UTAH BANKERS
ASSOCIATION

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October 18, 2012

The Honorable Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
Docket ID OCC-2012-0008 and OCC-2012-0009
RIN 1557-AD46

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Docket R-1430 and R-1442
RIN No. 7100-AD 87

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
comments@fdic.gov
RIN 3064-AD95 and RIN 3064-AD96

Re: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions and Prompt Corrective Action; Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; Advanced Approaches Risk-based Capital Rule. 12 CFR Parts 3,5,6,165, 167, Docket ID Nos.OCC 2012-0008, OCC 2012-0009, OCC 2012-0010, RIN 1557-AD46, 12 CFR Parts 208, 217 and 225, Regulations H, Q and Y, 12 CFR Parts 324 and 325, RIN 3064-AD95, RIN 3064-AD96, RIN 3064-AD97* .

Dear Chairmen and Mr. Comptroller:

The Utah Bankers Association has profound concerns regarding the approach, scope and timing of the three Notices of Proposed Rulemaking published by your agencies to revise current risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision entitled ''Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems'' (hereinafter collectively referred to as "the Proposals").

Our member banks have carefully evaluated the Proposals and it has become clear to us that the risks associated with the Proposals far outweigh any benefit you may envision. It is our strongest recommendation that the Proposals be abandoned and replaced with a simpler, more practical approach.

We are deeply concerned that the application of the Proposals with their associated costs and complexity will lead to the disappearance (through consolidation) of far more institutions than the 400 or so banks that were lost during the recent economic downturn. These rules will change the landscape of banking in America, a landscape that heretofore has made the American economy unique in all the world. Throughout our history, U.S. public policy ensured that bank services and credit are available to all and do not become concentrated in a few large providers. Community banks have played a key role in serving local needs. The implementation of the enormously complex and rigid requirements contained in Basel III, combined with the large number of other growing regulatory burdens, threaten to eliminate this cornerstone of our public policy and must not be continued. The scale needed to support these growing regulatory burdens is increasingly undermining the viability of the community bank business model and affecting access to capital for the larger banks.

In the end, the greatest impact of the Proposals will be on the American people, as the Proposals will effectively function like a tax on every American who relies on banking services. The ever-increasing amount and cost of capital under the Proposals can only be passed through to customers in the form of higher prices. Additionally, the anticipated consolidation of the industry due to the complexity of the Proposals will result in fewer, larger banks and less competition and innovation. It is becoming clear to us that these Proposals will hurt all Americans and will negatively impact many of the small businesses that employ them.

Finally, the fact that these increased capital requirements and their associated costs do not apply to the largest, bank-like credit unions represents an unacceptable expansion of the already unjustified competitive advantage that these tax-favored institutions enjoy over competing banks. The unilateral application of these Proposals to banks in this environment will lead to even more profound competitive market distortions and accelerate the consolidation of the industry.

In conclusion, we believe the Proposals will have an irreparable harmful impact on the U.S. banking system and the American businesses and citizens who depend upon it. In addition to these broader concerns, we have identified a number of specific concerns with the Proposals. Should you proceed along your current course, we would urge you to solicit additional public comment on any future revisions to the Proposals before they are adopted. Nonetheless, we are opposed to the Proposals and will pursue every available remedy to prevent this misguided approach from injuring the U.S. banking system and the Americans who rely upon it.

## ***Specific Areas of Concern***

*The Proposed Rules Impose an Undue Burden on Smaller Banks*

UBA is concerned that the complexity of the Proposals imposes unnecessary compliance burdens, with smaller institutions bearing a disproportionate cost. The Proposals fail to adequately match the complexity of the rules to the complexity of each bank.

This burden also inhibits long term planning for all banks as they try to fathom what the Proposals say and mean as well as to infer meaning from what they do not say. In effect, risk weightings and the burden in calculating capital requirements have become in themselves a major risk factor in business planning for banks.

*Not Include Accumulated Other Comprehensive Income in Tier 1 Capital*

We believe that the inclusion of Accumulated Other Comprehensive Income ("AOCI") in the calculation of Common Equity Tier 1 Capital ("CET1") will introduce excessive and unnecessary volatility to bank balance sheets. This could be catastrophic to the industry during periods of rising and falling interest rates, and enormously harmful to the economy in general.

The inclusion of the unrealized gains or losses in CET1 creates volatility in a bank's capital base that may never be realized. Interest rate swings create increases and decreases in market value of securities that do not reflect realized or, in many cases, probable changes to value. Many available-for-sale securities are classified in that category so that those securities may be used to strengthen liquidity positions and to provide flexible resources for prudent balance sheet management.

In addition, we believe the supervisory concerns expressed in this portion of the Proposals have already been adequately addressed. To the extent that an institution intends to sell securities in response to market changes, those securities are held in a trading account, and changes in value are reflected in the institution's income statement (and therefore its Tier 1 capital). In addition, if a security is other-than-temporarily impaired, the impairment is most likely charged to earnings, which again would cause that impairment to be reflected in the institution's Tier 1 capital. Given that the capital impact under the proposed rules would be no different for available for sale securities than those held in trading accounts, some banks may seek to move securities into trading accounts and become more active in securities trading, which we do not believe would be beneficial to the industry.

If this portion of the rule is adopted as proposed, smaller financial institutions that do not have the ability to hedge this risk will essentially be left with two options: reclassify available for sale securities as held-to-maturity securities, thereby reducing the liquidity of the institution, or maintain enough capital to meet appropriate capital ratios under all foreseeable interest rate scenarios. If the latter approach is taken by an institution, the institution will likely reduce its total and risk-weighted assets in order to obtain the desired capital ratios. In doing so, it will restrict lending in its community, thereby impacting the community and the consumers in it. In addition, smaller institutions will be forced to purchase primarily shorter-term investment securities, which will ultimately put negative pressure on their earnings and could have a significant impact on the municipal bond market.

We do not believe that including AOCI in CET1 will promote any desired supervisory objective. Instead, it will increase the volatility of bank balance sheets. In response, many banks would be forced to either reduce their liquidity or restrict lending in their communities, or some combination thereof. The Proposals would include unrealized gains and losses on available for sale ("AFS") securities in regulatory capital. We understand that the proposed treatment of AFS securities reflects an attempt to recognize potential credit losses in regulatory capital. While this may be a desirable policy goal, the Proposals would introduce new risks to banks in several ways, risks that we believe outweigh any benefits obtained.

*The Risk Weighting for Mortgages Will Harm Credit Availability*

Increasing the risk weighting for mortgages will be a disincentive for banks to hold mortgage related assets in any form. Additional disincentives include the increased compliance burden for anyone originating a mortgage loan and the uncertainty surrounding the parameters for a "safe harbor" allowing an originator to avoid being required to hold a percentage of every mortgage loan it originates. In combination, it is likely that only the largest banks have adequate resources to effectively offer mortgages. Dealing with the expense associated with the compliance burden will require a high volume of business that smaller banks cannot achieve.

This presents a risk that small banks will be pushed out of the mortgage business and large banks will only offer loans to the most creditworthy borrowers in order to avoid holding receivables requiring increased capital. This will also drive the mortgage business to nonbank originators not subject to bank capital rules, the same "shadow banks" that played such a significant role in the housing bubble in the last decade. Further, and significantly, it will also unduly constrain mortgage lending in the future and prolong the recovery of the housing markets.

*Limitations on Mortgage Servicing Assets Will Drive Servicing in the Wrong Direction*

The Proposals limit the inclusion of the value of mortgage servicing assets to ten percent of the institution's CET1, and possibly less if the institution has other "threshold deductions." A number of our members originate mortgages, sell the mortgages in the secondary market, and retain the servicing rights to provide a future stream of income. We believe these institutions represent some of the best and most prudent loan servicers available. However, instead of promoting their participation in the industry, the Proposals create significant disincentives to their involvement in mortgage loan servicing.

We believe limiting the inclusion of the value of mortgage servicing assets in institutions' capital, when combined with other factors, will force banks out of the mortgage industry when we believe that banks are the very solution to the problems in the mortgage industry that caused the financial crisis.

*Risk Weighting Past Due Loans Duplicates Loss Reserves*

Some new risk weightings duplicate other prudent mitigation measures and are unnecessary. One example is the proposed new risk weighting for past due and non-accrual loans. Those risks are already covered by the higher levels of loan loss reserves typically maintained for these loans, which impacts capital through provision expense. Adding new risk weighting requirements would incur an additional and unnecessary impact on capital.

*The Treatment of Unused Lines of Credit Will Harm Consumer Lenders*

One iteration of the rule would change risk weighting for unconditionally cancelable unused credit lines by adding 20% of those unused lines to the risk weighted assets (other iterations of the new capital rules would retain the current standard that has a zero risk weight for unused credit lines that are unconditionally cancelable). Changing the current standard for unconditionally cancelable unused credit in the final version of the Rule would significantly constrain the availability of all credit lines going forward, a result which will have a disproportionate impact on U.S. banks, especially large credit card issuers.

We understand the ostensible reason for this change is that a number of commercial borrowers tended to draw down credit lines more than usual as the recent recession deepened. At the same time, however, consumers tended to do the reverse. In fact, consumers began paying down credit card balances; a trend which started more than two years ago and continues today.

Many if not most of the commercial lines drawn down during the recession involved commercial loan commitments for which the bank was paid a commitment fee, thus it was contractually required to fund all draws up to the credit limit. If the new rules require holding capital against unconditionally cancelable lines for which no fee is paid, banks will be reluctant to grant lines exceeding expected usage, which will reduce the availability of credit and spending.

Commercial lines that are not unconditionally cancelable are already risk weighted under current capital rules and that would not change under Basel III. Credit lines that are unconditionally cancelable present far less risk than the non-cancelable commercial lines. A bank will fund increased draws on unconditionally cancelable lines only if it has the liquidity and capital to support the new receivables. If it is stressed it will simply cancel or reduce the lines. Our members report many instances of unused credit lines being cancelled during the recent downturn. UBA does not believe there is any justification for this proposed increase in the risk weighting of unconditionally cancelable unused credit lines and recommends eliminating this proposed change from the final regulation.

*Complex, Uncertain and Excessive Capital Requirements Will Limit Access to Capital*

The Proposals will increase costs and lower profitability and therefore reduce the amount of capital flowing into the banking industry resulting in the exact opposite of the desired impact. A growing number of impediments to investing in U.S. banks has already constrained and distorted the growth of the industry. These existing impediments include, among other things, the Volcker Rule, tax subsidized competition from large, bank-like credit unions and restrictions on activities of traditional bank holding companies. The effect of these restrictions can be seen in the fact that, at the end of the Second World War, U.S. banks provided the majority of all credit in the U.S. economy but in 2008 banks' share of credit had declined to about 20%.

The complexity, uncertainty and prospect for increased capital requirements will aggravate these problems and make it even harder for banks to attract capital. While these considerations do not outweigh the importance of safety and soundness, the ability to attract capital is also a crucial consideration that is too often given inadequate attention when setting bank capital requirements.

Perhaps the most significant flaw undermining the illusory goal of global uniformity promoted by the Proposals is the fact that U.S. banks will not have the same access to capital as their global counterparts. In virtually all other nations where Basel III would apply, strong, diversified parent companies, often in a better position to provide capital as required by these new, complex requirements, may own banks. The United States is the only member of the G20 that prohibits commercial companies from investing in banks. Utah's industrial banks present a compelling case for the benefits to all banks of removing rather than adding to the restraints on investing in banks. Regardless, we cannot adopt uniform capital standards with the rest of the world unless we consider uniform access to the same sources of capital.

As the eminent banking scholar Dr. James Barth observed in 2011:

> *These ownership restrictions place the United States out of step with most countries around the world. According to World Bank data, only four of 142 countries surveyed prohibit the ownership of banks by commercial firms. Most importantly, this restricts the ability of the U.S. banking industry to draw upon the substantial equity of commercial firms. This, in turn, limits the ability of the U.S. banking industry to enlarge its capital base and thereby to maintain its role as a major player in the increasingly competitive global banking industry.* [1]

In an economy that is primarily driven by credit, the adoption of the Proposals *must* be preceded by a robust public policy debate on the changes in capital standards and investment requirements that would allow our nation's banks unrestricted access to new sources of commercial and private equity.

*Further Restrictions on Deferred Tax Assets*

The Proposals disallow deferred tax assets ("DTAs") that arise from tax loss carry-forwards or tax credits. Further, the Proposals maintain the same ratio of allowable DTAs which arise from temporary timing differences. However, amounts that aren't disallowed are subject to a risk-weight of 250% in the Proposals. We believe this is an unnecessary hardship for banks. For most banks the single largest component of DTAs arising from temporary differences is the Allowance for Loan and Lease Loss ("ALLL"). Therefore, a bank must charge capital for its ALLL through the income statement and then potentially have further deductions from capital for the DTAs that arise by virtue of the ALLL.

UBA believes the Proposals could be made more reasonable if the risk-weight were lowered from 250%, perhaps to 150%. In addition, the amount of the ALLL included in Tier 2 capital could be increased from 1.25% of gross risk-weighted assets to 1.5% or 2%. In this way a bank is given additional credit in its capital for the ALLL.

*New Liquidity & Funding Ratios Should Recognize Practices Unique to the U.S.*

The Proposals also contains two new liquidity standards—the Liquidity Coverage Ratio and the Net Stable Funding Ratio. The former requires banks to maintain sufficient liquidity to meet net cash outflow over 30 days while the latter requires banks to maintain stable sources of funding relative to illiquid assets and contingent obligations over a one-year period.

UBA believes it is essential that the agencies define "stable" and "less stable" deposits before imposing liquidity ratios and thus avoid putting U.S. banks at a disadvantage. The introduction

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[1] James R. Barth and Tong Li. "Industrial Loan Companies: Supporting America's Financial System." Milken Institute (April 2011): 5 The Study found that along with the U.S., only Fiji, Guernsey and the Isle of Man prevent commercial ownership of banks: 35

of the term "stable deposits" is new to the banking lexicon. In the United States, policy discussion has focused on whether deposits are "core" as an indicator of stability.

Among nations with deposit insurance programs, U.S. banks uniquely have access to insured brokered deposits. These have proven to be among the most stable and reliable source of deposits available to banks. Unlike traditional core deposits, brokered deposits are not susceptible to a run. Brokered certificates of deposit cannot be terminated before maturity except in the case of the death of the depositor or adjudication of mental incompetency, and in practice are almost always held to maturity with less than 1% being redeemed early. [2]

UBA believes that the agencies should deem brokered deposits as stable when calculating these ratios and provide a means to adjust liquidity requirements for banks according to their specific profile. This is another area where one size does not fit all and the resulting misfit will be counterproductive and unnecessarily damaging to many of our member banks and the customers they serve.

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We reiterate our opposition and profound concerns regarding the approach, scope and timing of the Proposals. The risks associated with the Proposals far outweigh any benefit and will likely lead to a significant consolidation of the U.S. banking industry. The increased amount and cost of capital will function as a tax on the American people who rely upon the services our banks provide. Furthermore, it is entirely unacceptable to consider the Proposals if they do not apply to all competitors in the marketplace.

In conclusion, we believe the Proposals will have an irreparable harmful impact on the U.S. banking system and the American businesses and citizens who depend upon it. It is our strongest recommendation that the Proposals be abandoned and replaced with a simpler, more practical approach.

Sincerely,

Howard M. Headlee
President & CEO

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[2] See: "FDIC Core and Brokered Deposit Study as Mandated by Section 1506 of the Dodd Frank Wall Street Reform and Consumer Protection Act" (July 8, 2011) which found: "...research shows that, generally, banks' increasing reliance on core deposits reduces the chance of failure and reduces the DIF's losses when banks do fail." at page 3