November 15, 2012

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

Re: Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements; Initial Regulatory Flexibility Analysis

File Reference No. FDIC RIN 3064-AD96

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to provide comments on the Federal Deposit Insurance Corporation's (FDIC) initial regulatory flexibility analysis (IRFA), as required by the Regulatory Flexibility Act, in response to publication in the Federal Register of the joint notice of proposed rulemaking titled *Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements*. ICBA acknowledges that these comments provided pursuant to the IRFA, as requested by the FDIC as part of the joint rulemaking, will be considered when creating a final rule to implement the standardized approach. We also refer you to ICBA's comment letter submitted to the FDIC, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency, dated October 22, 2012, to address this proposed rulemaking. ICBA is very concerned about the impact of this proposal and the related proposed rulemaking on minimum regulatory capital levels titled *Regulatory Capital Rules: Regulatory Capital*,

[1] The Independent Community Bankers of America®, the nation's voice for more than 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With nearly 5,000 members, representing more than 23,000 locations nationwide and employing more than 280,000 Americans, ICBA members hold more than $1.2 trillion in assets, $1 trillion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action on those financial institutions covered by the IRFA, which are defined as banking organizations with total assets of $175 million or less. We believe that these proposed rulemakings are harmful to all community banks in the United States including all financial institutions covered under the IRFA, and if implemented as proposed will have a devastating impact on these institutions, the fragile residential housing recovery, and the overall economy. **Therefore, we would like to again stress our belief that Basel III and the standardized approach should not be applied to financial institutions in the United States with consolidated assets of $50 billion or less and that are not subject to enhanced prudential standards under the Dodd-Frank Wall Street Reform and Consumer Protection Act because they are not deemed to be systemically important financial institutions or SIFIs**.

At the outset, we commend the FDIC for concluding that the changes embodied in the Standardized Approach NPR, when considered without regard to other changes to the capital requirements that the agencies simultaneously are proposing, would have a significant impact on a substantial amount of small banks and savings associations. Further, if both the Standardized Approach NPR and the Basel III NPR were adopted together, the impact on small institutions would increase. This confirms to some extent what ICBA said in our original comment letter: that the proposal, if adopted, would have a significant negative impact on these institutions. We believe that if the same sort of analysis were applied to all sized community banks, the impact would be even more significant.

The summary of the IRFA states that a comparison of the existing risk-based capital rules with the proposed standardized approach may increase risk-weighted assets by 10 percent for small banks. However, it is unclear whether this is just a simple assumption or if the FDIC actually conducted a quantitative analysis to reach a conclusion on this increase. We note that the FDIC relied on data provided in the quarterly call report filings to reach its conclusions on changes to capital under the proposals. Since the call report does not currently track the information needed to reach these conclusions, it is unclear how the FDIC could reach a conclusion that risk-weighted assets may increase by a certain amount without further consideration of key factors that drive risk weight classification. For example, the call report does not currently report residential balloon mortgages or other residential mortgage loan underwriting criteria with any detail that would allow for categorization under the standardized approach. Without having this data available, we believe the 10 percent figure is an understatement and should not be relied on. A more investigative analysis should be conducted by the FDIC to quantify the increase in risk-weighted assets for these institutions.

Likewise, the FDIC concludes that the cost of implementing the alternative measures of creditworthiness for certain exposures will be approximately $39,000 per institution but does not really support this figure with any empirical evidence. Again, ICBA believes this figure is too low, and that the costs of having to perform additional due diligence to determine the risk weights of some of their investments will be much higher for small banks.

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The IRFA notes that small banks and savings associations that hold residential mortgage loans would need to maintain loan-specific parameters regarding underwriting and loan-to-value (LTV) ratios to determine the appropriate risk weight under the standardized approach. However, the IRFA assumes without any additional supporting explanation that these institutions should have this information regardless of whether the portfolio loan is originated or acquired in a purchase transaction. This assumption is not valid in light of the complexity of the underwriting and the LTV ratio requirements for both current and past loan production under the standardized approach. ICBA believes that for most of these institutions, obtaining the required data will require an exhaustive and costly effort in both systems enhancements and labor that may prove insurmountable, especially for the small institutions covered under the IRFA. These small banks have very limited resources available to complete the required loan reviews. Again, a more investigative analysis should be conducted by the FDIC to attempt to quantify the cost.

ICBA applauds the agencies for considering alternatives to the proposed rule to reduce burden and complexity. However, these alternatives mentioned in the IRFA are not significant and do not achieve their intended objective of simplifying the proposed rule for community banks of any size. Rather, they are counter-productive by adding complexity to the capital framework for these small banks without any meaningful relief. For example, use of the gross-up method for private label securitization exposures will be virtually impossible for community banks for a multitude of reasons. They will be cut off from these investment opportunities entirely as the costs required to hire third parties to complete the capital analysis will be prohibitive to any potential investment.

ICBA also believes that the agencies should have released their supplemental analysis under the Regulatory Flexibility Act when the original proposal was issued for comment last June. We note that the FDIC's supplemental analysis was released only four days before the end of the comment period for the Basel III proposal and that the OCC and the Federal Reserve have not yet released their supplemental analysis. This undermines the utility of the Regulatory Flexibility Act and impairs the public's ability to effectively comment on the proposal. Furthermore, all three banking agencies should establish a unified method for examining the proposal under the Regulatory Flexibility Act and should have compared their results prior to their release.

ICBA supports strong capital requirements. But these proposals are unnecessary for community banks and threaten their very existence. Again, ICBA strongly believes that Basel III and the standardized approach should not be applied to financial institutions in the United States with consolidated assets of $50 billion or less and that are not subject to enhanced prudential standards under the Dodd-Frank Wall Street Reform and Consumer Protection Act because they are not deemed to be systemically important financial institutions or SIFIs. These banks should not be subject to the complex risk weights and capital requirements of Basel III and the standardized approach.

However, absent a total exemption, ICBA strongly favors the following modifications to Basel III to simplify the rule and better align the proposed capital standards to the unique strengths and risks of community banking:

- ICBA strongly recommends that the regulators fully exempt banks under $50 billion in assets from the standardized approach for risk weighted assets. The new, drastic, complex, and punitive alteration of risk weighting for residential mortgages could single-handedly wipe out community banks that depend on residential lending to serve the needs of their communities;
- absent supporting evidence showing that they are risky assets, the proposed substantially higher risk weights for balloon mortgages and second mortgages should be reduced to their current Basel I levels to better reflect the high-quality nature of this asset class;
- accumulated other comprehensive income (AOCI) should continue to be excluded from the calculation of regulatory capital for banks under $50 billion in assets to avoid harmful and unnecessary volatility in capital adequacy;
- alternatively, if AOCI is not excluded from the calculation of regulatory capital for community banks, then changes in the fair value of all obligations of the U.S. government, mortgage-backed securities issued by Fannie Mae and Freddie Mac, and all municipal securities should be exempt;
- consistent with the Collins Amendment of the Dodd-Frank Act, bank regulators should continue the current tier 1 regulatory capital treatment of TruPS issued by those bank holding companies with consolidated assets between $500 million and $15 billion to reflect Congressional intent and reduce the capital burden for those community banks that would have difficulty raising capital;
- as was proposed for bank holding companies, the Federal Reserve should exempt all thrift holding companies with assets of $500 million or less from Basel III and the standardized approach or provide a policy rationale for why they are not exempt;
- bank regulators should include the allowance for loan and lease losses (ALLL) as part of the definition of tier 1 capital in an amount up to 1.25% of risk weighted assets while the remaining balance of ALLL should qualify for inclusion in tier 2 capital so that the entire ALLL will be included in a community bank's total capital. This treatment will give proper recognition to the loss-absorbing capacity of the ALLL;
- bank regulators should continue to allow mortgage servicing assets to be subject to the same higher deduction thresholds that apply under current rules as they do not pose a risk to community bank capital;
- community banks and in particular, Subchapter S banks should be exempt from the provisions of the capital conservation buffer. Alternatively, the phase-in period for the capital conservation buffer should be extended by at least three years to January 1, 2022 to provide community banks with enough time to meet the new regulatory minimums;
- the proposed risk weights for equity investments need to be substantially simplified and amended so that community banks will not be discouraged from investing in other financial institutions, particularly banker's banks, which are key business partners in community bank lending;

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- in the absence of a full exemption from the standardized approach, any changes to risk weights under the standardized approach should be applied prospectively to give community banks enough time to comply;
- regulators should make accommodations to ensure that Basel III and the standardized approach do not negatively impact the nation's minority banks and the diverse communities they serve. Minority banks should be preserved and promoted; and
- if Basel III and the standardized approach are to apply to community banks, then they should also apply to credit unions to limit their competitive advantage.

ICBA appreciates the opportunity to comment on this IRFA. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 659-8111 or james.kendrick@icba.org.

Sincerely,

/s/

James Kendrick
Vice President, Accounting & Capital Policy