From: Missouri Independent Bankers Association, Jerry Sage

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

Subject: Regs H & Y Regulatory Capital Proposals

Comments:

September 9, 2012

Dear Sirs:

While you are likely all too familiar with this damaging proposal, we would like to point out the likely effects and consequences of their regulations on community banks -

While we are obviously concerned about the damaging effects of this proposal on community banks, the ultimate losers in this draconian change are consumers, small businesses and local government entities, who will face higher borrowing costs and diminished availability of both credit and bank services. There is never a "good time" for public policy to result in such outcomes, but given the tenuous state of the economic recovery, such seems especially counter-intuitive at this juncture.

This is a remarkably complex and cumbersome proposal, and the requirements for compliance and adherence will significantly add to an already untenable level of regulatory burden and cost for community banks.

We all recognize the importance of adequate capital in our financial institutions. As we pay FDIC premiums, it behooves us to have a strong industry with minimal failures. Capital levels are currently at record levels in Texas community banks... we learned from the 1980's. The regulatory requirements for community bank capital continue to increase, and are generally well in excess of the levels contemplated in the proposal for common equity and Tier 1.

The risk weightings, especially in the mortgage loan category, are excessive, and will further chill an already challenging market. Rules already in effect and proposed, including escrow requirements, balloon note limitations, appraisal standards, additional disclosures, "QM" and "QRM," and new "zero tolerance" on the "Good Faith Estimate," among others, have significantly curtailed mortgage lending among community banks in our state, especially the "in-portfolio" loans. A number of our member banks have simply stopped making mortgage loans to their customers, thanks to regulatory and legislative "overkill" in an attempt to fix problems that we didn't contribute to nor participate in.

Higher risk weightings for commercial real estate lending will also limit credit availability and raise costs for borrowers in this struggling market.

Further, the proposal appears to ignore the existence of the Allowance for Loan and Lease Losses in providing for a buffer for both identifiable and anticipated exposure in the loan portfolio. If additional risk weights are applied to "problem" loans, does that negate the necessity of specific reserve allocations?

The proposal contemplates reflecting market valuation swings of a bank's AFS portfolio in Tier 1 capital. This is now referred to as "Accumulated Other Comprehensive Income" (AOCI), and will require community banks to hold additional capital to compensate for volatility in interest rates. Penalties for falling below mandated regulatory capital levels are severe, and banks will likely move to shorter maturities, sacrifice liquidity and/or forgo expansion or growth based upon inevitable swings and market uncertainty.

Community banks are not captive to the whims of Wall Street analysts on a quarterly basis, and are in it for the long term. Short term interest rate swings should not be included in the regulatory capital calculations. Further, with the current artificially low interest rate environment that has been a blessing to the larger institutions and a curse to most of the small players, the only movement in rates will be upward, which will negatively impact all of our banks.

Large banks have the ability to hedge the interest rate risk exposure on their securities portfolios. Community banks don't have that luxury and are unable to do so in an economically feasible manner.

Further, the cost of borrowing for already strapped municipalities and other government entities will increase as banks will be loath to hold longer maturity securities for fear of interest rate swings and capital degradation.

One of the hard fought victories in the Dodd-Frank debate was the ability for banks under $15 Billion to continue to count Trust Preferred Securities (TrUPS) as Tier 1 Capital. A significant number of our members utilized this regulator-approved hybrid capital vehicle, and this proposal not only reverses that treatment, but appears to directly contradict the will of Congress.

The proposal has a disparate impact on community banks vis-à-vis the too-big-to-fail banking conglomerates-

Community banks are struggling mightily to keep up with the costly and burdensome tsunami of regulations and edicts coming from Washington, D.C. Large banks have the ability to absorb these compliance costs more efficiently. Access to the capital markets is limited in many cases for community banks. With additional regulatory costs, legislative and regulatory mandates impacting revenue opportunities (mortgage lending restrictions, overdraft limitations, interchange price fixing), more risk and lower loan demand in the marketplace due to the economic slowdown and the low interest rate environment, earnings are understandably under stress. Higher capital requirements and additional expenses will only exacerbate these problems, making the attraction of new capital with the promise of more risk and a lower return on equity a difficult proposition.

Even under existing capital rules, there has been an historic "disconnect" between the capital levels required of community banks and what the large banks have been required to keep. Regulatory requirements for small banks have always been higher, and there is no reason to believe that this disparity will not continue under this new proposal.

As more and more regulatory burden is added to these banks, a number of our members are contemplating selling or merging. As community banks are the primary source of credit to small business borrowers, and those businesses create the bulk of the new employment opportunities and economic activity in this country, we believe that is a perverse and tragic consequence to solving problems caused by others in the financial services industry. Further consolidation and concentration of the banking industry should not be a goal - intended or otherwise - of public policy. The Basel Capital proposal epitomizes unnecessary regulatory burden, and will have severe consequences on the community banking sector.

Sincerely,

Jerry Sage
Missouri Independent Bankers Association