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October 19, 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 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.

CliftonLarsonAllen is a top 10 accounting firm and we work with over 600 community banks throughout the nation. We are concerned about the negative impact that Basel III will have on the nation's community banking model and believe that Basel III will be harmful to the short-term and long-term economic vibrancy of the country.

Complexity

Basel III is overly complex and represents an undue burden on community banks. We concur with FDIC Director Thomas M. Hoenig's statement "that a capital rule must be simple, understandable and enforceable." Basel III was designed for large, international banks and does not work well for small, community banks with their simple balance sheets and community-based lending.

Community banks are already overwhelmed with the massive changes of a rapidly increasing regulatory burden. Too often we are asked the disheartening question, "How big does a bank need to be in order to be viable?" The authorities should be advocating fewer regulatory burdens, rather than proposing new ones.

This burden threatens the financial success of community banks. Previous generations of community bankers could rely on a fairly simple business model to support their communities and earn a living at the same time. The never-ending crush of new regulations will certainly slow the growth of this important business sector.

Community banks lack the financial or human resources to comply with these proposals on top of the landslide of other new compliance rules. In order to compute the appropriate risk weightings, significant human and data processing resources will be needed to comply with the complex task. We seriously doubt the usefulness of this exercise, and believe that the added cost and burden of compliance is reason enough to exempt community banks from this proposal.

Accumulated Other Comprehensive Income

The current low interest rate environment has created issues for a number of our bank clients. As we are all aware, there is little room for downward movement in interest rates, and when rates inevitably move upward, all banks will be faced with potentially significant unrealized losses in their securities portfolios. This will not only introduce significant volatility into the capital ratios, but could easily create scenarios in which a formerly well-capitalized bank could face sanctions due solely to market rate movements. Further, the mark-to-market requirement will require banks to hold more capital to compensate for inevitable swings in interest rates, thus limiting lending opportunities and economic growth.

Also, if a bank is engaging in appropriate asset-liability management practices, it will have reasonably ‘matched’ its interest sensitive assets with its interest sensitive liabilities. In plain English, the unrealized loss in the investment portfolio will be offset by low cost deposits, leaving the bank’s net interest margin essentially unchanged despite the rise in interest rates.

In this case, the unrealized loss has no impact on the strength of the bank’s capital position. Unrealized losses in the investment portfolio are offset by corresponding low-cost deposits. The inclusion of unrealized gains and losses is meaningful only in a liquidation scenario.

Community banks should continue to exclude Accumulated Other Comprehensive Income from capital measures as they currently do today.

Real Estate Lending

The proposal discourages banks from making mortgage and real estate loans, especially those kept in the bank’s own portfolio as is common in community banks.

The proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden that will penalize community banks and possibly jeopardize the fragile housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will harm community banks that offer these loan products to their customers and deprive customers of financing options for their home. Additionally, higher risk weights for balloon loans will further penalize community banks who use this technique to mitigate interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages that will make their balance sheets and net income more sensitive to changes in long-term interest rates. Home equity loans may become more expensive for borrowers or disappear altogether. Higher capital costs imposed by these proposed risk weightings will inhibit the ability of community banks to make mortgage loans, especially the "non-traditional" loans so necessary to maintain the vitality of rural areas.

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.

Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans.

Trust Preferred Securities (TruPS)

One result of the Dodd-Frank debate was the ability to count TruPS as Tier 1 capital for banks and holding companies under $15 billion in assets. A significant number of our clients utilized this capital source. This proposal not only phases out that treatment, it appears to directly contradict the will of Congress. Congress passes laws and regulators are charged with adopting rules implementing those laws. This disregard for Congressional intent is a troubling precedent that must not be allowed.

Community banks have limited access to capital. The investment community is already skeptical about future bank earnings and the viability of the community bank model. As a result, banks are having difficulty attracting additional capital. Further calls for capital will only make the community bank model less attractive, depriving small businesses and consumers of financing options.

We strongly encourage you to follow federal law on this issue, and allow those entities with TruPS to continue to include that capital in the Tier 1 category.

Conclusion

It is not only community banks that will suffer if these proposals are enacted. Small businesses, families and rural communities will face fewer choices, diminished credit availability and higher borrowing costs.

We strongly encourage you to exempt all financial institutions with less than $15 billion in total assets from the Basel III requirements.

Thank you for the opportunity to comment on these proposals.

Sincerely,
CliftonLarsonAllen

Jerry Felicelli, CPA
Partner