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MID-SIZE BANK COALITION OF AMERICA

November 29, 2012

Mr. Michael S. Gibson
Director, Division of Banking Supervision and Regulation
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Impact of Proposed Capital Rules on Mid-Size Banks

Dear Mr. Gibson:

On behalf of the Mid-size Bank Coalition of America ("MBCA"), I am writing to highlight the MBCA's concerns about the proposed capital rules to implement Basel III that would apply to MBCA members if adopted as proposed ("proposed rules").[1] The MBCA submitted a comment letter on the proposed capital rules to the federal banking agencies (the "Agencies") on October 22, 2012. I have enclosed a copy of that letter.

The MBCA is a non-partisan financial and economic policy organization comprising the CEOs of mid-size banks doing business in the United States. Founded in 2010, the MBCA, now with 31 members, was formed for the purpose of providing the perspectives of mid-size banks on financial regulatory reform to regulators and legislators. As a group, the MBCA banks do business through more than 3,800 branches in 41 states, Washington D.C. and three U.S. territories. The MBCA's members' combined assets exceed $450 billion (ranging in size from $7 billion to $30 billion) and, together, its members employ approximately 77,000 people. Member institutions hold nearly $336 billion in deposits and total loans of more than $260 billion.

The MBCA appreciates the willingness of the Federal Reserve to reconsider provisions in the proposed capital rules that have raised serious concerns among our member banks. We are particularly encouraged by your statement at the Senate Banking Committee's recent hearing on "Oversight of Basel III: Impact of Proposed Capital

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1 *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action*, 77 Fed. Reg. 52791 (Aug. 30, 2012); *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements*, 77 Fed. Reg. 52887 (Aug. 30, 2012).

Rules" that the Federal Reserve is "sensitive to concerns expressed by community banking organizations." We appreciate your specifically recognizing our concerns about the proposed treatments of unrealized gains and losses on securities ("AOCI") and the proposed risk-weightings of residential mortgage loans. And we applaud your pledge to be mindful of our comments when you consider changes to the proposed rules.

The MBCA fully supports the fundamental goal of capital adequacy underlying the proposed capital rules, but the cumulative effect of the significant changes in capital and risk weights should be weighed carefully and the potential ramifications well understood. The MBCA has serious reservations regarding the agencies' current proposed treatment and recommends that the agencies instead adopt an approach that recognizes the unique characteristics and role mid-size banks play in the financial system.

I. Treatment of Smaller Banks

At the Senate Banking Committee hearing, as well as in recent public statements, the agencies have indicated a willingness to consider simplifying the application of the proposed rules as they are applied to community banks (generally, those with consolidated assets of $10 billion or less) in recognition of the role these banks play in their communities, particularly in the mortgage lending area. The MBCA urges the agencies to afford mid-size banks (those with total consolidated assets of $10 billion to $50 billion) the same simplified capital treatment as community banks. As discussed below, mid-size banks more closely resemble community banks than large banks in terms of their role in the community and the financial system more broadly. Further, mid-size banks will face a similar and disproportionate compliance burden as community banks when compared to the large banks. Finally, if the capital rules are adopted as proposed, mid-size banks will face strong pressure to consolidate and/or merge with larger institutions, increasing systemic risk and decreasing consumer choice.

Like smaller community banks, mid-size banks primarily serve the communities in which they are located and are critical providers of credit to consumers and small businesses. Mid-size banks, like community banks, maintain limited risk profiles and simplified balance sheets, engage in conservative lending practices and common-sense underwriting, and have far simpler corporate structures compared to large banks with over $50 billion in consolidated assets. As a result, mid-size banks have conservative loan-to-deposit ratios and good credit availability, but far fewer resources to devote to compliance and other administrative costs. Banks under $50 billion in consolidated assets were not responsible for the risky banking practices and asset structures that contributed to the 2008 financial crisis, and no purpose is served by requiring these banks to hold additional capital against risky behaviors in which mid-size banks do not engage.[2] Instead, mid-size banks, like community banks, should be subject to capital rules commensurate with their resources, banking practices, and role in providing credit and other services to their customers.

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[2] *See Bank Failures Since 2007 by Asset Size Bucket*, prepared by Keefe, Bruyette & Woods, Nov. 19, 2012 (attached hereto).

If implemented in their proposed form, the Basel III capital rules will place substantial burdens on mid-size and community banks that lack the resources to comply with some of the rules' more complex aspects, such as the new categories for risk-weighting mortgages. These new standards would require a series of complex evaluations of banks' loan commitments and other factors. Although large banks may already undertake such analyses, mid-size and community banks will likely have to undergo significant retooling of their computer systems in order to comply. They may even need to hire additional staff to determine their capital levels on a day-to-day basis, as those levels will be determined by new, more complex and volatile regulatory concepts such as common equity tier 1 capital and the capital conservation buffer. As Senator Patrick Toomey pointed out at the Banking Committee hearing with respect to community banks, these would be "very significant compliance costs for institutions that nobody has ever suggested are systemically significant." The same is true for mid-size banks.

The Basel III framework was designed to harmonize global banking standards applicable to the large, internationally active and systemically important financial institutions. Imposing all the complexities of that framework on banks with assets under $50 billion could have the adverse consequence of increasing systemic risk by effectively forcing those smaller to consolidate and merge with larger institutions. Further, this would accelerate the process of thinning out the community and mid-sized banking sector. For consumers, such thinning-out means fewer alternatives, and likely higher rates on loans and lower rates on deposits. It also means consumers and borrowers will have to deal with a very large bank that may not be familiar with the needs of their community – marking an end of the local connection so many mid-size and community banks have with the customers they serve.

II. Precedent for the $50 Billion Threshold

The approach advocated by the MBCA and community banks is within the authority of the banking agencies under Section 171. Moreover, in other sections of the Dodd-Frank Act, Congress recognized that financial institutions with total consolidated assets of less than $50 billion pose far less risk to the financial system as a whole than those with higher asset levels. The MBCA asks that the agencies recognize this threshold in developing appropriately tailored capital rules as well.

Section 171 of the Dodd-Frank Act requires the agencies to set minimum risk-based capital requirements not less than the generally applicable risk-based capital requirements under the prompt corrective action regulations implementing Section 38 of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure, nor quantitatively lower than the generally applicable risk-based capital requirements that were in effect for insured depository institutions as of the date of enactment of the Dodd-Frank Act.

While Section 171 sets a quantitative floor, it also provides the agencies substantial flexibility to tailor specific elements of the capital requirements to different institutions based on asset size. In fact, the agencies already have recognized this flexibility in their proposed capital rules – by subjecting only banking organizations with $250 billion or more in total consolidated assets or consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more to separate and additional capital requirements. The MBCA urges the agencies to develop a third, simplified set of capital standards for smaller banking organizations with less than $50 billion in assets. We believe the agencies could do so while maintaining the floor required under Section 171, as they have done with the two approaches in the proposed rules.

Further, other sections of the Dodd-Frank Act recognize the $50 billion threshold as an important indicator of the size and riskiness of banking organizations. Section 165 of the Dodd-Frank Act requires the Federal Reserve to establish prudential standards, including risk-based capital requirements and leverage limits, for bank holding companies with total consolidated assets equal to or greater than $50 billion. Such standards must be "more stringent than the standards and requirements applicable to . . . bank holding companies that do not present similar risks to the financial stability of the United States."[3] This statutory language recognizes the greater risks that large banks pose to financial stability and requires different capital standards based on whether a banking organization crosses the $50 billion asset threshold. Other provisions of Title I of the Dodd-Frank Act also use the $50 billion asset threshold as an important metric of the potential threat to financial stability that a financial institution might pose.[4]

Our member banks support the principle that the amount of capital required should be reflective of an institution's risk. Applying the proposed capital rules to mid-size banks and the largest banks alike could cause significant disruption to the banking industry, undermine the competitiveness of mid-sized banks, and slow the growth of jobs and the overall economy.

III. Negative Consequences for the Housing Market and the Economy

Under the capital rules as currently proposed, certain residential mortgage products will no longer be profitable unless the interest rate charged to the customer increases dramatically to cover the higher capital and compliance costs. The expected end result is that many consumers will either have to pay more, do without, or go to the unregulated nonbank sector. The MBCA urges the agencies to adopt capital requirements that will permit mid-size banks to continue to serve these customers.

The ability to offer prudently underwritten, nontraditional mortgage products is one of the ways in which mid-size and smaller banks set themselves apart. These products include interest-only loans, low or no-documentation loans, and junior liens. Unlike large banks, MBCA members continued to underwrite these loans prudently before, during, and after the financial crisis. As a result, many MBCA members have

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3 12 U.S.C. § 5365(a)(1)(A).

4 *See* 12 U.S.C. §§ 5325-27, 5331, and 5363.

interest-only and low or no-documentation loan portfolios that are performing as well or better than their amortizing loan portfolios. Mid-size banks will be placed at a competitive disadvantage if these products receive the less favorable Category 2 risk weight treatment simply because they do not meet the Category 1 definition, which includes only the most traditional mortgage products.

Moreover, in many cases, the proposed capital rules will penalize a bank that refinances or restructures a customer's loan by requiring the bank to assign a higher risk weight to the new loan. This capital treatment would severely hamper efforts to aid qualified borrowers who have been hit by the decline in home values by discouraging banks from offering the opportunity to refinance or restructure loans. The proposed rules also will penalize banks for retaining mortgage servicing rights by requiring certain reductions from Tier 1 common equity capital and assessing a capital charge against these assets. Mid-size banks are particularly interested in retaining mortgage servicing rights because they value long-term relationships with their customers. This capital treatment discourages banks from aligning their interests with those of their customers.

When coupled with the other provisions affecting mortgages – including Qualified Residential Mortgages, restrictions on capital treatment for mortgage servicing assets, an increase in risk weighting for mortgage loans, implementation of complex rules resulting in an increase in capital required for securitizations – regulated lenders will likely focus only on loans they can sell or securitize with or to Fannie Mae or Freddie Mac. This will only accelerate the concentration of mortgage credit in these institutions and further hinder the resolution of their conservatorship status.

The proposed capital rules would impose a capital charge on unused lines of credit with a term under one year, unless they are unconditionally cancellable. This would lead to uncertainty for small businesses. When the economy shows signs of trouble, banks may cancel a line of credit even though the financial condition of the business borrower remains strong. As a result, small business owners will have a more difficult time planning, hiring, and running their businesses.

The MBCA urges the agencies to take these potential consequences into account when developing simplified capital rules for mid-size and community banks.

IV. Capital Levels of Banks

Finally, the MBCA is very concerned that capital levels will become more volatile under the proposed rules due to the impact of market-value changes in available-for-sale investment securities. Generally, most analysts expect that an increase in lending will accompany an economic recovery, along with an increase in interest rates. However, under the proposed capital rules, the effect of any increase in interest rates will be a reduction in capital, potentially restricting credit and hampering any economic recovery. We believe the existing rules for determining impairment are sufficient for determining whether an adjustment to income, and thus capital, is necessary and that the proposed capital treatment of AOCI introduces volatility into the capital level of banks unrelated to credit.

V. Recommendations

We believe that it is important that rules implementing Basel III do not create an unlevel playing field, aggravate economic volatility, or limit consumers' access to banking services. We ask that the agencies consider these and other consequences in finalizing any rules applicable to mid-size banks.

Yours truly,

Russell Goldsmith
Chairman, Midsize Bank Coalition of America
Chairman and CEO, City National Bank

Attachments

cc: Mr. Jack Barnes, People's United Bank
Mr. Greg Becker, Silicon Valley Bank
Mr. Daryl Byrd, IBERIABANK
Mr. Carl Chaney, Hancock Bank
Mr. William Cooper, TCF Financial Corp.
Mr. Raymond Davis, Umpqua Bank
Mr. Vincent J. Delie, Jr., F.N.B. Corporation
Mr. Dick Evans, Frost National Bank
Mr. Mitch Feiger, MB Financial, Inc.
Mr. Philip Flynn, Associated Bank
Mr. Paul Greig, FirstMerit Corp.
Mr. John Hairston, Hancock Bank
Mr. Robert Harrison, First Hawaiian Bank
Mr. Peter Ho, Bank of Hawaii
Mr. Gerard Host, Trustmark Corp.
Mr. John Ikard, FirstBank Holding Company
Mr. Bob Jones, Old National
Mr. Bryan Jordan, First Horizon National Corp.
Mr. David Kemper, Commerce Bancshares, Inc.
Mr. Mariner Kemper, UMB Financial Corp.
Mr. Gerald Lipkin, Valley National Bank
Mr. Stanley Lybarger, BOK Financial
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Mr. Joseph Otting, One West Bank
Mr. Joe Pope, Scottrade Bank

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Bank Failures Since 2007 by Asset Size

Prepared for:

M B C A

MID-SIZE BANK COALITION OF AMERICA

November 19, 2012

Jeffrey A. Brand *Managing Director*

KBW
CELEBRATING FIFTY YEARS EST. 1962

KEEFE, BRUYETTE & WOODS

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Banking Industry Analysis by Asset Size

KEEFE, BRUYETTE & WOODS

CELEBRATING FIFTY YEARS EST. 1962

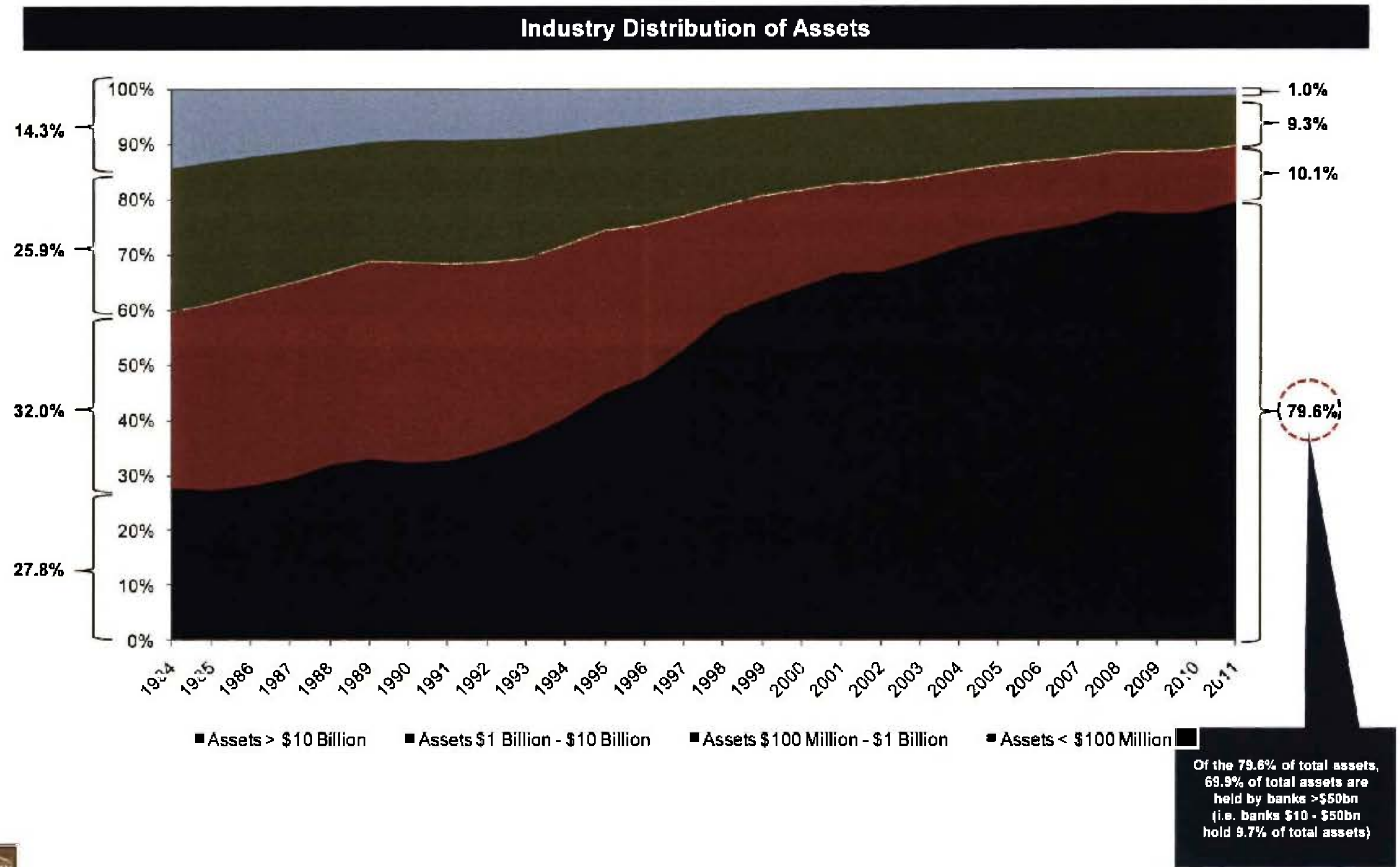
Number of Banks by Asset Size Bucket

U.S. Banking Companies by Assets [1]

	Number	Total	Cumulative
All Banks & Thrifts	6,880	100%	100%
< $100M	2,298	33.4%	33.4%
$100M - $500M	3,304	48.0%	81.4%
$500M - $1B	657	9.6%	91.0%
$1B - $10B	531	7.7%	98.7%
$10B - $50B	58	0.8%	99.5%
$50B - $1T	34	0.5%	99.9%
> $1T	4	0.1%	100.0%

Source: SNL Financial
(1) Top tier regulatory consolidated

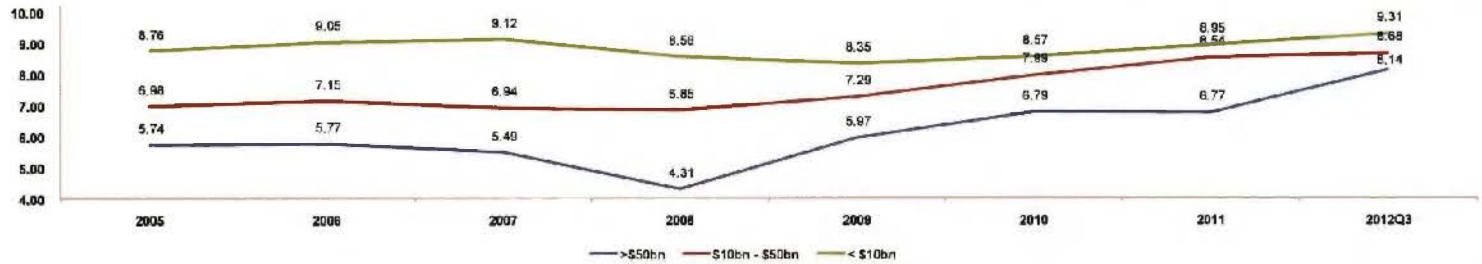
Industry Distribution by Asset Size Bucket



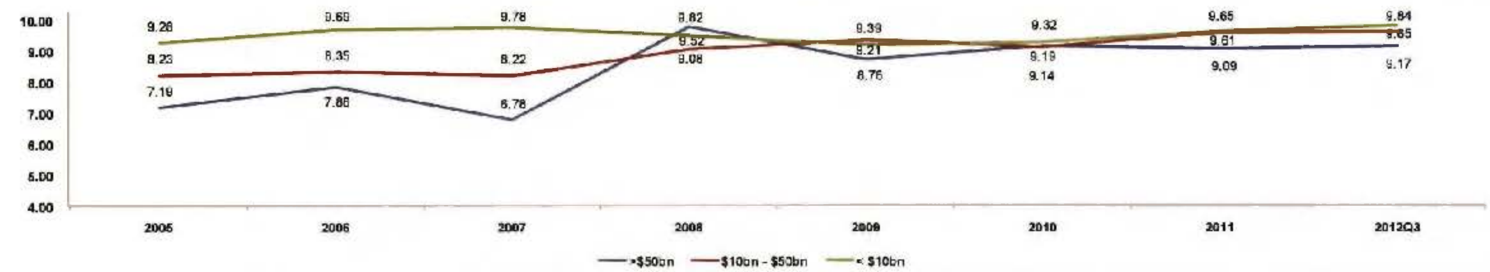
Source: FDIC and SNL Financial as of 12/31/2011

Capital Ratios by Asset Size Bucket

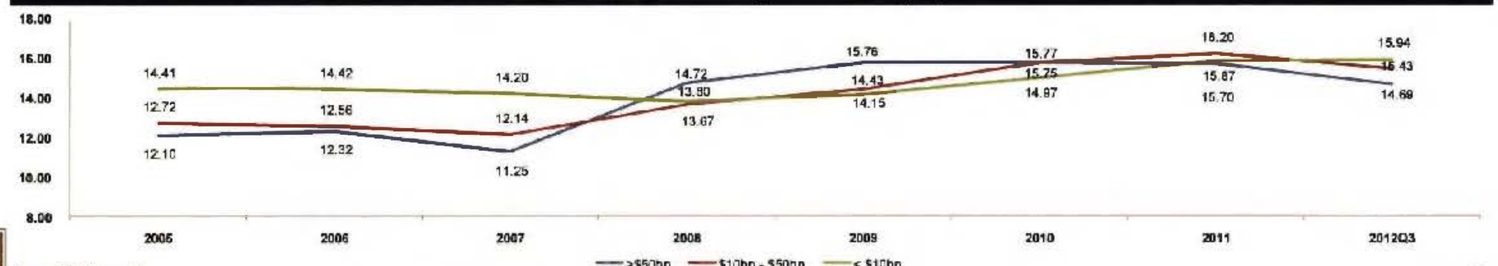
TCE / TA (%)



Leverage Ratio (%)



Risk-Based Capital Ratio (%)

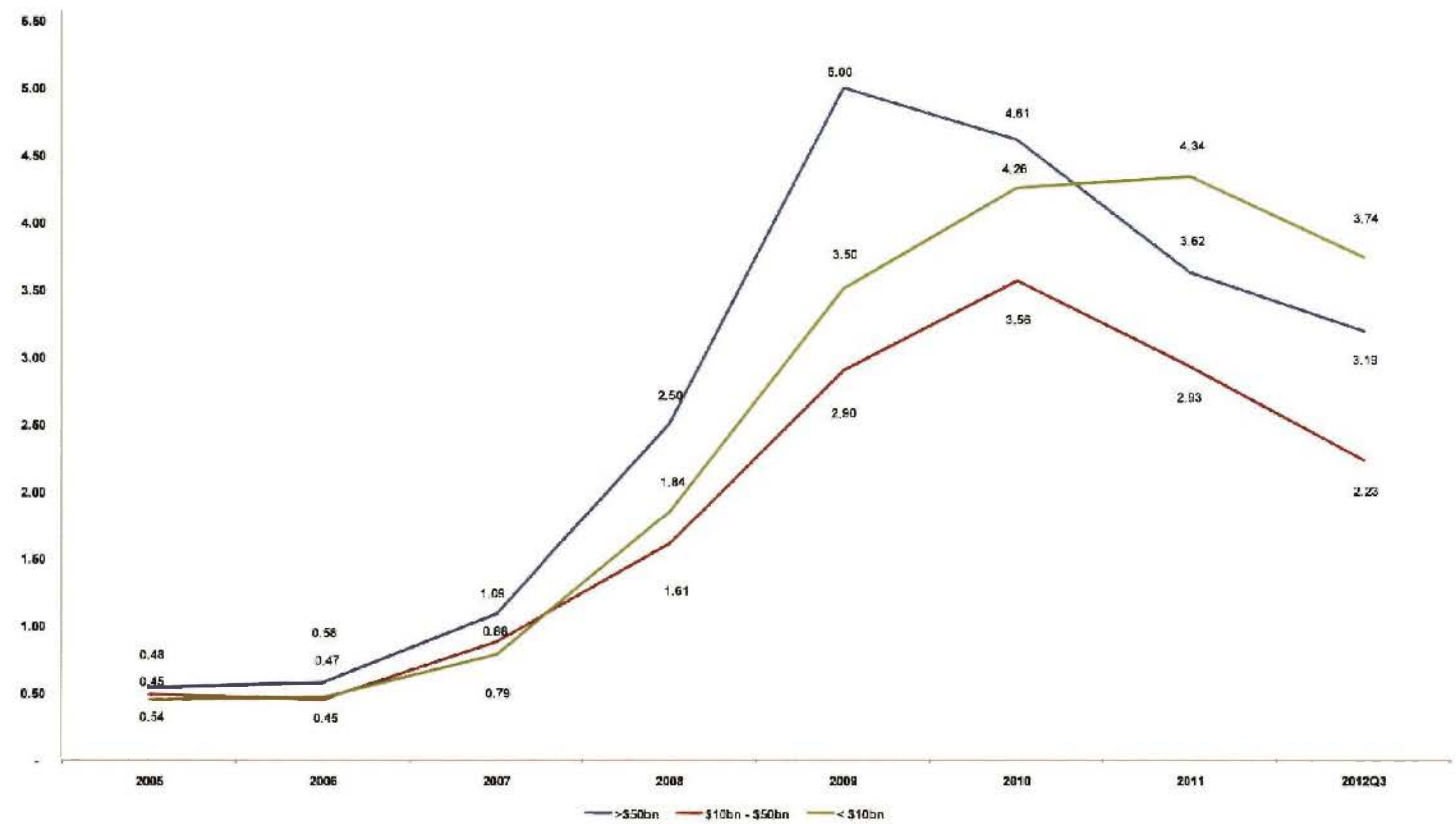


Source: SNL Financial

Note: Data represents all 1,144 public banks (19 banks >$50bn assets, 45 banks $10bn - $50bn assets, 1,080 banks <$10bn assets)

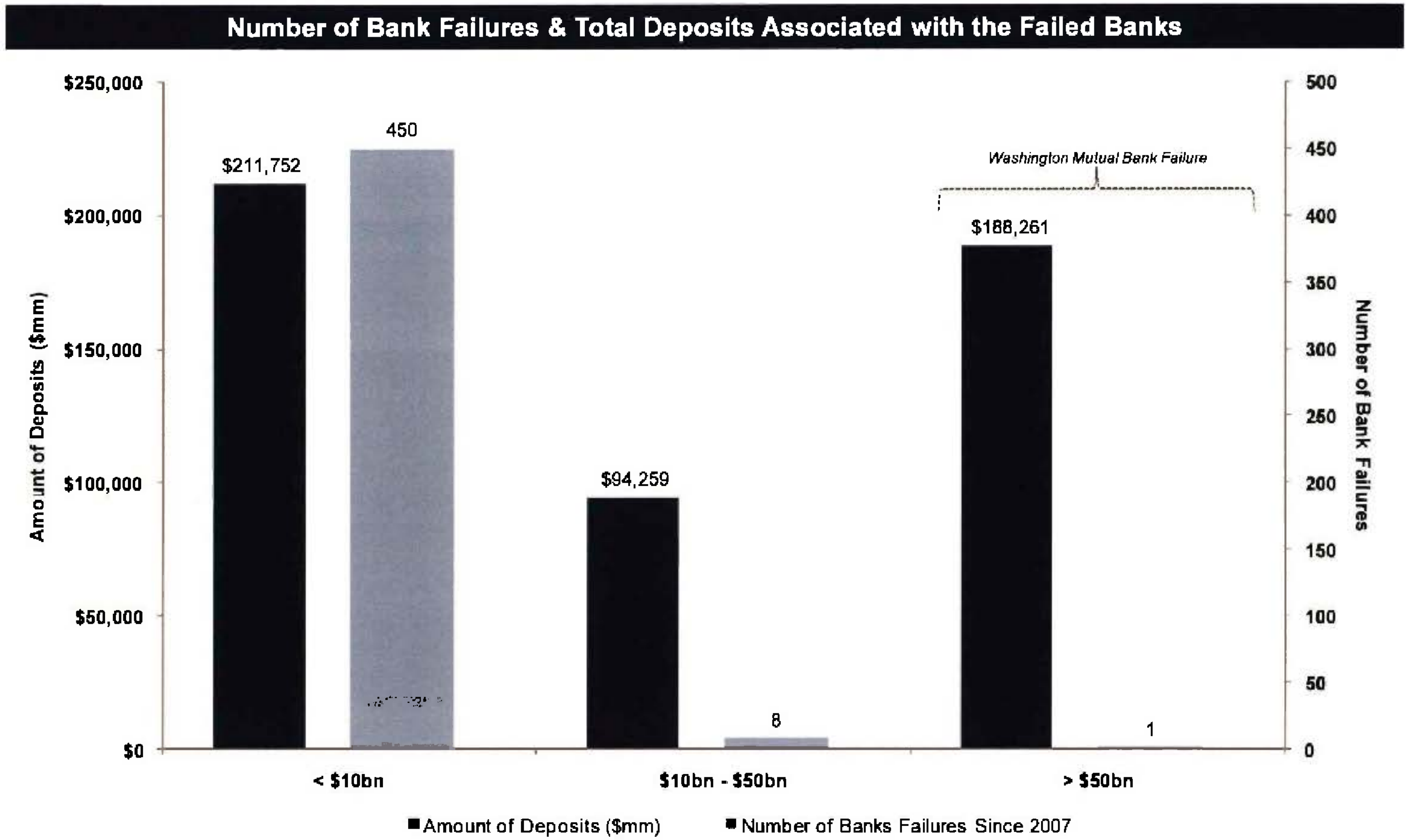
Asset Quality by Asset Size Bucket

NPAs + Loans 90PD / Loans + OREO (%)



Source: SNL Financial
Note: Data represents all 1,144 public banks (19 banks >$50bn assets, 45 banks $10bn - $50bn assets, 1,080 banks <$10bn assets)

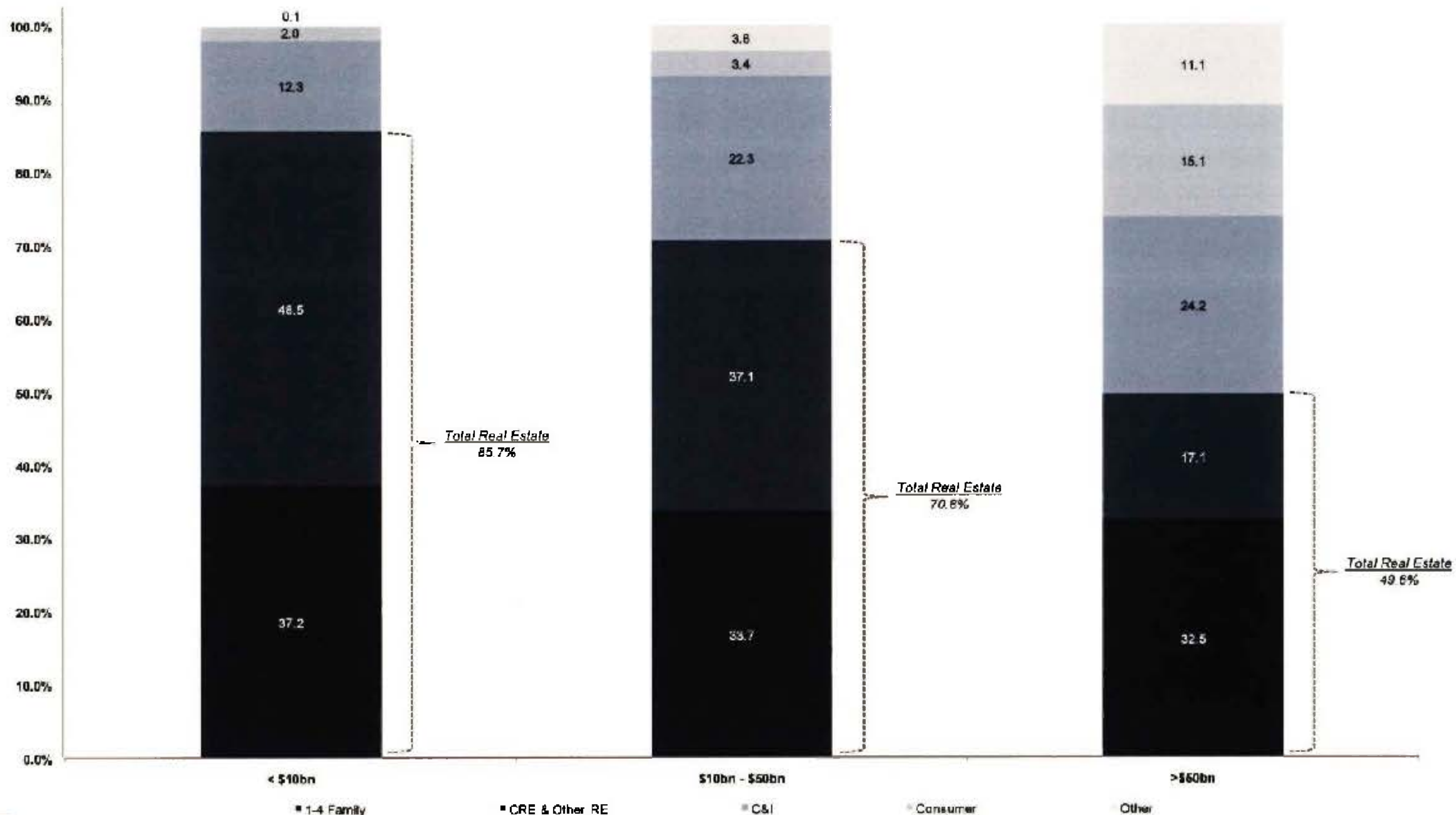
Bank Failures Since 2007 by Asset Size Bucket



Source: SNL Financial

Loan Mix by Asset Size Bucket

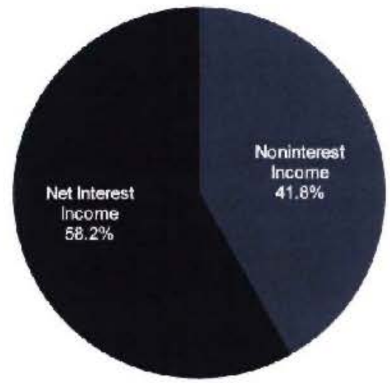
Loan Composition



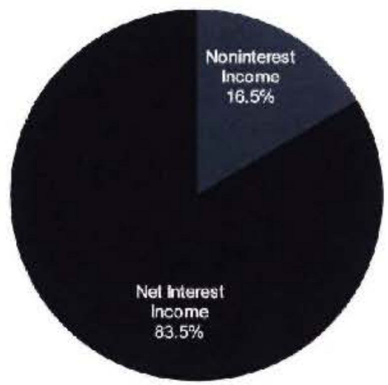
Source: SNL Financial
Note: Data represents all 1,144 public banks (19 banks >$50bn assets, 45 banks $10bn - $50bn assets, 1,080 banks <$10bn assets)
Note: "CRE & Other RE" includes CRE, multifamily, and construction / land development loans. "Other" includes all other loans & leases

Revenue Distribution by Asset Size Bucket

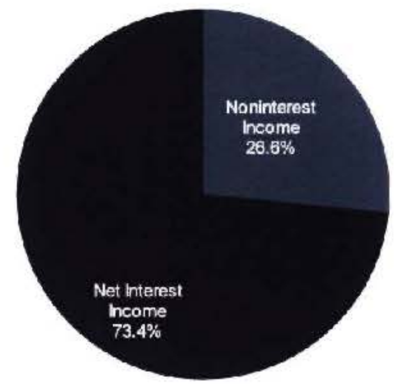
Assets: > $50bn



Assets: < $10bn



Assets: $10bn - $50bn



Source: SNL Financial
Note: Data represents all 1,144 public banks (19 banks >$50bn assets, 45 banks $10bn - $50bn assets, 1,080 banks <$10bn assets)