



October 22, 2012

The Honorable Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

The Honorable Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions (FRS Docket No. R-1430, OCC Docket No. OCC-2012-0008, FDIC RIN 3064-AD95);

Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements (FRS Docket No. R-1442, OCC Docket No. OCC-2012-0009, FDIC RIN 3064-AD96)

Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rules; Market Risk Capital Rule (FRS Docket No. R-1442, OCC Docket No. OCC-2012-0010, FDIC RIN 3064-AD97)

Dear Secretary Johnson, Chairman Gruenberg, and Comptroller Curry:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this comment on the proposed rules on *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.

Advocacy Background

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The RFA,¹ as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),² gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.³ The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to these written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁴

Requirements of the RFA

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Pursuant to the RFA, the federal agency is required to prepare an IRFA to assess the economic impact of a proposed action on small entities. The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities.⁵ In preparing the IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or

¹ 5 U.S.C. § 601 et seq.

² Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

³ Small Business Jobs Act of 2010 (PL 111-240) § 1601.

⁴ *Id.*

⁵ 5 USC § 603.

reliable.⁶ In the memorandum on regulatory flexibility that accompanied President Obama's Executive Order (E.O.) 13563, the president expanded the existing requirement for an agency to document the decision to reject an alternative that may reduce regulatory burdens on small entities. The RFA requires agencies to explain in the final regulatory flexibility analysis accompanying final rules why significant alternatives were not selected.⁷ President Obama directed that a similar explanation be provided for proposed rules.⁸ The RFA requires the agency to publish the IRFA or a summary of the IRFA in the Federal Register at the time of the publication of a general notice of proposed rulemaking for the rule.⁹

Pursuant to section 605(a), in lieu of an IRFA, the head of the agency may certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. However, a certification must be supported by a factual basis.

The Proposed Rulemakings

On August 30, 2012 the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) published three joint notices of proposed rulemaking in the Federal Register that would revise and replace the agencies' current capital rules and implement Basel III and certain provisions of the Dodd-Frank Act.

In the *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (Capital Rules) proposed rule, the agencies are proposing to revise their risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision (BCBS) in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III). The proposed revisions would include implementation of a new common equity tier 1 minimum capital requirement, a higher minimum tier 1 capital requirement, and, for banking organizations subject to the advanced approaches capital rules, a supplementary leverage ratio that incorporates a broader set of exposures in the denominator measure.

Additionally, consistent with Basel III, the agencies are proposing to apply limits on a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified amount of common equity tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. It would establish more conservative standards for including an instrument in regulatory capital. The revisions set forth in the proposal implement section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which

⁶ 5 USC § 607.

⁷ 5 U.S.C. § 604(a)(6).

⁸ Memorandum for the Heads of Executive Departments and Agencies, "Regulatory Flexibility, Small Business, and Job Creation" (76 Fed. Reg. 3827, January 21, 2011).

⁹ 5 USC § 603.

requires the agencies to establish minimum risk-based and leverage capital requirements.¹⁰

The second notice of proposed rulemaking is *Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements* (Standardized Approach). In that proposed rule, the agencies are proposing to revise and harmonize their rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating aspects of the BCBS's Basel II standardized framework in the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," including subsequent amendments to that standard, and recent BCBS consultative papers. The Standardized Approach proposal also includes alternatives to credit ratings, consistent with section 939A of the Dodd-Frank Act. The revisions include methodologies for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. It also would introduce disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with \$50 billion or more in total assets, including disclosures related to regulatory capital instruments.¹¹

The Capital Rules proposal and the Standardized Approach proposal would apply to all banking organizations that are currently subject to minimum capital requirements. This includes national banks, state member banks, state nonmember banks, state and federal savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement as well as top-tier savings and loan holding companies domiciled in the United States. Small financial institutions currently comply with the minimum capital requirements of Basel I. The agencies are requesting comment on whether to permit certain small banking institutions to continue using portions of the current general risk-based capital rules.¹²

The third proposed rulemaking is *Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule* (Advanced Approach). In that proposal, the agencies are proposing to revise the advanced approaches risk-based capital rules consistent with Basel III and other changes to the BCBS's capital standards. The agencies also propose to revise the advanced approaches risk-based capital rules to be consistent with section 939A and section 171 of the Dodd-Frank Act. Additionally, in this proposal, the OCC and FDIC are proposing that the market risk capital rules be applicable to federal and state savings associations and the Board is proposing that the advanced approaches and market risk capital rules apply to top-tier savings and loan holding companies domiciled in the United States, in each case, if stated thresholds for trading activity are met.¹³

¹⁰ 77 Fed.Reg.52792, August 30, 2012.

¹¹ 77 Fed. Reg.52888. August 30, 2012.

¹² 77 Fed.Reg. 52935.

¹³ 77 Fed. Reg.52978.

Compliance with the RFA

Advanced Approach Proposal

The OCC and the FDIC certified that the Advanced Approach proposal would not have a significant economic impact on a substantial number of small entities. Although the Board did not certify and stated that it was preparing an IRFA,¹⁴ it did not, however, provide the information that is required by the RFA for an IRFA. For example, the Board did not identify any compliance costs, alternatives that may reduce costs, the projected recordkeeping requirements or duplicative laws.

The Board states that the entities that would be affected would be subsidiaries of large banking organizations. As such, they would rely on the systems developed by their parent banking organizations and would have no additional compliance costs.¹⁵ If the Board believes that there will be no compliance costs and the small entity comments are in agreement, the Board may prepare a certification for the Advanced Approach proposal. If, however, the small entity comments indicate that there will be significant direct compliance costs, the Board will need to prepare and publish for public comment an IRFA that complies with the requirements of the RFA prior to going forward with the final rule.¹⁶

Standardized Approach Proposal and the Regulatory Capital Proposal

The agencies prepared an IRFA for the Standardized Approach proposed rule.¹⁷ The agencies also prepared an IRFA for the Regulatory Capital proposal because the agencies believe that the impact of the Regulatory Capital proposed rule would be significant when combined with the requirements of the Standardized Approach proposed rule.¹⁸ Advocacy commends the agencies for considering the cumulative impact of the proposals on small entities. Although it is not required, it is a “best practice” in terms of truly understanding the economic impact of the agencies’ actions.

In terms of alternatives, the agencies listed the alternatives that are being considered. However, there was no discussion of the burden reduction of the alternatives. Advocacy appreciates the fact that the alternatives may reduce the economic impact on small entities. Advocacy encourages the agencies to provide a more detailed discussion of the alternatives and their reduction in economic burden in the regulatory flexibility analysis.

¹⁴ 77 Fed. Reg. 52996-52997.

¹⁵ 77 Fed. Reg. 52996-52997.

¹⁶ See, *Southern Offshore Fishing Association v. Daley*, 995 F. Supp. 1411 (M.D. Fla. 1998).

¹⁷ Due to a publication error, the FDIC’s IRFA for the Standardized Approach proposed rule was not published in the *Federal Register* until October 17, 2012. Because of the late publication, the FDIC extended the comment deadline on the IRFA to November 16, 2012. See, 77 Fed. Reg. 63763. Advocacy appreciates the extended deadline and commends the FDIC for providing small entities ample time to review and comment on the IRFA.

¹⁸ 77 Fed. Reg. 52834-52837.

The agencies solicited comment on the economic impact of the proposals and additional alternatives that may reduce the impact on small entities. In addition, the agencies created regulatory capital estimation tools to help community banking organizations and other interested parties evaluate the economic impact of the proposals on their operations.¹⁹

Impact on Small Entities

Advocacy appreciates the effort that the agencies have made to determine the economic impact of these actions on small entities. According to the Independent Community Bankers Association (ICBA), the proposals are problematic for small community banks.²⁰ Basel III was designed to apply to large, international banks²¹ that may have engaged in highly leveraged activities in the past. Community banks operate on a different business model - one that is designed for long term service to their respective communities, many of which are in areas that are not served by large banks. Because of this, community banks should be able to continue to use the current Basel I framework for computing their capital requirements.

There are different aspects of the proposals that may be problematic and onerous for small community banks. For example, according to ICBA, increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks for offering products that are crucial to customers in small communities. Without balloon loans, community banks will be forced to originate 15- or 30- year mortgages that will make their balance sheets more sensitive to long-term interest rates. These changes may also require significant software changes at a time when the small banks are being inundated with changes due to the requirements of the Dodd-Frank Act. As such, they may exit the mortgage market.

Advocacy understands that ICBA has asked its members to use the regulatory capital estimation tools to ascertain what the potential impact of these proposals may have on their organizations and to submit comments on that potential impact. Advocacy encourages the agencies to give careful consideration to the information provided by the small community financial institutions in determining the economic impact of the actions as well as analyzing alternatives that may reduce the impact on small community financial institutions. In addition, Advocacy encourages the agencies to provide full consideration to the alternatives supported or suggested by the community banks to reduce the economic burden of the proposals. Advocacy specifically encourages the agencies to allow small banks to continue under the current framework of Basel I.

¹⁹ See, <http://www.fdic.gov/regulations/capital/calculator.html?source=govdelivery>.

²⁰ ICBA Newswatch Today, "Fine: Basel III Should Not Apply to Community Banks," July 25, 2012, located at <http://www.icba.org/publications/NewsletterDetailNWT.cfm?ItemNumber=129726#story1>.

²¹ ICBA Newswatch Today, "Fine: Imposing Basel III on Community Banks 'Insane,'" August 21, 2012, located at <http://www.icba.org/publications/NewsletterDetailNWT.cfm?ItemNumber=138915#story2>.

Conclusion

Small banks have undergone a number of changes over the past few years. There are more changes expected to come. During that time, small banks have complied with Basel I and it has not been problematic. The requirements of Basel III will impose additional burden at a time when small banks are implementing several costly changes. Advocacy recommends that the agencies consider the impact of these rules on small entities and fully analyze the alternatives suggested by small entities.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

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Cc: Boris Bershteyn, Acting Administrator, OIRA