FOUNDERS FINANCIAL Corporation

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October 19, 2012

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

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, D.C. 20219

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

RE: Basel III Capital Proposals

Ladies and Gentlemen:

We greatly appreciate the opportunity to comment on the comprehensive revisions to the regulatory capital framework for U.S. banking organizations that were approved by your respective agencies and released for comment in June.

Background Information

This comment letter is written on behalf of our bank holding company, Founders Financial Corporation, and its wholly owned subsidiary, Founders Bank & Trust (hereafter, collectively "Founders"). Located in Grand Rapids, MI, Founders is a privately held state chartered, non-member community bank, founded in 1991.

After successfully outgrowing our de novo related losses in our first three years, we have subsequently produced 71 consecutive quarters of profitability. Now in our 21st year, Founders has total assets of approximately $450 million, four branches, 98 employees, and thousands of loan, deposit, and trust customers.

In 2012, we will serve the credit needs of our primary service area with commercial loan relationships ranging in size from $25,000 to $6 million, and we will originate well over $200 million of conventional mortgage production that will be sold in the secondary market. During a recession-like environment in the State of Michigan for nearly a decade, Founders has maintained capital levels significantly in excess of "Well Capitalized", and as a result did not seek either TARP or SBLF capital.

During the period of exceptionally tight or nearly nonexistent lending conditions among our local competitors in 2008-2010, our bank continued to provide soundly underwritten credit to our community, including existing customers as well as many new customers. Today we maintain one of the very best non-performing loan ratios in the state of Michigan (presently under 0.7% of loans).

General Statement of Comment

We urge the regulatory bodies to significantly revise, or better yet withdraw and set aside both Basel III and Standardized Approach for Risk-Weighted Assets. We believe these proposals, if implemented as written, will have a serious negative impact on community banking, and most certainly will have unintended consequences for our current customers and future prospects.

Our Concerns

1. These proposals are not properly based upon empirical, statistical data as the underlying rationale for very large changes to minimum capital requirements and the calculation of risk-weighted assets.

For example, we have examined the first lien residential mortgage portfolio which Founders currently maintains. This portfolio represents approximately 30% of the bank's total loan portfolio, and has been an exceptionally profitable segment of our business. Our strategy involves two primary objectives, including substitution of higher yielding whole mortgages for investment securities, and funding high quality loans that fall just outside secondary market guidelines. A portion of these mortgages include 10% down payment and somewhat higher yields. These loans are within the supervisory LTV guidelines and our historical data calculations have shown that the higher yield succeeds in enhancing the bank's return while providing the customer with a cost reduction compared to the cost of PMI, and tax deductibility on the additional interest.

Losses on our mortgage portfolio during the period of financial crisis 2008 to 2012 vary from approximately .4% to 1.3% per year. This is substantially better than national averages and our Michigan peer group. We see no data driven reason, based on our historical losses, that capital requirements for the future should be raised 50% on the portion of our portfolio with LTV's between 80-90%.

Further, the ALLL methodology process, under the regulatory supervision and approval that currently exists, differentiates between banks that underwrite mortgage loans properly and banks which do not. Using this specific example to illustrate our concern, absent promulgation of statistics and data that back up a 50% increase in capital for loans of this type, the increase appears to be arbitrary and unwarranted.

Another even more obvious example is that it seems impossible to believe that data would support high LTV consumer home equity loans requiring 200% of the capital allocation of consumer unsecured loans. It should also be noted that we have presented only two examples among many potential examples.

2. These proposals are not properly accounting for the cumulative impact of yet to be implemented portions of other law.

We believe that it is impossible to effectively set new capital ratios at this time due to the many unresolved, and pending regulatory changes. For example, the Consumer Financial Protection Bureau (CFPB), as directed by the Dodd-Frank Act, will eventually re-characterize the mortgage industry by establishing a definition for a "qualified" mortgage. Until that definition is known, it is not prudent to assess whether more or less capital should be required for a community bank to issue such a mortgage.

Further, the CFPB has yet to define whether "qualified" mortgages will contain a safe harbor or rebuttable presumption in subsequent litigation. Surely a safe harbor would be deemed "less risky" by any reasonable standard for a community bank to maintain on balance sheet mortgages.

3. Basel III, the Standardized Approach and other pending regulatory matters are potentially severely restrictive of credit for various types of community bank lending products.

Higher capital requirements are inherently dilutive to a bank's return on equity. A lower return on equity ratio leads to less demand for ownership of shares by local investors, and lower share prices. In the event that capital is allocated away from the banking system by investors, capital rationing by banks is a logical result.

Simply put, raising risk based capital requirements on certain loan types causes a disincentive to fund those loan types. Further, we would submit the concern that this issue <u>will likely disproportionately impact low and moderate income customers in a negative way</u>, not only in credit availability, but in the cost of credit if it remains available.

On an ROE basis, the Standardized Approach requires a 35% risk weighting for Tier One residential mortgage loans with LTV's below 35% and 100% risk weighting for LTV's above 90%. In an environment where capital is somewhat scarcer, the rational decision for a bank to make is to fund three loans with under 35% LTV, rather than one loan of greater than 90% LTV. It is a reasonably safe assumption that a low or moderate income borrower is less likely to have a 65% down payment on a home purchase or refinance.

Further, if for CRA reasons or strategic reasons a bank elects to fund the high LTV loan at 100% risk weighting, in order to obtain an equal ROE compared to a 35% risk weighted loan, the interest rate spread would need to be more than three times as large.

In summary, we believe the proposals provide incentive for banks to review and potentially eliminate currently profitable loan offerings, and at a minimum increase pricing on certain loan categories to accommodate the additional capital required.

4. These proposals are likely to force community banks to decide between a more rational safety and soundness focused approach and a more capital conservation based approach.

Specifically, there is an incentive in the Standardized Approach to originate consumer loans as unsecured loans instead of higher LTV consumer home equity loans. For example, assume a customer has an $11,000 home improvement loan request, $100,000 home appraisal and an $80,000 first lien mortgage that had earlier been sold by the bank into the secondary market. This loan would be 100% risk weighted if unsecured and 200% risk weighted if secured.

In summary, it is in the interest of the banking system to obtain collateral on these loan types without the application of punitive additional capital requirements.

5. The proposal to include Other Comprehensive Income in capital ratio calculations for the first time poses a serious and unnecessary problem for community banks.

Founders holds all securities as "available for sale" but in reality has sold exceptionally few securities during the entire history of the bank. We understand that the value of securities is a critical issue in the resolution of failed banks. However, we believe it is incredibly onerous to require a healthy bank to offset $1 of decline in the value of a security due to rising interest rates with $1 of new capital to retain the same capital ratio.

Further, since few if any community banks would actually be adding capital to offset securities valuation declines, this change would dramatically reduce the amount of capital for lending activities. For example, Founders' current securities valuation includes an unrealized gain of $2 million. If interest rates rise and this becomes a $1 million unrealized loss, our capital ratio would be reflecting $3 million less capital, which would equate to $30 million worth of small business loans. If rates are rising, that should be indicative of an improved economy. That is absolutely the worst time for community banks to be faced with curtailing lending activities, as those activities are critically important to sustaining economic expansion.

6. The proposals should not increase capital requirements for loans that are 90 days past due.

Community banks certainly notice and are keenly aware when a loan becomes 90 days past due. Absent some rare circumstance, these loans will be in non-accrual status and are thus, by definition, impaired and subject to a FAS 114 specific allocation. An effective process of problem loan accounting management, subject to routine regulatory examination, should effectively determine how much capital is necessary for reserves or charge-off on a loan level basis. To further allocate additional capital should be unnecessary.

7. Lastly, but most importantly, community banks simply do not possess the granularity of data on their information systems to comply with the loan level specificity that the Standardized Approach requires.

Given appropriate lead time, community banks could likely systemically capture all of the data necessary to determine which risk weighting is proper to apply on new originations going forward. However, to determine which risk weighting applies on a retroactive basis for prior originations would literally involve a file by file manual, substantive review.

Specifically looking at Tier One and Tier Two mortgage differentiation as an example, we believe no community bank has systemically collected all of the answers to all of the tests involved to determine which tier applies. We count as many as 14 standards that need to be met to qualify for Tier One treatment. Many of these are simply not ascertainable from core system data. We cannot begin to estimate the size and cost of a loan level, retroactive analysis.

Conclusion

Founders Bank & Trust supports strong and effective regulation. We understand that regulations must be updated to changing environments, and we are firm believers that the banking system can and should learn from its prior mistakes. However, we believe that the Basel III and Standardized Approach proposals take these concepts too far, and community banks and their customers stand to be affected in a particularly negative fashion.

Community banks are already facing the incredibly daunting task of absorbing the Dodd-Frank Act with its abundance of new regulations. We recently hired an additional employee in our Compliance department just to keep up with the additional regulatory requirements, and likely will be forced to add another next year, increasing overhead and non-interest expense. We also have needed to contract with outside vendors for additional support and expertise. We estimate that total additional expense of these current proposals along with other new regulations could amount to nearly $300,000 in 2013 alone. We are gravely concerned that the cumulative effect of all of these changes will essentially make the cost of doing business prohibitive for community banks, including Founders Bank & Trust.

We respectfully request that the regulatory agencies reject Basel III and the Standardized Approach proposals, or strongly consider revising them to provide an exemption for community banks of $1 billion or less.

Thank you for your consideration. We are grateful for the opportunity to provide our comments.

Respectfully submitted on behalf of Founders Financial Corporation's Board of Directors,

L. Beard

Laurie F. Beard
President & CEO
Director

Gregory S. Conway
Executive VP & Chief Lending Officer
Director