1STBANK

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April 10, 2012

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Ms. Johnson:

This letter is written in response to the request for comment on the proposed Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (Docket No. 1438 and RIN 7100-AD-86), which implements sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act), requiring the establishment of enhanced standards for risk-based capital and leverage, liquidity, risk management, counterparty credit exposure, stress testing, and debt-to-equity requirements for larger financial organizations.

The primary section for which we would like to comment relates to the stress testing requirements, as this is the only area that directly impacts our organization at the present time. We understand the requirements of the Act and are generally supportive of the manner in which the proposed rule sought to implement the requirements. We believe that a nine quarter planning horizon is an acceptable time period for the stress tests to cover. However, we did note that this was stated as a minimum time period. While we appreciate the desire to provide flexibility within the rule so as not to require supplemental rulemaking to implement changes, we believe that the planning horizon should be no longer than the proposed nine quarters. It is challenging to predict economic conditions for longer periods of time. We engage in capital planning and typically run scenarios over a two-year time period. The assumptions beyond this time period become significantly more subjective, challenging to project and likely produce less reliable results. The tests must be conducted annually, and the scenarios will be developed each year. Since two of the scenarios are adverse and severely adverse, extending these out much beyond a two year period has the potential to significantly overestimate capital depletion. With the proposed public reporting requirements, the potential to unnecessarily alarm the public will exist.

We do have some concerns with the proposed public disclosure requirements of the regulation. For background purposes, our institution is an $11.5 billion, privately held bank holding company. Being privately held, we do not publish forward looking earnings projections. Under the proposal, we would be required to do so annually, and the publication would be based solely on the scenarios developed for the tests. We understand that the Act requires the Board to require publication of a summary of the stress test results. However, the method of publication and information to be included in the publication is left to the discretion of the Board.

We do not believe that public disclosure should be required for privately held institutions. In many respects, being a privately held institution has provided a competitive advantage. We have not needed to publish forward looking earnings expectations, which allows our board and management to focus on long-term value creation versus managing to short-term earnings expectations. Disclosure of all of the proposed data would provide no real value to our shareholders. The company stock is held primarily by current and former employees. The sale of shares outside of the company has been very limited. The shareholders are all fully informed of the risks, including lack of liquidity, associated with holding private company stock. They also receive periodic reports on financial performance. Given the negative nature of the stress tests, publication would do nothing more than create potential stress for shareholders that have no ability to liquidate holdings should they desire to do so.

From a public perspective, we also have concerns about the publication of stress testing results. The primary users of the results will be the financial institutions, regulatory agencies, investors, and analysts. They are in the best position to understand the purpose, assumptions, and results of such tests. However, broad publication on an institution's website provides the general public with information. Depending upon the severity of the scenarios being conducted, the publication of results can lead to the potential improper reporting of the data in local media. This can have the effect of creating unwarranted fear with consumers about the health of an organization. This becomes more likely with the publication of a broad range of data, including potential loss rates under the stressed scenarios. As we move away from the recent crisis, the level of fear will decline. However, as we approach the next economic downturn or crisis, these results will become a focus once again. The potential for the creation of panic will exist, and the publication of the data could lead to other challenges, which may include the possibility of creating runs, as was seen with a couple of institutions in the early stages of this past crisis.

For privately held institutions, we believe that there should be no public reporting requirement. If public reporting is required, we believe that institutions should be allowed flexibility in determining the appropriate disclosure method. For example, we should be allowed to make the results available to our shareholders upon request. Alternatively, the Board could include the ratio data within required public regulatory reports. This may not be practical for all types of covered companies, but it could be effective for similar organizations, such as bank holding companies.

We also believe that the amount of information being reported should be limited to only the resulting capital ratios under each of the scenarios. This is ultimately what is being measured and determined to be most relevant. As mentioned previously, we do not publish forward looking earnings reports. Doing so would only encourage managing to the baseline expectations, should they be different from the company's own projections. We are also a regional organization and have not suffered loss rates as high as institutions with national footprints. This is due in part to a number of factors, including the economic conditions in the areas in which we operate. It is our understanding that the scenarios will be developed at a later time and adjust going forward. However, there has been nothing indicating that the scenarios will be tailored to a specific institution's exposure. The larger institutions are permitted to create their own scenarios for the additional test. The same allowance does not exist for smaller institutions under the proposed rule. Not having more specific information on the scenarios makes it challenging to provide appropriate feedback on the level of reporting detail we believe will be appropriate.

We strongly believe that the tests should be tailored to the specific geographic exposures of an institution. If that is not the intent, then strong consideration should be given to allow for smaller organizations covered under the rule to also develop their own stress testing assumptions and scenarios to be presented in conjunction with the mandated test results. The rule should provide for this flexibility. There are significant differences in risks and exposures for institutions of varying sizes as well. A one size fits all approach does not seem to be appropriate and may not provide meaningful results that institutions could utilize for planning purposes. This would lessen the effectiveness of the exercise and runs the risk of the process being completed solely as a task to comply with regulatory requirements.

As for the timing of the tests, we believe that it would be more appropriate to move the stress test earlier in the year and base it on June 30 call report data as opposed to the September data. We monitor our capital plan throughout each year, as do most institutions. However, we conduct our budgeting process in the fourth quarter of each year, with our final budget typically being approved in December. Under the proposed time line, we would be conducting and reporting our stress testing results in the later part of our budgeting process. Part of the purpose of the stress test is to use it in capital planning. It would be more appropriate to have the test conducted, reported and reviewed prior to the time we are engaging in our annual planning. A timeline beginning with the June 30^{th} data would fit more appropriately. Alternatively, we would ask that the Board consider conducting the annual test based on the March 30 data and having the covered companies conduct the additional test based on September 30 data. While the data would be slightly older than our proposal, it would work better from a timing and operational perspective for our organization.

The Board has also solicited comment on the timing of the initial test and what challenges institutions would face in conducting the first test later this year. I believe that we would have significant challenges in being able to fully conduct a test in such a short period of time, especially given the fact that the scenarios will not be made available until later this year. We have started conducting some internal stress tests, but we do not have the experience of the largest institutions that have already been subject to this type of testing. We request that the initial test be delayed for at least one year in order to give the smaller institutions some additional time to study and understand the requirements. Alternatively, if the Board adopts our suggestion to base the test on June 30 data, then we believe that we could be in a position to conduct the first test in the third quarter of 2013.

We would also like to provide comments on the section of the proposal covering risk management structure and practices. We are generally supportive of the manner in which the proposal seeks to implement the requirements of the Act. However, the rule should not be overly prescriptive in its requirements. Risk management structure and programs should be tailored to the size and complexity of the organization. For those institutions covered, the Act requires the establishment of a risk committee that is responsible for providing oversight to the risk management practices of the company (Dodd-Frank Act Section 165(h)(3)(A)). The language in the proposed rule echoes the oversight provision, but it is less clear in the regulatory expectations for the function of the committee. The requirements section related to risk management framework can be read to not only require oversight, but also require approval of specific procedures involved in the day to day management of risk in the organization.

The risk committee is an integral part of ensuring proper risk management oversight. It is important for the committee to have an understanding of the risks facing the organization and ensure that management handles them appropriately, given the strategic direction and objectives adopted by the company's board. The board approves the major policies of the organization, including major risk tolerances. Management has typically been charged with creating and implementing procedures to ensure business objectives are carried out effectively. The proposal seems to blur the line between director duties and management responsibilities by requiring the risk committee to document, review and approve the procedures utilized in the business lines of the company to manage the various risks. We do not believe that this was the intent of the Act or proposal and encourage the Board to amend the language for clarity.

We also have some concerns with the requirements for risk committee expertise. While we understand the desire to have someone with specific bank holding company or depository institution risk management experience, we don't believe that the definition should be that restrictive. The definition will restrict the number of potential candidates, which will make it more difficult for smaller institutions to find qualified individuals to meet the regulatory requirement. Risk management practices are continuing to evolve over time. The underlying principles aren't necessarily restricted to financial companies. There are other industries where risk management principles can be applied effectively within banking or other financial organizations. By being more flexible in the definition, organizations can have a larger pool of potential candidates and have the ability to take advantage of other industry professionals that could bring a fresh risk management perspective to financial companies without opening up the organization to undue risk.

Finally, we would like to comment on the requirement for covered companies to appoint a chief risk officer. We do not believe that the regulation should mandate a specific risk management position within a financial organization, except as otherwise required by the Act. The Act only requires the establishment of a risk committee. It does not require the appointment of a specific position within the company to act as chief risk officer. Business operating structures, including risk management, should be left to the discretion of the organization. The board and senior management are in the best position to determine an appropriate operating structure for the company. If an organization determines that a risk committee structure provides appropriate oversight, then that should be sufficient. Weaknesses in practices would be identified through the examination process and addressed appropriately.

Thank you for taking our comments into consideration. If you have any questions or would like further clarification on anything contained in this letter, please contact me at (303)235-1321.

Sincerely,

David A. Kelly

David A. Kelly, CRCM
President - Loan Operations