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NBA Nebraska Bankers Association
Extraordinary Service for Extraordinary Members

October 22, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Delivered via e-mail:
regs.comments@federal reserve.gov

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Delivered via e-mail:
regs.comments@occ.treas.gov

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Delivered via e-mail: comments@fdic.gov

RE: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Ladies and Gentlemen:

I appreciate the opportunity on behalf of the Nebraska Bankers Association (NBA) to submit comments on the proposed Basel III notice of approved rulemaking issued in June 2012, by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The NBA is a trade association which represents 212 of the 216 commercial banks and 11 of the 12 savings and loans in the state of Nebraska.

While recognizing that capital is extremely important to the continued vitality of financial institutions, the NBA has many concerns with the proposed Basel III capital standards. Basel III was designed to enhance the capital position of specifically targeted, systemically significant financial institutions engaged in international banking transactions and activities. Unfortunately, the vast majority of our nation's community and regional banks that are also subject to the proposed capital standards will be placed at a competitive disadvantage compared to institutions in other countries.

The NBA has encouraged its members to submit comment letters highlighting the specific impact of the proposals on their institutions and their customers. However, the NBA generally believes that the proposed Basel III capital requirements will reduce funds available for lending and drive up loan rates, which will adversely impact businesses and their ability to create jobs, thereby hurting consumers and the state and national economy.

Requiring even higher capital requirements for the nation's community banks, which already maintain high levels of capital, will inevitably result in reduced lending and higher priced loans for customers of our member banks. Community banks, particularly in today's environment, generally have limited access to capital markets. The likely response to any requirement to beef up their capital will be to tighten credit for individuals and businesses, once again undermining the activities required for an economic recovery in our country.

While the NBA believes that the proposals should be withdrawn or, at a minimum, community banks exempted therefrom, a number of issues lead us to this conclusion, including:

1) **Unrealized gains and losses should not flow through capital.**

   Allowing unrealized gains and losses on available for sale securities to flow through to regulatory capital would bring interest rate risk into the regulatory capital standards, greatly increase the volatility of banks' capital ratios, and undermine prudent risk management. It also raises concerns about a bank's investment in municipal bonds issued by local political subdivisions.

2) **Phasing out Trust Preferred Securities for institutions between $500 million and $15 billion.**

   The Basel III capital proposal reverses course from Dodd-Frank in failing to "grandfather" Trust Preferred Securities for these institutions. Trust Preferred Securities have served as an effective source of capital for community banks, allowing them to grow and better serve their customers.

3) **The deduction of mortgage servicing assets.**

   Mortgage servicing is extremely important to banks because it allows them to maintain relationships with customers whose mortgages have been sold. Many community banks have filled a "niche" and acting as mortgage servicers and their expanded involvement in this market should not be artificially restricted by the treatment proposed under the Basel III capital standards. The proposed treatment of mortgage servicing assets will drive community banks out of this segment of the market, or significantly inhibit their ability to provide this service.

4) Increased risked-weighting on delinquent loans.

Basel III's risk-weighting of delinquent loans is counter-intuitive as it creates an incentive for banks to move more rapidly to foreclose rather than attempting to allow borrowers to "work out" their loans and remain in their home or continue to operate their business. Providing banks with a disincentive to work with customers will not help the economy emerge from the severe challenges currently being faced, but rather will compound these problems.

While the level of delinquencies in Nebraska banks may not cause this aspect of the rule to be of significant concern at this time, changes in economic conditions could certainly present difficulties. Banks already set aside reserves for loans that have fallen into "past due" status. By increasing the amount of capital that must be held on delinquent loans, the bank effectively has to "set aside" capital on two occasions. A better solution is to continue to manage "problem loans" through the loan loss reserve guidance and not by adding an additional capital requirement.

5) Capital conservation buffer.

The capital conservation buffer, together with proposed increases in the minimum capital requirements, establishes a *de facto* minimum level of capital. Numerous banks have utilized S Corporation status for their holding companies, relying on the ability to dividend funds to the holding company for tax purposes. Under the new 2.5 percent buffer, banks in this position would be required to maintain these minimums in order to continue to dividend funds to the holding company without restrictions. The buffer would effectively become the minimum capital ratio with an additional cushion most likely to be retained to ensure that the bank doesn't fall below the threshold and face restrictions on their ability to dividend. Retaining additional capital for these reasons would further limit the amount of funds available to serve the bank's community and their customers and the ability of the bank to grow.

6) Risk-weighting for 1-4 family residential mortgages.

The proposed 1-4 family residential mortgage categories are too limited and would serve to penalize banks for providing core banking services to their customers. Many community banks offer loan products based on three- and five-year balloon payment loans in order to maintain and monitor their interest rate risk. Banks in smaller communities don't have the option to offer 30-year fixed rate mortgages or to sell those mortgages to Fannie Mae or Freddie Mac due to community size or appraisal requirements. Increasing the risk-weights on these loans from 50 percent to up to 200 percent is significantly restrictive and appears to serve no beneficial purpose to lenders or their customers.

7) Failure to provide transition or "grandfathering" for existing loans.

The proposed Basel III capital proposal serves to change the rules in the "middle of the game" with respect to existing loans. Judgments and decisions were made by banks based on the rules applicable at the time that the loan was originally made and will now be "second guessed." In order to satisfy the requirements to provide information and calculation relating to these loans, banks will need to allocate funds and significant manpower to research all existing loans in order to obtain the required information.

In closing, the NBA and its member banks are supportive of strong capital standards for banks in the United States. However, the standards must be clear, easy to implement, and sustainable. Overly complex capital rules in general will serve to increase costs to the industry, curtail credit availability, and fuel further consolidation within the industry. More specifically, the complexity of the proposed rules will disproportionately impact smaller institutions that do not maintain the staff or computer systems to generate the granularity needed to make required reports under Basel III. The NBA would respectfully request that the proposals be withdrawn or that an exemption for "community banks," broadly defined, be established.

Sincerely,

George Beattie

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President & CEO
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/jsh