October 19, 2012

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

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

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were issued in June 2012 by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the “Agencies”).

Marquette Bank, a wholly owned subsidiary of Marquette National Corporation, is a $1.6 billion, state member community bank which was established in 1945. The Bank has 23 branch offices primarily located in the southwest side of Chicago. We are truly a community bank serving both small to mid-size businesses and individuals of all means, especially through our mortgage department which has provided loans for the purchase or refinance of homes in the markets we serve. We are dedicated to the communities we serve and we strive to be a leader in helping to improve each of our communities. As a testament to our efforts, the Bank has recently received an “Outstanding Rating” from the Federal Reserve for our Community Reinvestment Act (CRA) activities. This is the sixth consecutive Outstanding Rating.

As you know, all banks in the Chicago MSA have been under severe financial stress due to recent economic downturn and subsequent decline in real estate values. In fact, a number of community banks in our market have failed during this period. The failures have placed further pressure on already depressed real estate values as the FDIC-assisted buyers have effectively purchased the failed institution’s loans at deep discounts and the subsequent sales of these properties at these deep market discounts contributed to and exacerbated the erosion of real estate values. We believe that a number of these institutions failed in part because of very high concentrations in construction and development lending and poor lending policies and controls. Finally, the failure of banks in our market area puts more responsibility on remaining institutions to meet the credit needs of consumers.
While our bank has been directly impacted by this environment, we continue to remain strong and our capital levels have been maintained well in excess of current "well-capitalized" minimums. At September 30, 2012, our bank has a leverage ratio of approximately 8.8% and a total risk-based capital ratio of 14.5%. Our allowance for loan losses is also strong at 2.8% of total loans.

The following items are the areas of the NPRs that we have the greatest concerns:

**Requiring Unrealized Gains and Losses Flowing Through Regulatory Capital**

A major area of concern is the inclusion of gains and losses on available-for-sale debt securities in the common equity Tier 1 computation. Allowing unrealized gains and losses to flow through capital would introduce substantial volatility into regulatory capital and would force banks to maintain regulatory capital ratios substantially above the levels that would otherwise apply to avoid the dividend and discretionary bonuses restrictions that fall into the capital conservation buffer. The inclusion will also cause banks to reduce the mix and duration of their securities portfolios considerably to maintain capital ratios at desired or required levels or force banks away from the investment portfolio into riskier assets such loans that don't require market adjustment.

The United States of America is in an unprecedented period of low interest rates. Eventually when interest rates rise, the market value of bank investments and regulatory capital and ratios will decrease. The change in capital may force banks to curtail loan growth or shrink their loan portfolios to maintain sufficient capital ratios.

Currently all of our bank's securities are available-for-sale. If this proposal is adopted, we may have to classify future investment purchases as held-to-maturity to minimize capital volatility. This action will eliminate our ability to manage our investment portfolio as a source of liquidity and a tool to manage interest rate risk.

**Requirement to Hold Capital for Credit Enhancing Representations and Warranties on Residential Mortgages**

Our first concern about this section of the proposal is that it is ambiguous. We are unclear as to what representations and warranties would cause our bank to maintain capital on a loan we have sold.

Since 1998, our bank has been actively involved in the business of originating conforming residential real estate loans in the markets we serve. We have sold well over $2 billion in loans during this period. A substantial portion of these loans are sold to investors, Fannie Mae or other entities, using their underwriting guidelines as a basis of approval. Since 1998, we have not had to repurchase a single loan from any investor. Based on the estimated volume of loan sold that are still outstanding, our bank could be required to maintain ongoing capital of at least $150 million for an exposure that we believe is very little.

Under the Basel III proposal, a bank that provides a credit enhancing representation or warranty on a loan sold to third parties, would treat such an arrangement as an off-balance sheet guarantee and apply a 100 percent credit conversion factor to the transferred loans while credit-enhancing representations and warranties are in place. Under the current general risk-based capital framework, risk based capital charges do not apply to mortgages once they are sold to third parties, even where the seller provides representations and warranties to take back mortgages that experience very early payment defaults.
Finally, there is little evidence that the temporary representations and warranties associated with “pipeline mortgages” have resulted in significant losses for regulated banking organizations, even during the financial crisis. As a result, we urge the Agencies to retain the 120 day safe harbor in the current rule.

**Increased Risk Weight for Residential Mortgage Loans**

For over 15 years, our bank has originated and held in our loan portfolio a number of different types of mortgages to individuals in the markets we serve. While the Bank’s policies and underwriting guidelines have been conservative to minimized risk, they have always been flexible enough to provide credit to individuals, including those who may be economically challenged. Our loss experience in traditional conforming first mortgages has been favorable compared to peer banks as well as other portfolio segments the Bank has maintained.

We are opposed to the proposed rule to revise the risk weights for risk-based capital. Our position is that there is no support for the proposed risk weights and the capital allocation under the NPR is much higher the capital actually needed based on our own loss experience. In addition, in periods of time of higher risk (such as now), we already provide for potential loss exposure by making appropriate adjustments to qualitative and economic factors which are incorporated in our general reserve component of our allowance for loan losses.

Finally, the proposed risk weighting of mortgages is simply too complex and have been proposed to apply on a retroactive basis. Existing mortgages currently on banks’ balance sheets were underwritten and priced with existing capital standards in mind. Logistically, the ability to properly report data under the proposed mortgage categories is overwhelming. In some cases the data may not have been required or documented at the time these mortgages were originated. may not exist or will require staff to go through old loan files to determine appraisal values and borrower characteristics to determine the appropriate risk weight.

**Elimination of Tier 1 Capital Treatment for Trust Preferred Securities**

We are strongly opposed to the Basel III proposal which eliminates Trust Preferred Securities (“TPS”) as qualifying capital for all bank holding companies above $500 million in assets. The NPR treatment is mandated under the Dodd-Frank legislation and is inconsistent with the intent of the Collins amendment which grandfathered TPS for institutions between $500 million and $15 billion.

Our holding company, Marqueste National Corporation (“MNC”), is a privately held company with a good performance history but without access to the capital markets. Over five years ago, MNC issued its TPS and currently a portion of these securities receive consolidated Tier 1 Capital treatment. For MNC its TPS are a very cost effective capital source. If this capital no longer receives Tier 1 Capital treatment, it will reduce our Bank’s ability to grow our balance sheet and may require us to curtail or reduce future lending initiatives.

Currently community bank access for any alternative Tier 1 Capital is very limited and any new capital would be much more expensive. Ultimately subsidiary banks would bear the cost to service this higher-cost capital which would reduce the accumulation undivided profits and bank capital ratios. We therefore urge the Agencies to withdraw their proposed phase-out of TPS for institutions between $500 million and $15 billion and maintain the framework established by Congress.
Increased Risk Weight on Delinquent Loans

Under current general risk-based capital rules, the risk weighting of an exposure does not change if it becomes past due, with the exception of residential mortgage loans. In the NPR, the Agencies have proposed to require banking organizations to assign a risk-weight of 150% to an exposure that is not guaranteed or not secured if it is 90 days or more past due or on nonaccrual.

We believe the increase in risk-weighting for past due loans is not necessary since banks already establish specific loss reserves for “impaired” past due loans is required under GAAP. For loans not impaired, general reserves are also established to account for potential exposure. By increasing the amount of capital for past due loans, we are being required to set aside capital twice. We believe the risk related to problem loans should continue be accounted for the allowance for loan losses and not by adding an additional capital requirement.

Limitation of Loan Loss Reserve in Tier 2 Capital

Since the early 1990s one issue that continues to perplex us is the limitation of the allowance for loan losses in total risk-based capital (1.25% of risk-based assets). The NPR is proposing that this treatment remain unchanged. For our bank, the portion of the allowance which is excluded is approximately $14 million which, as a percentage of risk-weighted assets, is 1.4%.

In an era when most community banks have reserves well in excess of 1.25%, why would limitations be placed on the amount which qualifies as Tier 2 capital? Doesn’t the total allowance for loan losses serve as a “capital conservation buffer”?

We are generally in support of increasing the capital requirements for those banks that present systemic risk, but we believe the proposed Basel III capital framework and requirements are unworkable and inappropriate for community banks. The proposed risk weights represent an unnecessary and redundant source of capital allocation. In our opinion, the capital and risk-weighted NPRs will severely constrain our ability to grow and lend for the foreseeable future.

Thank you for your consideration.

Sincerely,

George S. Monsada
President & CEO
Marquette Bank and
Marquette National Corporation