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CITYWIDE BANKS
OF COLORADO, INC.
Banking with the Human Touch
6500 E. Hampden Avenue, Suite 203
Denver, Colorado 80224-3002

October 18, 2012

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: RIN 3064-AD95 and RIN 3064-AD96

Dear Regulator:

We write in reference to the proposed Basel III regulatory capital reforms. As you know, the Basel III discussions have ben conducted for many years with only the largest systematically important Banks internationally. We were surprised June 7, 2012 to be informed the Federal reserve, the Treasury, the FDIC and the OCC in an interagency-coordinated proposed rule release, published these requirements for all banks $500 million and larger. We all believe that a strong capital foundation is important, however, the timing and ability for community banks to raise more capital are significantly impaired by both the rules as published and the time frame required.

Many of the new rules fly in the face of other recently published guidance by regulators. For instance regulations on CRE Lending promulgated under Dodd-Frank. Again Community Banks have had no chance for input in shaping the Basel III accords, and many make little sense for Community Banks. A further issue, for all, the many foreign governments and regulators and the systematically important Banks abroad seem to be backing out of the current Basel III proposal.

Community Banks, due to size and ownership structure, generally have limited access to capital markets. As proposed, the Basel III rules operate to immediate requires higher capital levels by the imposition of RBC rules on a consolidated basis. Many Community Banking organizations, while prudently managed, operate with a higher level of leverage at the parent company level. The additional leverage is incorporated into the common equity of the subsidiary Bank, providing for sufficient capital ensuring the financial stability of the Bank and minimizing risk to the FDIC insurance fund. In addition, the proposed Basel III rules concurrently disallow previously approved capital instruments that were equivalent to common equity (Trust Preferred Securities). Accordingly, the proposed rules hold Community Banks to an irrelevant capital ratio standard, while eliminating highly efficient and effective equity-equivalent capital instruments. In response to these conditions, a contraction in the size of balance sheets will likely be forced on many Community Banks reducing available credit to business customers and consumers alike. Further, the inequitable capital ratio requirements if implemented as proposed further exacerbate the competitive disadvantage with unregulated lenders. Private Equity Funds, Insurance Carriers, Securities Brokers, and Credit Unions are all allowed to lend without the constraints imposed by Basel III.

Longstanding regulatory policies and banking statutes address investment portfolio administration for Community Banks. These longstanding policies incorporate expectations of credit risk and interest-rate risk avoidance, earnings augmentation, and investments in local communities. Generally Accepted Accounting Principles and risk-based capital rules presently require inclusion of unrealized gains and loss as Other Comprehensive Income, where the gain or loss results from a change in market interest rates, which is a component of equity capital. Gains and losses are subsequently included in Retained Earnings upon the realization of the gain or loss at disposition. Further, current rules and GAAP require a direct charge to earnings and adjustment to equity capital for investments where a change in market value is other than temporary. Accordingly, existing risk based capital rules address unrealized investment gains and losses for Banks that do not have the ability to maintain their respective positions in those securities, or where loss of principal or interest is expected. Inclusion of the unrealized gains and losses in the calculation of risk based capital ratios would create an incentive for Banks to forego certain investments, in particular investments in longer-term securities due to the financial reporting volatility associated with changes in market interest rates. Longer term securities often serve to reduce interest rate risk which enhances capital adequacy, well as provide for increased yield that is accretive to internal capital formation. Accordingly, the proposed Basel III rules create redundancy and additional potential risk, as well as conflict with existing Regulatory Policy regarding prudent investment portfolio management.

New rules for risk weighting are redundant given existing regulations, policies, and Generally Accepted Accounting Principals and will likely serve to reduce available credit in local communities. Specifically, concentrations in Commercial Real Estate lending activities are presently addressed through regulatory policy limiting aggregate concentrations as well as GAAP that requires ALLL adequacy to cover credit risk. A similar consequence is created for Banks in attempting to resolve loans where the obligor is experiencing financial difficulty. Certain past due loans, where GAAP requires an adequate ALLL to cover potential loan loss, are assigned a higher risk weighting. The increased capital allocation creates an incentive for Banks to move rapidly to foreclosure rather than attempting to cooperate with and assist allowing the borrower to remain in their home or to continue to operate their business enterprise. This would be against the operating principals at community banks that exist because of their presence in smaller communities. This inability to work with customers would solve few, if any, problems created in the last banking crisis.

The onerous risk-weighting rules create other conflicts for Bankers in managing exposure to interest rate risk and credit losses. As proposed, certain variable rate mortgages and mortgages with higher loan-to-value ratios require higher risk weighting. While the occurrence of abusive lending practices is recognized, rules incorporated in Dodd-Frank address what is considered an eligible mortgage that include a variable rate mortgage through more appropriate underwriting including. The Basel III proposed rules, however, create a conflict where Bank management is forced to choose between managing capital levels and prudent interest rate-risk mitigation. In addition, certain mortgages underwritten with a higher loan-to-value ratio, other than direct government guaranteed loans, are assigned a higher risk weighting than an unsecured credit facility creating an incentive to lend on an unsecured basis rather than managing credit risk through a collateral assignment, this frankly is absurd. Although abuses were also evident, mortgage lending with a higher loan-to-value ratio is appropriate for the consumer and the lending institution, when properly underwritten, and is consistent with initiatives and objectives as provided by the Community Reinvestment Act.

Also, there is again here a conflict between substantial and costly work by Community Banks to risk grade and stress their loans, portfolios and overall enterprise, and the proposed rules. For instance, is the Advanced Internal Rating based treatment of stress to be utilized or is it something else to be written? What happens to the Banks own stress testing?

In summary, it is difficult to specifically comment on rules never discussed and / or not yet drafted. We know that the new rules do not help Community Banks or the areas they serve. Basel III could have disastrous effects on nearly every aspect of Community Banking.

Other additional questions and issues presented in the proposed rules are as follows:

<u>Capital:</u>

1. Most Community Banks, including Citywide Banks, are not large enough to effectively participate in capital markets.
2. The holding company for this Bank is a source of strength for the Bank itself. The inclusion of it in a combined leverage calculation effectively removes the holding company as a source of capital input and strength, for instance, we earlier in the recession crises were able to have a long-term asset moved from the Bank by payment from the holding company.
3. The elimination for previously approved, highly effective capital instruments, such as our Trust Preferred Securities, will effectively cause us to shrink the Bank. The inability to participate in capital markets makes our capital structure relatively more expensive and the only other effective approach for this dilemma will be to stop lending and downsize the Bank with run-off of existing loans. Needless to say, the continuing economic problems will be exacerbated by the removal of further liquidity for consumers and small business from the local economy. Additionally, banks in this dilemma will also be right-sizing to be able to still make a profit and have to consider lay-offs of staff along with branch closures.
4. Regarding the disallowance of Trust Preferred Securities, could the proposed capital rules be amended to provide for a less onerous phase out, such as ratably to the original maturity date?
5. Banks, too big to fail will have access to capital markets and potentially "too big to fail" government capital, like the TARP program, to further concentrate Banking.

Many smaller banks may be forced to sell at unreasonably low prices, or more could become problem banks.

Efficiency:

1. The complexity of Basel III has great potential for significant costs, and therefore further eliminating lines of business that may become unprofitable due to increased risk-weighted capital costs. Additionally, the added cost of the infra-structure to track and report will necessitate strict cost controls elsewhere. In a community Bank like ours it will mean the potential of reducing or eliminating certain retail and business lines which will negatively impact the local economy.
2. Elimination of retail and business lines will further concentrate the type of lending Citywide Banks has in its portfolio. Again the potential for concentration comes at a time when the economy and Banks can ill-afford it. This rule implementation has great possibility of further extending a feeble recovery in our community.

All involved parties agree than an ongoing strong capital base provides for the maintenance of satisfactory financial condition. We do, however, urge revision of the more onerous proposed rules that will likely serve only to reduce the capacity of Community Banks to continue to provide access to credit. We appreciate your consideration of these comments.

Sincerely,

Jeffrey J. Schmitz
EVP/COO