this new proposal.

As more and more regulatory burden is added to community banks, many are contemplating selling or merging. As community banks are the primary source of credit to small business borrowers, and those businesses create the bulk of the new employment opportunities and economic activity in this country, it is a perverse and tragic consequence to solving problems caused by others in the financial services industry. Further consolidation and concentration of the banking industry should not be a goal – intended or otherwise – of public policy.

The Basel III proposal epitomizes unnecessary regulatory burden and will have severe consequences on the community banking sector.

Thank you for your time and consideration.

Respectfully submitted,

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