Three Rivers Bank of Montana

Mission Statement:
Three Rivers Bank of Montana is independently owned and locally operated and is a vital contributor of time, talent, and resources to the communities we serve. We are dedicated to enhancing our shareholders value, and committed to making our work environment enjoyable, educational, and fulfilling.

October 16, 2012

Jennifer J. Johnson Secretary,
Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue, N.W.
Washington D.C. 20551

RE: **EXEMPT SMALL COMMUNIYT BANKS FROM BASEL III**

Dear Sir or Madam:

Small Community Banks should be exempt from Basel III

The proposals for Basel III should be intended for the very large financial institutions (banks) not the **Small Community Banks** (SCB) I'm concerned that our own U.S. regulatory authorities want SCB to do business the same way the very large banks do business using this over burdensome and costly capital accounting recommended. These proposals are costly and very unnecessary for SCBs. I have heard if Basel III is put into action it will cause many SCBs to sell or merge. The result of this consolidation could mean there would be up to 3,000 less SCBs by the next decade! I need to ask you this; is this good for the people of the United States of America? Is this good for the smaller communities of America who depend on small community banks to do business with? Will it be good for YOU? With fewer banks to regulate there should be less government agencies and employees. Right?

If a SCB is to stay in business its management and board of directors know bank capital is the most important asset of the bank. Many SCB's have a tier 1 capital ratio greater than 8%! The big banks are struggling to maintain a 6% tier 1 capital ratio, because they are driven by Return of Equity and not by Return on Assets which many SCBs like to use.

With SCB's maintaining Tier 1 Capital ratios above regulatory standards and their emphasis on safety and soundness the SCB's should be <u>exempt</u> from the agencies who propose these new rules.

SCB's purchase securities for liquidity needs and hope to receive a fair return on the investment. SCB's usually do not trade securities as a rule of thumb; however SCB's must identify the investment available for sale or held to maturity. When the investment increases in value it increases the bank's capital, if the investment falls in value it decreases capital. If the investment is held to its maturity the investment will not have an effect on the capital only if the investment is sold prior to its maturity does it have an impact. The Mark to Market could create situations for a well capitalized bank to hold more capital to compensate for changes in interest rates, reducing its opportunities to grow and create other opportunities to help grow the communities it operates in. The Mark to Market also will create a liquidity bottle neck with the proposed rules, SCB's may never have the opportunity to sell an investment when it has liquidity needs. If this is the case it may increase the SCB's marginal cost of funds, because banks will need to go to the open market to gather liquidity and possibly face higher interest rates which will produce more cost to the bank to operate.

As the Executive Council of State Community Bankers Associations (CCBA) has stated ***"Risk Weighting will be challenging, expensive, and a disincentive to mortgage lending:*** *Assigning proper risk-weightings to various assets will be an expensive and time-consuming undertaking, which will require additional staff and expensive software. This will serve as a disincentive to mortgage and real estate lending at community banks, especially loans kept "in-portfolio" as is common in the community banking model. Particularly harmful to community banks is the punitive impact of changes to balloon mortgage loans and all second liens including home equity lines. These loans provide solid financing alternatives to home loan borrowers in underserved and rural communities and play a large role in shaping the local economies of the communities in which the loans are originated. Additionally, community bank lending, which focuses on tailoring loan products to the specific needs of the customer, is a powerful force in small business formation and growth that fuels job creation. As relationship-based lenders, community banks possess the local expertise needed to complete quality underwriting for these loan products and provide forms of financing that larger banks will not offer. Further, the introduction of "High Volatility Commercial Real Estate" (HVCRE), with a 150% risk weighting and limited exemptions, will in our assessment also limit a bank's willingness to make these loans and raise borrowing costs in this already challenged market. Further depressing residential and commercial real estate lending will result in additional harm to an already shaky rural real estate lending market.*

Where does the Allowance for Loan and Lease Losses fit into the mix? Specific allocations of capital are made for higher risk, classified, past due and non-accrual loans. However, the proposal does not allow for adequate inclusion of the allowance in the determination of regulatory capital. We must remember that the allowance represents the first line of defense against harmful credit loss and it properly represents an allocation of capital to meet that objective. Yet the proposal continues to cap the allowance while ignoring its importance by not elevating at least some component as higher tier capital. It appears that with the additional capital requirements, perhaps there will be adjustments in the way this important risk management tool is utilized by banks and evaluated by the regulators.

From a macro perspective, this particular point in the economic cycle would appear to be perhaps the worst time possible for regulatory policies that result in disincentives for banks to fund properly underwritten real estate loans. While apparently well-intentioned from all *appearances, many of these changes will limit choices and raise costs for the consumer. Further, the resultant increased market share and concentration of residential real estate mortgage loans in the largest institutions is simply not healthy for our economy.*

Mortgage servicing asset deductions from capital could impact mortgage availability. *Mortgage servicing assets (in excess of 10% of Common Equity Tier 1) will face new deductions from capital. Further, capital would be required against assets with credit enhancing representations and warranties, including mortgages sold to Fannie Mae, Freddie Mac, and third party aggregators. As previously discussed, this is one more potential hurdle and expense that could impact the cost and availability of mortgages. Additionally, this severe penalty is an attack on the high-quality nature of community bank servicing that ignores the fact that community bank servicers' work diligently with borrowers to resolve payment problems to achieve a more favorable outcome for the customer."*

Have you ever been overwhelmed? SMALL COMMUNITY BANKS ACROSS AMERICA ARE! This bank and its team- members I have managed for 26 years are definitely OVERWHELMED! In the year of 2012 it has had two safety and soundness examines, one compliance exam, which is not finished or completed by the FDIC for the 5th month in a row, and 2 audit exams. It seems to me our team-members are working for the regulators not the Stockholders or its customers! If you check the banks Camel ratings they are very good and continue to improve.

I've heard the optimum bank size in 10 years will need to be three quarters of a billion to one billion in size. If this is true the State of Montana may only have 3 to 5 SCBs doing business in the state out of 33 SCBs who are doing business today. Currently there is **ONE** SCB with a billion or more dollars in assets in the state and that is Stockman Bank head quartered in Miles City, Montana. The other billion dollar plus banks are regional or Nationwide banks so they don't count. Will this be good for Montana, the people of Montana, for the regulators, and the Free Enterprise system of Montana and America?

BASEL III will not be good for SCBs! The most common sense thing to do is EXEMPT SMALL COMMUNITY BANKs from it. BASEL III will bring bank consolidation, burdensome regulation, more costs, and capital ratios that should not be a part of SMALL COMMUNITY BANKS and less GOOD JOBS! Let the SMALL COMMUNITY BANKS CONTINUE TO USE BASEL I. It works for us; you don't need to fix it!

Sincerely,

John R. King
Chairman and CEO

JRK/dlb

cc: Senator Baucus
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