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October 19, 2012

The Honorable Thomas J. Curry, Comptroller  
Office of the Comptroller of the Currency  
[regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)  
Docket ID OCC-2012-0008 and OCC-2012-0009  
RIN 1557-AD46

The Honorable Ben S. Bernanke, Chairman  
Board of Governors of the Federal Reserve System  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)  
Docket R-1430 and R-1442  
RIN No. 7100-AD 87

The Honorable Martin J. Gruenberg, Acting Chairman  
Federal Deposit Insurance Corporation  
[comments@fdic.gov](mailto:comments@fdic.gov)  
RIN 3064-AD95 and RIN 3064-AD96

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (the "Basel III Proposal") and Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (the "Standardized Approach Proposal")

Dear Heads of Agencies:

The Illinois League of Financial Institutions (ILFI) is writing you today to voice our concerns regarding the Basel III Notices of Proposed Regulations released June 7, 2012. With close to 100 members, the ILFI has been advocating on behalf of Illinois' thrift/banking industry since 1880. Our membership is comprised of community sized thrifts and commercial banking institutions and today we are reaching out to you on behalf of our member banks.

#### General Concerns

When the international banking regulators met in Switzerland over several years ironing out the Basel accords, many of us in the banking industry thought we understood what they were doing in setting these proposed rules. We believed that Basel III was intended to mandate a

larger capital cushion to help the global financial markets deal with the top financial institutions worldwide that pose a major risk to the financial markets. We thought Basel III was aimed to specifically target international, systemically-significant institutions. We did not believe that the Basel III accords were meant to include hometown community thrifts/banks like those located in small rural towns like Salem, Illinois.

If you do not exempt our community thrifts/banks from Basel III, you will be adding significant compliance burdens to the very entities that are the engines of economic growth to their communities at a time when they are least able to absorb additional compliance burdens. These burdens will fall on community entities that have NO international transactions except the occasional foreign traveler's check that comes through in settling an estate.

### The Uniqueness of the United States Banking Model

While these Basel III discussions were taking place, was the issue ever raised that the American banking model is vastly different from its European counterpart? Europe does not have community banks and in the case of many other countries on the continent, they do not have super regional banks either. These rules were designed by individuals thousands of miles away, who are completely out of touch with the American banking system.

We are concerned that no one will enforce these Basel III Capital requirements. What will the penalty be if the European banks do not comply? Are the Chinese banks, considered by most the largest institutions worldwide, subject to these Basel III accords as well? The Chinese to my understanding have very different accounting and regulatory standards from the rest of the world. Who will enforce these standards in China and elsewhere?

Placing America's Community banks, a segment of the industry with already high capital standards, at even higher capital requirements puts them at an extreme disadvantage. On several occasions, Chairman Bernanke has stated that American banks, especially our community banks, are already subject to higher capital standards and in fact are well capitalized already. If that is the case – what good does it do to impose these standards on ALL U.S. thrifts/banks NOW? Forcing U.S. thrifts/banks to take on this burden NOW during this continuing time of economic slowdown and uncertainty is impractical and unjustifiable. The LAST thing Illinois' community thrifts/banks need is to have new capital standards such as those proposed thrust on them.

After several trips to Washington to discuss the issue, it seems everyone is willing to talk about the importance of community banks, yet no one is willing to step up to help them. Exemption is one answer. Total withdrawal of these proposed rules is another.

The phenomenon that is the community thrift/bank and the vital role it plays within communities around our country is constantly underestimated. While community thrifts/banks may represent only 10% of banking assets in the country, they account for more than 40% of all small business loans made nationwide. These small business loans are made every day and, in turn, create jobs for their neighbors. There are 30 million small businesses in the United States. If half of them each hired just one new employee, our high unemployment rate

would drop below 5%. Forcing community thrifts/banks that are the sources for small business growth to focus energies now on new artificial capital standards is counterproductive to our overall economic goal of economic recovery. If our country continues to move forward in applying Basel III as it stands, it will be a devastating blow to the entire banking industry, stifling economic growth and destroying our country's one true source of job creation.

I am a former regulator. My commitment to continue emphasizing the importance of not only maintaining high levels of capital but safety and soundness has not wavered from my days as an Assistant Commissioner at the Illinois Office of Banks and Real Estate. The Illinois League's membership agrees that high standards for capital are essential. We are uncertain, however, that this overly confusing, "one-size fits all" approach is the best solution. It is no small coincidence that as regulation becomes more complex, it also becomes less effective. As the pages of rules and regulations pileup, the only "jobs" being created are those for regulators, lawyers and compliance officers.

#### Mortgage Programs offered by Federal Home Loan Banks

We are also concerned about the Proposed Rule's potential impact on the mortgage programs that have been established by many of the Federal Home Loan Banks ("FHLBanks") whereby they acquire and fund conventional and government-insured residential mortgage loans originated and serviced by member institutions, known as Acquired Member Assets ("AMA") Programs. These programs operate under the names Mortgage Partnership Finance<sup>®</sup> ("MPF<sup>®</sup>") Program<sup>1</sup>, first established in 1997, and the Mortgage Purchase Program ("MPP"), established in 2000.

These programs are very popular with smaller community financial institutions because they provide an alternative to the traditional secondary market that can be difficult or prohibitively costly for many community lenders to access. For example, more than 200 community financial institutions in Illinois have used the MPF Program to provide over \$23 billion of mortgages to help their low and middle income customers buy a new home or lower the cost of their existing home through refinancing. Nationwide, more than 1,500 FHLBank member institutions have participated in the AMA programs to fund over \$200 billion of mortgages in every State and the District of Columbia.

The AMA programs use a unique risk-sharing structure that allows participating members to retain a significant portion of the credit risk of the conventionally underwritten, fixed-rate mortgages they originate. The FHLBanks buy the loans and hold them on their balance sheet, managing the interest rate risks. Allocating the risks in this manner results in a more efficient and lower cost mortgage financing benefitting the members' homebuying customers.

<sup>1</sup> "Mortgage Partnership Finance" and "MPF" are registered trademarks of the Federal Home Loan Bank of Chicago.

To achieve the risk-sharing, the structure of several AMA products requires participating member to provide a credit enhancement of a defined portion of a pool of residential mortgage loans that have been sold to the FHLBanks. Even though the loans are held on the balance sheet of the FHLBank, the participating member must hold risk-based capital ("RBC") against its off-balance sheet credit enhancement ("CE") obligation. As we understand the Proposed Rule, the amount of RBC required for participating members would be increased for some MPF products and decreased for others, depending on the product used. Further, the proposed rule would not grandfather existing MPF pools under the current RBC rules.

Under the "standardized approach" described in the Proposed Rule, there are three possible definitional paths for a participating members' credit enhancement obligation in the AMA Programs: (1) "traditional securitization"; (2) "synthetic securitization"; and (3) "retail exposure." Based on our analysis, a member's credit enhancement required under the MPF Program would likely fall into the "synthetic securitization" definition and resulting methodology.

Our concern arises from the Proposed Rule elimination of the existing regulatory approach for RBC that has been in place since the MPF<sup>®</sup> Program was rolled out to members in 1997. In its place, the Rule would use a much more complicated formula that would increase the required amount of RBC in many instances. Further, the added complexity of the Proposed Rule is likely to deter many smaller community lenders from originating traditional mortgages for sale in the secondary mortgage market.

The added regulatory burden of this proposal, combined with other new regulations from a variety of Federal agencies, is likely to overwhelm many smaller institutions with limited resources and manpower. Many such institutions may simply exit the mortgage origination market, further concentrating this market into the hands of a few very large financial institutions and reducing choices for American consumers.

#### Unique Problems for Thrifts

Community thrifts/banks do not have the operational capabilities, from a scale and risk management perspective, to manage the volatility of bank balance sheets that will be introduced if the proposals are adopted without substantial modification. As a result, community thrifts/banks will limit their product offerings or price them substantially higher than the comparable products of more complex banks in order to mitigate the risks introduced by the proposals forcing an institution's paper gains and losses to flow through the capital account during changing rate environments. Mutual thrifts particularly will be disadvantaged since they rely on retained earnings to fund capital growth.

Additionally, as a result of the Federal Reserve's Small Bank Holding Company Policy Statement, the Basel III Proposal generally would not apply to bank companies with total consolidated assets of less than \$500 million. However, because the Small Bank Holding Company Policy Statement does not cover savings and loan holding companies there is no similar exemption for savings and loan holding companies with less than \$500 million of total

consolidated assets. Smaller savings and loan holding companies face the same challenges that smaller bank holding companies do with respect to raising capital. They generally do not have access to public equity markets and therefore need to rely on alternative sources of capital, such as debt. Further, because these companies have not previously been subject to consolidate capital requirements, many of them do not presently have capital structures that would allow them to comply with the requirements of the Basel III Proposal. Therefore, should a general exemption not be adopted, we suggest inserting an exemption for savings and loan holding companies with less than \$500 million in total consolidate assets. To fail to do so would be unnecessarily punitive to small savings and loan holding companies.

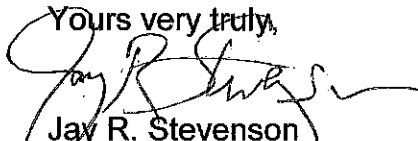
#### Conclusion

For the general and specific reasons detailed above, we believe that this is not the time to impose new capital standards on community thrifts/banks in Illinois or anywhere else in the United States. If ever there was a time to simply say STOP – this is it. If Basel III has merit, it will still have merit three years from now. We respectfully urge you to stop implementation now and reconsider Basel III AFTER economic recovery is assured and achieved.

On behalf of Illinois' banking industry, we appreciate your thoughtful consideration of what the broad application of Basel III could do to our nation's community thrifts/banks. We must work hard to tailor regulation to reflect the vast differences in size and complexity of our many unique institutions. If we continue on our current path, one thing is certain: community thrifts/banks will cease to exist.

Thank you for your consideration of this comment letter.

Yours very truly,



Jay R. Stevenson  
President

Cc: The Honorable Richard J. Durbin  
The Honorable Mark S. Kirk  
The Honorable Bobby Rush  
The Honorable Jesse Jackson, Jr.  
The Honorable Daniel Lipinski  
The Honorable Luis Gutierrez  
The Honorable Mike Quigley  
The Honorable Peter Roskam  
The Honorable Danny Davis  
The Honorable Joe Walsh  
The Honorable Jan Schakowsky

The Honorable Robert Dold  
The Honorable Adam Kinzinger  
The Honorable Jerry Costello  
The Honorable Judy Biggert  
The Honorable Randy Hultgren  
The Honorable Tim Johnson  
The Honorable Don Manzullo  
The Honorable Bobby Schilling  
The Honorable Aaron Schock  
The Honorable John Shimkus