



September 24, 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<sup>1</sup> 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.

I work for Bank of Commerce in Chelsea, OK. The bank was founded in 1896 and has always strived to serve the communities loan needs, particularly their home financing needs. Today, the bank has a total of six locations and employs 50 individuals and has over \$140MM in assets, the majority of which is loans. During our 115 years, we have maintained sufficient capital for our operations and have always exceeded the regulatory capital requirements and plan to always do so. However, the Basel III Capital Proposals threaten all of these items, due to the increased and vague capital requirements and the risk weightings associated with the proposal. I have outlined and described my concerns on the following pages and how the proposals will affect Bank of Commerce and our 115-year heritage.

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<sup>1</sup> 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.*

## **Applicability of Basel III to Community Banks**

First and foremost, is the question of "Should Community Banks be required to calculate their capital under Basel III?". In short the answer is NO. Community banks, like Bank of Commerce, should be allowed to continue using the current Basel I framework for computing our capital requirements. Basel III was designed to apply to the largest, internationally active, banks and not community banks. Community banks did not engage in the highly leveraged activities that severely depleted the capital levels of the largest banks.

Bank of Commerce operate on a relationship-based business model that is specifically designed to serve customers in our communities on a long-term basis. This contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. The largest banks operate purely on transaction volume and pay little attention to the customer relationship. This difference in banking models should demonstrate that Community banks do not need the tougher capital standards that were designed with larger banks in mind.

## **Incorporating AOCI as Part of Regulatory Capital**

Inclusion of accumulated other comprehensive income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for most community banks, including mine, represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities. Additionally, demand for many implicitly and explicitly government guaranteed securities has risen due to a flight to safety and government intervention in the capital markets. This increased demand has caused credit spreads to tighten further increasing bond valuations. Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. This decline will have a direct, immediate impact on common equity, tier 1, and total capital, as the unrealized losses will reduce capital balances. At my bank, for instance, if interest rates increased by 300 basis points, my bank's bond portfolio would show a paper loss of -\$2,260,311. This would mean that my bank's tier one ratio would drop by 1.72%.

Large financial institutions have the ability to mitigate the risks of capital volatility by entering into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Community banks, like mine, do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry. Community banks should continue to exclude AOCI from capital measures, as we are currently required to do today.

## **Capital Conservation Buffers**

Implementation of the capital conservation buffers for community banks will be difficult to achieve under the proposal. Many community banks will need to build additional capital balances to meet the minimum capital requirements with the buffers in place.

Community banks, mine included, do not have ready access to capital that the larger banks have

through the capital markets. The prevalent way for us to increase capital is through the accumulation of retained earnings over time. Due to the current ultra low interest rate environment, community bank profitability has diminished further hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) in order for those banks that need the additional capital to retain and accumulate earnings accordingly.

### **New Risk Weights**

The proposed risk weight framework under Basel III is too complicated and will be a regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks that offer these loan products to their customers and will deprive customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. Many community banks will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE. Second liens will either become more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages.

### **Proposed Phase-out of Trust Preferred Securities**

We object to the proposed ten-year phase-out of the tier one treatment of instruments like trust preferred securities (TRUPS) because it is a reliable source of capital for community banks that would be very difficult to replace. We believe it was the intent of the Collins amendment of the Dodd-Frank Act to permanently grandfather tier one treatment of TRUPS issued by bank holding companies between \$500 million and \$15 billion. Phasing out this important source of capital would be a particular burden for many privately-held banks and bank holding companies that are facing greatly reduced alternatives in raising capital.

While we applaud the fact that TRUPS issued by bank holding companies under \$500 million, like ours, would not be impacted by the proposal, consistent with the Collins Amendment, we urge the banking regulators to continue the current tier one treatment of TRUPS issued by those bank holding companies with consolidated assets between \$500 million and \$15 billion in assets.

### **Subchapter S Community Banks**

Imposing distribution prohibitions on community banks with a Subchapter S corporate structure conflicts with the requirement that shareholders pay income taxes on earned income. Those banks with a Subchapter S capital structure would need to be exempt from the capital conservation buffers to ensure that their shareholders do not violate the provisions of the Internal Revenue Code. We recommend that the capital conservation buffers be suspended during those periods where the bank generates taxable income for the shareholder.

Thank you for taking the time to consider my comments above, I urge you to consider my concerns and the concerns of my fellow bankers, and pass legislation exempting Community banks from the burdensome and harmful affects of the Basel III Proposals.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam Anderson", followed by a long horizontal line extending to the right.

Adam Anderson  
EVP, CFO  
Bank of Commerce  
Catoosa, OK 74015