

From: Colorado Bankers Association, Don A. Childears  
Proposal: 1442 (RIN 7100-AD 87) Regs H, Q, & Y Regulatory Capital Rules  
Subject: Regs H & Y Regulatory Capital Proposals

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Comments:

Colorado Bankers Association  
Over a Century: Building Better Banks, Helping Coloradans Realize Dreams  
Don A. Childears, CBA President/CEO

Betsy with your solid banking background we seek your guidance on a few questions and your advice on Basel III. If you feel you can't comment just let me know, but if you can share reactions I welcome them.

Our member banks (big national banks to small rural community banks) all seem to be very concerned about many issues presented in the proposed Basel III capital requirements. The proposals are like an onion: we keep peeling back the layers and finding more that concerns us. We've tried to focus on a few targeted (worst) provisions but it seems bankers' concerns run deeper to the bulk of the proposal. The last thing that should happen is for bank advocates like us to fail to express these deep concerns and the regulators adopt the proposals with few changes, and bad consequences then unfold.

We want the concerns we are hearing from Colorado banks to be understood. We know the proposals were not authored by you, but we seek your insight. I know there are too many questions below to answer in a timely way, so let me pose a couple of basic questions: How do regulators determine the right balance (between banks' interconnected roles of providing loans and being safe and sound), or when lending damages bank safety, or - in particular - when capital requirements hurt lending? Did the agencies know such fundamental questions as below would arise, have they quantified the responses, if so where can we in the industry obtain the answers, and if not then why didn't they address these basic questions before proposing such an impactful set of requirements?

Out of dozens of concerns, here are questions on a few of our concerns:

- Record capital - Banks hold record amounts of capital (16%+ total risk-based in CO) and yet are pressed for even more. New higher capital requirements are layered on top of these historic high levels of capital and extensive existing loan loss reserves to reach unprecedented levels. That then is increased further by the 2.5% buffer, then by risk-weighting for certain kinds of loans, the proposals' written expectation that banks operate above the requirements at all times, and actual examiner application in the field. This is compounded by multiple banks seeking additional capital simultaneously driving the price of capital even higher.

- Ø Why are so many redundant layers of capital proposed?

- Ø What is the impact on customers and the economy of such higher capital requirements?

- Ø What is the failing in community banks that this is meant to address?

- Trust Preferred - As I recall the resolution of the Collins amendment several years ago on the floor of the Senate, the adopted Dodd/Frank Act language provided that banks under \$15B could retain existing trust preferred while not issuing more. That was the political resolution in the Senate on trust preferred. The proposals seem to reduce a lengthy retention period (e.g., 22 years) to 10 years. For many community banks this is exceptionally

expensive.

Ø Do regulators perceive the proposals contradict statute adopted by Congress in the Dodd/Frank Act?

Ø If Congress wanted trust preferred to be disallowed for [\$15B institutions wouldn't it have provided for that?

Ø Have the regulators estimated the impact this will have on bank balance sheets, bank demand for capital, and bank lending? If not, why not?

· Risk-weighting - We perceive capital requirements will become a significant driver of how banks are managed since such requirements incent banks to minimize certain assets.

Ø With various accelerated risk-weights for residential mortgages (ranging from 35% to 200%) based on LTV and product and underwriting features and with certain high-risk industries (e.g. home builders) risk-weighted up to 150%, what is the impact on housing considering banks don't yet know their environment regarding major issues like QM and QRM?

Ø Shouldn't such an impact be understood before finalizing regulations?

Ø If not does that reflect a regulatory attitude that capital requirements should be set regardless of the impact on borrowers and the economy?

Ø Do regulators perceive many banks will avoid certain lending areas due to risk-weighting for past-due loans, acquisitions, development and construction loans, commercial real estate, and certain other short-term loans?

Ø With banks discouraged from such lending what do customers needing such loans do to obtain credit? Do they turn to the less regulated nonbank sector?

Ø How do we address the numerous questions this raises about loan modifications, workouts.?

· Less credit available - Less credit (and liquidity) will be available to small businesses, damaging the economy, as banks must reduce lending to meet higher capital standards; this limits economic activity. How does this impact the Fed's policies aimed at economic growth?

Ø Uncertainty/transition - Lenders facing an uncertain future will take a cautious approach and restrict lending until the rules are clear; customers will be hurt as banks resist growth and expansion until there is certainty. As banks make the transition to higher requirements they will be forced to reduce lending.

§ Does this uncertainty in banking metastasize to undermine confidence among businesses?

§ How does this reduced lending impact public confidence in banks?

Ø Targeted credit reductions - The proposals increase capital requirements for past-due loans, acquisitions, development and construction loans, and certain other short-term loans - discouraging banks from making those loans.

§ Will bank executives be motivated to manage the bank's lending to minimize the expense of capital?

§ How far does this move toward government allocation of credit?

§ Have regulators quantified the cost of reduced lending to the economy or specific sectors?

Ø Housing - Due to higher capital requirements, loans for housing will be harder to obtain - including for residential mortgages, home construction, and land development.

§ What is the impact on housing of increased capital requirements?

§ How have regulators determined the amount of risk-weighting for specific kinds of lending (e.g., home construction)?

Ø Community development - We believe the same bad impact will occur in community development lending.

§ How is financing of affordable housing (loans, bonds) helped or hurt by the

capital changes?

§ Should that be known first?

- Compounds customers' financial difficulties - We believe the excessive capital requirements make delinquent loans so expensive to be on a bank's books that the bank is strongly motivated to resolve the delinquency ASAP by quickly calling the note, seizing collateral, foreclosing... These actions may not be in the best interest of the customer or even the bank. The proposed capital treatment incents banks to be more aggressive at loan payoff strategies and discourages certain kinds of lending, often compounding already difficult finances for the customer.

Ø Does the capital outcome justify the impact this has on customers?

Ø While this encourages the outcome regulators desire, was the resulting pain for the business, the economy and the bank considered as the proposals were formulated? If so where can we see that analysis? If not why not?

- Double whammy - Basel III requires banks to build capital at the same time that GAAP accounting requires bigger loan loss reserves. Those reserves aren't allowed to be built in good times, but only when the economy and businesses are struggling.

Ø What is the logic for the redundancy, the pressure to meet two goals concurrently (reserves and capital), and to reach those goals in tough times?

Ø While this can meet regulators' desire for capital, what stress does this put on the bank and what is the impact on customers? Has this been quantified?

General concerns

- Complexity - The rules' complexity and detail make it expensive for banks to apply and difficult for investors and others to evaluate the capital condition of banks.

- Risk - As capital increases, ROI can decrease. To attract investors, a bank has few tools but to increase ROI by making loans it otherwise would not make. Excessive capital can increase risk in banks - counter to bank safety & soundness.

- Investors deterred - Since ROI decreases as capital increases, deterring outside investors, this also makes it difficult and/or expensive for a bank to attract new capital.

- Shrink/consolidate - As banks find it harder to raise new capital, some banks will be forced to shrink or sell - leading to less credit or less competition.

We want your perspective. As you can see we are concerned that the damage to be done to American consumers and businesses is so severe that the proposals should be withdrawn and completely reworked to provide rational capital requirements. It appears to us that the proposals can't just be tweaked. We hope you can enlighten us.

Thank you for your attention. We appreciate all guidance you are able to provide us.

Don A. Childears

Colorado Bankers Association