LA12-765

K. MICHAEL CONAWAY, CPA
11TH DISTRICT, TEXAS

DEPUTY REPUBLICAN WHIP

WASHINGTON OFFICE:
1527 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
PHONE: (202) 225-3605
FAX: (202) 225-1783

http://conaway.house.gov

COMMITTEE ON AGRICULTURE

COMMITTEE ON ARMED SERVICES

COMMITTEE ON STANDARDS OF OFFICIAL CONDUCT

HOUSE PERMANENT SELECT COMMITTEE ON INTELLIGENCE

Congress of the United States
House of Representatives

October 17, 2012

The Honorable Ben Bernanke
Chairman
Federal Reserve Board of Governors
20th and C Street, NW
Washington, DC 20551

The Honorable Thomas J. Curry
Comptroller
Office of the Comptroller of Currency
250 E Street, SW
Washington, DC 20219

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Gentlemen:

As your agencies consider how to implement the most recent proposal from the Basel Committee on Banking Supervision to enhance capital and reporting requirements for U.S. Banks, I hope that you will look beyond the largest banks and closely examine the impact that the new requirements will have on community banks across our nation.

These rules will have a cost to all banks, but for a community bank these costs will be disproportionately high. The costs will impact their ability to lend in their community, hurting not only the bank, but also the businesses which rely on credit extended by the bank.

The risks community banks manage and the services they offer are qualitatively and quantitatively different than those at larger banks. It is not appropriate to burden them with the same complex capital and accounting requirements as institutions that are fifty, a hundred, or a thousand times larger. Most small banks do not have the manpower to prepare and comply with the complex asset valuation schemes that Basel III proposes. Nor do they have the financial resources to meet the additional capital requirements envisioned by the rules.

Even if they did fully comply though, it is unlikely that their adherence to Basel III would offer significantly greater protection than a simpler scheme for smaller banks. First, community banks are already generally well run; most have deeply interested shareholders and unique local ties that can assess risks far better than a formula. Second, the failure of a community bank simply does not pose that much risk to the larger financial system, which is the ostensible rationale behind the Basel III rules.

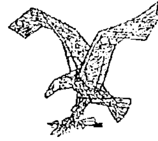
In January 2011, President Obama issued an Executive Order which required regulators to assess the costs and benefits of any proposed rule, as well as examine alternatives to the rule that could be less costly to implement. Implementing the new Basel III standards should be afforded the same consideration of costs and benefits.

I have attached letters from the leaders of three community banks based in the 11th Congressional District. As a former officer at a local bank, I share the concerns they have outlined.

Community banks are the backbone of banking in my district, spread across rural Central and West Texas. These banks district are owned by and serve members of the communities they operate in. If their ability to lend and serve their customers is damaged, the communities they serve and the people I represent will suffer the consequences.

Sincerely,

K. Michael Conaway
Member of Congress



FIRSTCAPITAL BANK
OF TEXAS

August 29, 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 Stop2-3
Washington, D.C. 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:

I appreciate the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I am in support of increasing the capital requirements for banks in our country to ensure that our industry can weather the storms that will come our way in the future. I think we all have that goal in common. However, I do have concerns about the proposals which have been approved by the agencies and placed out for comment.

Our bank was formed in 1998 in Midland, Texas. Since that time we have entered into the Lubbock and Amarillo markets. We are now located in the three major markets in the Panhandle of Texas. Since we began in 1998, we have grown to over $650 million in assets. We are primarily a business bank, serving small to medium size businesses in each of our markets. We also serve many individuals of all means, especially through our mortgage division which provides over $200 million per year in home loans to people living in our three markets. We are dedicated to the communities we serve and we strive to be a leader in helping to improve each of our communities. Just one example of this was our recent donation of 26 residential lots to Habitat for Humanity in our Midland market. That donation provided Habitat with about a three year supply of lots on which to build affordable housing for needy families. At the time, Habitat was almost out of lots on which to build.

We, like most other community banks in our country want to make sure we are able to continue serving our communities in the way we have in the past. A strong economy is dependent on job growth and job growth is dependent on availability of capital to fund the small businesses of our communities that produce most of the jobs. We want to ensure that the new rules do not reduce the ability of our community banks to provide this capital.

The following items are the areas of the proposal in which I have concerns:

I. **Requirement that gains and losses on available for sale securities must flow through to regulatory capital.**

Our country is in an unprecedented period of low interest rates. Most banks have significant gains in their investment portfolios. This proposal would serve to increase regulatory capital in the short term. As interest rates begin to rise, this inflated capital would be quickly reversed and could move very dramatically in the other direction. While nothing will have changed in a bank's equity, its regulatory capital ratios could change very dramatically. This proposal will introduce a significant amount of cyclicality and volatility into the system which is opposite of what I believe the goal should be.

Our bank and others could be forced to reduce the size of our balance sheets as the economy begins to improve, simply because interest rates begin to rise. This could serve to undermine an economic recovery as banks reduce lending and concentrate on pulling back to maintain capital ratios. Our small business customers and consumer customers will be impacted by the reduced availability of credit under this scenario.

Our bank's reaction to this will probably be to sell all of our AFS securities and to place all future purchases in Hold to Maturity. This will eliminate the cyclicality and volatility of the proposal, but it will also eliminate our ability to manage our investment portfolio through different interest rate and economic cycles, a core tool to offset the inherent rate risk in our loan and investment portfolios.

II. **Elimination of Trust Preferred Securities**

Our bank has held about $3 million in Trust Preferred Securities for about 10 years. This is not a large portion of our capital, but is a very cost effective source of capital for us and has allowed us to grow our bank and as a result to better serve our customers. The elimination of this source of capital will reduce our ability to grow our balance sheet by about $35 million. This will reduce the amount of loans we will be able to provide to our communities to support job growth. When you multiply this affect across the country, the potential reduction in loan availability is significant. This proposal is in direct contradiction of the country's goal to spur job growth.

Trust Preferred Securities were grandfathered under Dodd –Frank, but are now being eliminated by the new capital proposal. Community banks have much more limited sources of capital than the large banks do and this rule is an additional strike against community banks.

III. **Increased risk weighting for residential mortgage loans**

Our bank provides a significant number of mortgages to people living in the three markets we serve. We are one of the largest community bank providers of mortgages in these markets. This proposal along with some of the proposals being considered by the Consumer Financial Protection Bureau threaten to significantly reduce or even drive our bank away from this very important business segment.

Since the inception of our bank, we have never lost one cent on a residential home loan. Our underwriting has been very strong as opposed to many of the non-bank mortgage lenders who were the real culprit in the housing crisis. However, the community banks are being forced to pay dearly for the

sins of others. The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that would be considered much riskier in our experience. This one section of the proposal will definitely reduce the number of loans that we are able to provide in our markets.

In addition to the effect on our ability to lend, the change from assigning "risk weightings to asset classes" to assigning "risk weightings to individual loans" will create an administrative nightmare. We will have to add "at least" one full time person, and probably more, just to assign and maintain risk weightings on the classes of loans that are identified in the proposal. You will not be able to just assign a risk weighting when you book the loan, you will have to continually re-evaluate the risk weightings based on changes in collateral values, past due status and other risk factors.

I question the ability to truly examine a bank's performance in properly assigning risk weightings under this rule due to the amount of people and time it will take to review the data.

I question the comments I have heard from some recently that the new proposal will have a small effect on most community banks. Much of the information needed to evaluate the effect is not available. Each bank will be different and most community banks, if any, have not yet performed the massive exercise necessary to evaluate and assign the risk weightings to every loan in their portfolio.

IV. Requirement to hold capital for credit enhancing representations and warranties on 1-4 family residential home loans which have been sold into the secondary market

My first concern about this section of the proposal is that it is ambiguous. I am unclear as to what reps and warranties would cause our bank to set aside capital on a loan we have sold and for how long. Some of the reps and warranties in our correspondent contracts as they relate to fraud, misrepresentation or later identified deficiencies in underwriting, are considered life of the loan reps and warranties. Since our bank has sold well over $1 billion in loans over the last 10 years, we could be required to set aside $85 to $100 million in capital for loans which have been sold for a long period of time. This would place us in a capital deficient position we could never recover from. If you grandfather those loans and tell us we only need to maintain capital against loans sold on a go forward basis, then we will have to exit this business altogether.

The reps and warranties which refer to early default or premium refund clauses do not subject the bank to the repurchase of the loan. Our only liability would be to refund the premium we earned along with a processing fee. For example, on a $275,000 government guaranteed loan, the premium earned could be around $6,950 and the processing fee would be $2,500. This would represent the bank's only liability for early default on the loan. The rule presently seems to state that the bank would have to maintain capital for 100% of the loan vs. the actual liability of $9,450. It seems to me that the capital we maintain should be commensurate with the amount of risk we are assuming.

In the 10 years we have been involved in the mortgage loan business, we have only had to repurchase one loan. The loan we repurchased was based on a disagreement regarding the underwriting rules. We repurchased the loan and it has paid as agreed to this point.

This rule as presently drafted threatens to drive every community bank in the country out of the mortgage lending business. It probably means that all of the business would move to the big banks assuming they have a way around the rule. I can't bring myself to believe that is what is intended.

V. Change in risk weighting for home equity and second lien loans

We presently hold about $12 million in second lien loans to customers in our markets. We have provided this program for over five years and have never experienced a loss on a loan in this segment of our portfolio. In fact, we almost never have any past due loans in this segment of our portfolio. These loans are priced higher to compensate for the added risk and since we have not experienced losses, it has been a very profitable segment of our business.

This program has been used by the bank to supplement the bank's secondary mortgage program. It has allowed our customers to achieve the best pricing they could achieve on their mortgage loan. This proposal will cause our bank to discontinue this program and to discontinue making any kind of home equity loan.

VI. New rules regarding "High Volume Commercial Real Estate"

I feel that this rule is probably a good one from the standpoint of recognizing the different risk profiles that exist in these types of loans. It will tighten up the underwriting and structuring of these transactions between banks. However, it will reduce the number of development projects nationwide and it may cause our bank to turn away from deals that we might have been able to do before. We will strive to make sure that every development project we do will fall into the 100% category.

My biggest concern with this rule is the administrative concern of assigning a risk rating to every single loan based on all of the criteria and the exceptions provided in the rule. This will necessitate increased staffing to accomplish.

VII. Proposal to increase risk weights on delinquent loans

We are fortunate to have very few delinquencies at this time that would cause this rule to affect us. That could change based on economic conditions. My concern with this rule is that we already set aside reserves for loans that fall into a past due status of this severity. By also increasing the amount of capital we hold based on the past due status, we are being required to set aside capital two times. I feel that the risk related to problem loans should continue to be managed through the loan loss reserve guidance and not by adding an additional capital requirement.

The impact on our bank to this rule will be to increase our aggressiveness in moving loans that become 90 days past due off the balance sheet. It will reduce our willingness to work as long with a borrower to remediate issues.

In conclusion, the proposal as it is currently written will greatly impact our bank in the following ways:

1. It will significantly increase the amount of capital we will need to hold above and beyond the increase which would occur as a result of the increased "capital ratios". Each item I have detailed above will either increase our risked based assets or it will decrease the amount of capital we have. This is with no change in the way we do business.

2. I have no way at this time to ascertain the full impact on our bank because of the amount of work that we will need to undertake to understand the rules, train our staff on how to apply the rules to our balance sheet, implement the coding of each individual loan in our portfolio with the new risk weights, re-program our core processing software to handle the new coding requirements and then create the

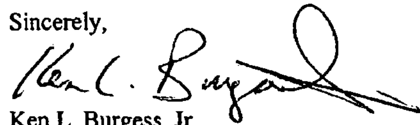
necessary reports to analyze the data. We will probably be required to hire a consultant to help us work through the front end of the process to assure that we have accurate data and to assure that our staff fully understands how to code the loans properly.

3. If the proposal to hold capital on loans we have sold into the secondary market force us to exit the mortgage business, we will lose in excess of $1 million after tax to our bottom line annually which will have a big impact on our overall profitability. We will have to lay off 23 of our 150 person staff. When you multiply this affect across the country as other community banks are forced to do the same, the number of job layoffs and the loss of income to the industry are significant.

While I fully support an increase at some level in the amount of capital that banks hold, the cumulative effect of each of the items reflected above will have a severe impact on most of the community banks in this country. I strongly urge you to consider this impact and to consider a possible exemption for most of our community banks from the bulk of these rules. Our nation's community banks need to be able to continue serving our communities and helping to strengthen our local economies.

Thank you for your consideration.

Sincerely,



Ken L. Burgess, Jr.
Chairman

cc: Senator John Cornyn
Senator Kay Bailey Hutchison
Congressman K. Michael Conaway
Congressman William M. "Mac" Thornberry
Congressman Randy Neugebauer
Mr. Wayne Abernathy, American Bankers Association
Mr. Eric Sandberg, Texas Bankers Association

September 25, 2012

Office of the Comptroller of the Currency
Federal Reserve Board
Federal Deposit insurance Corporation

RE: Basel III

Dear Madam(s) and Sir(s):

West Texas State Bank is headquartered in Odessa, Texas with two locations and has 4 additional branches in the communities of Kermit, Ft. Stockton, Monahans, and Midland. We are a closely held bank that has been in existence since 1937 and has always enjoyed a good financial and regulatory reputation. Our community bank has realized an increase in regulatory oversight which is NOT a result of our mismanagement of the bank, but rather a knee jerk reaction of regulators in response to the financial crisis and the mistakes of a few, not the mistakes of many.

The proposed rules under BASEL III (along with increased supervision) concern us enough to publically comment. Three aspects that we take issue with are: Unrealized losses in the security portfolio flowing through capital, increased risk weighting requirements, and an overall increase in the regulatory burden. These issues are expanded on in the remainder of this letter.

UNREALIZED GAINS/LOSSES

West Texas State Bank has approximately $375,000,000 in assets and at this time has approximately $120,000,000 in AFS securities. How should our bank deal with this proposal, especially when interest rates rise again? Will we have to create an additional capital buffer as a cushion during value fluctuation? **If so, we are taking resources from customer needs and bank growth.** Should we limit our investments in longer duration assets? How will this affect local governments and the housing markets? This proposal could cause a number of banks to sell all or part of their AFS portfolios. Have federal regulators considered what impact this will have on the markets for those securities? We are concerned about how this proposal might impact our asset liability function and our liquidity and contingency funding plans.

We are a community bank and, as such should not be thrown into the "mark-to-market" frenzy that has consumed other segments of the financial services industry.

The most likely result of this proposal will be an increase in employee time to monitor our AFS portfolio.

1501 West University • (432) 337-2851 • P.O. Box 7409 • Odessa, Texas 79760-7409
2426 North Grandview • (432) 367-5000 • P.O. Box 7409 • Odessa, Texas 79760-7409

RISK WEIGHTING OF ASSETS

As previously mentioned, our bank has approximately $375,000,000 in total assets. We have approximately $30,000,000 in mortgages and $13,000,000 in construction projects on our books. All of our mortgages contain balloon payments as we cannot afford to take on the interest rate risk by committing to a rate for a term longer than 60 months (which was praised by regulators). Consequently, the risk weighting for our institution will increase under the proposed rules. By increasing the risk weights, our capital will have to be bolstered, the costs of our loans will increase for the borrowers, the regulatory burden will rise, our earnings will be impaired, and the local construction industry could suffer job losses. **Most importantly, it will limit the availability of mortgages in the communities where we offer loans.**

REGULATORY BURDEN

We are already laboring with 83 employees in an environment involving increased regulatory scrutiny in compliance exams and the new burdens being placed on us by the Dodd-Frank Act.

It appears that as proposed, Basel III will require us to change our internal reporting systems and provide additional employee training. More than likely we will have to hire additional employees. The complexity of the data requests probably means that we will also have to install new software systems and/or look for third parties to provide them. **None of these requirements will allow us to help our customers in our community. The compliance costs will pull money out of capital and earnings rather than help our borrowers.**

In conclusion, the rules as written do more harm than good for community banks that are the lifeblood of our economy when it comes to serving the needs of consumers and small businesses. I encourage you to use common sense and not enact regulations that hinder the ability of banks to serve their customers. The sound management of Texas banks have not led to failures...please don't make us pay for the sins of others.

Sincerely,

Josh McKeever
Executive Vice President

October 9, 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. As a small community bank CEO, I am very concerned about the effects that the Basel III proposal will have on my bank and my community. If adopted as written, this will effectively slow down certain types of lending in rural areas and threaten the existence of small banks in our country as we know it. Small community banks are the lifeblood of rural communities and a one size fits all approach for Basel III will hurt our nation's economy.

Here is an example of just one consequence of the Basel III plan. Under the current Basel I rules, which all banks now operate, when calculating Risk Based Capital, 1-4 residential mortgage loans are risk weighted at 50% of the loan balance. Under the new rule, if these loans have a balloon payment, they are now risk weighted up to 200%. Let me explain how this negatively affects small banks and the communities that they serve. Tejas Bank, like hundreds of banks in this country, is not large enough to offer 30 year fixed rate mortgages due to the interest rate risk. We are currently in a historically low interest rate environment and cannot afford to be locked into these low rates for 30 year periods. (I believe that this type of lending is

---

[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.*

1405 S. Stockton • P.O. Box 140 • Monahans, Texas 79756-0140 • Ph: (432) 943-4230 • Fax: (432) 943-4532

what caused the Savings and Loan disaster of the 1980's.) So, in an effort to control interest rate risks for the health of the bank, the loans are "ballooned" every 5 years with 20 year amortizations, to allow the loans to be re-priced to current market rates. The new Basel III proposals will consider a balloon loan a greater risk for a bank, and automatically slot this type of loan as a Category II higher risk loan. Now, the same loan that has always been categorized a 50% risk weighting will be categorized up to 200% in some cases.

This one portion of the proposal will significantly reduce many banks Risk Based Capital levels without the Bank making a single bad loan. If Basel III is not amended to remove this provision of the plan, Tejas Bank will probably be forced to stop making mortgage loans in Monahans and Iraan, Texas. Many borrowers in these small communities cannot qualify for a loan with a mortgage company, so this will drastically reduce these small communities citizens ability to get a home loan. I do not believe this is the regulatory intent, but this is one of the consequences. If accepted as written, The Basel III proposal will push small banks like ours into a corner and force us to make a difficult decision. The banks will be forced to either make 30 year fixed rate loans that will cause undue interest rate risk for the bank, or no longer make mortgage loans which will cause loss in income to the bank and loss of a local lender for small communities. It is hard to find the positive in this option. I respectfully request that you reconsider this portion of the Basel III proposal, and further consider if this proposal should even apply to banks less than $500 million in assets. Thank you for your consideration.

Sincerely,

Todd Hunt
CEO
Tejas Bank