From: Choice Financial, Jeff Kram

Proposal: 1442 (RIN 7100-AD 87) Regs H, Q, & Y Regulatory Capital Rules

Subject: Regs H & Y Regulatory Capital Proposals

Comments:

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

Choice Financial is expressing opposition to the joint proposed rulemakings on minimum regulatory capital and the standardized approach for risk-weighted assets titled Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action and Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements. The size, scope, and impact of these proposals represent a challenging obstacle for community banks and are presented for review at a time of extensiveeconomic difficulty for both the domestic and global economy. The precise changes to the levels of community bank regulatory capital by these proposals, with their radical impact on definition and calculation methodologies, present complex questions and challenges that prevent banks from quickly and easily understanding the regulatory framework and its impact on community banks and the communities they serve. Following are some specific areas of Basel III and their effects on Choice Financial Group.

Inclusion of AOCI in regulatory capital: Including accumulated other comprehensive income (AOCI) as regulatory capital will dramatically increase regulatory capital volatility and require community banks to hold capital substantially in excess of regulatory requirements. The Basel III rules are being implemented during a time of historically low rates and most banks have positive AOCI resulting from unrealized gains in the investment portfolio. These gains are primarily due to low interest rates and will reverse into net losses as rates rise. The yield curve is steep and rates will rise in the future. This will result in millions of dollars of lost capital to Choice Financial and other community banks. In many cases those unrealized gains and losses never come to fruition as the bonds are held to or near maturity and not actively traded.

Phase out of Trust Preferred Securities (TPS): Inconsistent with the intent of Dodd-Frank, the Basel III capital rules do not grandfather TPS for institutions between $500 million and $15 billion. The TPS will be required to be phased out beginning in 2013 with 10% of TPS value excluded from capital and 10% annually excluded thereafter until fully phased out by the end of 2021. Specifically for Choice Financial with $20 million of TPS this will result in $2 million less capital in 2013. This equates to $20 million less potential loan growth for the bank just for this one provision in the first year of Basel III. By the end of the phase this results in $20 million less capital for Choice Financial and potentially $200 million of less loan volume capacity. This is a significant impact to Choice Financial and to the rural markets we serve. $200 million of loan volume equates to nearly our entire portfolio of Ag real estate and Ag operating loans.

Currently there is limited access to capital markets for a community bank. Investors are focused on investing funds for growth opportunities and not to fill capital holes caused by changes in regulation. This makes it even more difficult for community banks to replace Trust Preferred Securities.

Changes to risk weightings: Risk weights for residential mortgage assets will further deplete capital levels by requiring additional capital cushions for certain residential mortgage loans that do not fit within a narrow definition of assets qualifying for preferable treatment. Choice Financial will need to conduct a thorough analysis of residential loan portfolios to understand which assets will fall within the associated residential loan categories and how their classification will impact future capital levels. Furthermore, those loans will have to be recoded and tracked placing additional burden on bank staff. The end result of course will be more capital required to be held by Choice Financial and other community banks. A primary function of any community bank, Choice Financial included, is to provide financing for homes in the communities we serve. Raising the risk weights on residential loans will impair home financing by raising borrowing rates and limiting borrower access to financing. Additionally, raising risk weights on balloon mortgages penalized community banks that attempt to mitigate interest rate risk. Furthermore, higher risk weights for nonperforming loans only duplicates the purpose of the allowance for loan losses and our current risk rating system.

Additionally:

Basel III was originally conceived to apply only to the largest, systemically important and internationally active banks.
Community banks did not engage in the reckless behavior that contributed to the recent financial crisis and subsequent economic downturn.
Imposing complex and excessive capital standards will threaten the nation's economic recovery and limit lending, investment, and credit availability in Main Street communities.
Basel III will force community banks to hire new compliance staff, compute complex risk weights for residential mortgages, and limit their loan offerings to meet the requirements of arbitrary risk-weighted buckets-which will result in disastrous and unintended consequences to the communities they serve.
Community banks have lower risks because they operate under a relationship-based model that cannot be measured solely by imposing analytical capital standards.
Subchapter S corporation banks will be significantly affected by dividend restrictions imposed by the proposed capital buffer.

As stated above, the Basel III rules have significant and serious consequences for community banks such as Choice Financial Group. Sure the Basel III rules will have the effect of increasing capital levels in most banks and increasing the quality of capital held by banks. Basel III will probably also result in some savings to the deposit insurance fund with a few less bank failures in the future. However those savings will pale in comparison to the lost lending ability of community banks and lost investment in our communities through home loans, agriculture, commercial and consumer lending. Finally, banks under 5-10 billion don't have a systemic risk factor to the insurance fund or economy, which conflicts with the initial purpose of Basel III.

Thank You,

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