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ColeTaylorBank

October 11, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue
NW Washington, DC 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, NW
Washington, DC 20429

Re: Comments on Basel III and Standardized Approach NPRs
OCC Docket ID OCC 2012-0008, OCC Docket ID OCC-2012-0009
Federal Reserve Board Docket No. R-1442
FDIC Docket RIN 3064-AD95, AD96
Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action

Ladies and Gentlemen:

To be clear, I recognize there is an appropriate role for regulatory oversight in the banking industry. However, I am writing this letter to express my sincere concerns specifically relating to Basel III regulatory capital rules. I am CEO of a midsize community bank and fearful that application of these international banking regulations will severely limit my organization's ability to provide consumer and commercial clients with the liquidity and flexibility they need when attempting to obtain traditional banking products. I believe Basel III, as currently proposed, falls short of strengthening the U.S. Banking industry, and in fact, will weaken the community banking model and shift lending towards less regulated companies.

Since the start of the economic crisis the banking industry has been working at a rapid pace with bank regulators towards a common goal of strengthening capital and constructing a sustainable business model. As of June 30, 2012, the average tier 1 risk based capital ratio for commercial banks with assets between $1 billion and $10 billion was approximately 15.0%[1], or 900 bps above "Well Capitalized". Digging deeper into these results indicates asset quality and underwriting procedures have improved and there are positive signs that companies are borrowing and banks are willing to lend. I do not take these improvements as a sign we should take a sigh of relief. In fact, I believe we should continue to work on strengthening our banking system. However, Basel III is too complex and does not incent community banks to stay in the businesses, such as residential mortgage banking, that have been core to our strategy for decades.

1 Source: SNL Data as of June 30, 2012

My hope is that comment letter from this institution and other community banks will be taken to heart and considered as valuable insight into the unintended impact that will be caused by layering these rules onto an already complex U.S. regulatory environment.

Our company, Taylor Capital Group, Inc. (TAYC), headquartered in Chicago, Illinois is a $4.8 billion, is the bank holding company of Cole Taylor Bank (CTB). CTB has been serving the banking needs of closely held middle market, small businesses and the people who own and manage them in the Chicago market for more than 80 years. Since 2009, we have successfully launched profitable national business lines providing residential mortgage lending and asset based lending, which are helping to strengthen our capital base and are diversifying our business model. In the summer of 2012, we launched a national equipment finance business, complementing our other business lines. The products and services we offer do not consist of complex banking instruments. We are helping consumers buy their first homes, refinance their existing mortgage, offering attractive deposit rates and helping commercial customers during this economic recovery while carefully monitoring and controlling credit risk centrally.

Although no longer a "TARP" bank, TAYC utilized the program to ensure customers had a source of credit through difficult economic times. Since 2007, CTB has grown total assets from $3.5 billion to more than $4.8 billion. In addition, CTB total risk based capital ratio has grown from 11.9% at the end of 2007 to 15.0% as of June 30, 2012 and our asset quality metrics indicate we are at pre-crisis levels. This growth and asset quality improvement is attributable to the Banks ability to find the right opportunities, hire industry expertise and employ prudent risk management practices to build a viable and sustainable and diversified business model.

Although I have many concerns relating to Basel III, below are the four most impactful to our organization. I have not described the rules proposed in Basel III as I am assuming they are all well known.

1. **Higher risk weighting of residential mortgages based on Loan to Value (LTV) and the concept of a phase-in period for implementation.**

   Specifically, the changes to the risk weighting of mortgages based on LTV will have the greatest impact to first time homebuyers. I won't go into statistics, but it's logical that products with higher risk weighting will cost more for the borrower. Banks will compete aggressively for borrowers with lower LTV ratios, while borrowers with LTV's greater than 80%, regardless of ability-to-pay, will experience higher interest rates. I also believe banks will phase-in pricing immediately as opposed to waiting for the phase-in of the rule.

   Also, LTV is only one variable that factors into the risk profile of the loan. Other risk factors of risk include; capacity based on income, past history of payment record (e.g. credit score), changing home values over time. Therefore, assigning risk weights based on LTV is not an accurate reflection of the risk of default or loss given default. The changes in underwriting standards have already made mortgages more expensive and harder to obtain, this will exacerbate the situation further hurting the recovery in housing. In comparison, this capital treatment is harsher than unsecured commercial loans which over the long term have much higher default and loss rates

   An unintended consequence, and additional risk to the economy, will be borrowers converting more of their savings into their down payment in order to obtain lower interest rates, creating risk to the consumer in the event of family hardships. In the short term, this could have a disproportionate negative impact on low and moderate income families and minorities in achieving the American dream of homeownership. In the long term, this may lead to a large number of people who cannot purchase a home due to the inability to save enough for a downpayment.

I believe the rapid change that has already occurred in the mortgage industry, including regulatory change, makes this aspect of Basel III unnecessary. There have been numerous regulations and self corrections made in the mortgage industry, including the tightening of underwriting standards by Fannie Mae and Freddie Mac. I believe these changes will have a positive lasting effect, but adding the proposed Basel III changes will only move the industry backwards. Significant increases in capital requirements may lead to a reduction in lending, or at the very least a significant increase in the cost of such lending. The end result will be that mortgage lending will be pushed out of the banking industry and into less regulated companies. Isn't this where much of the mess was made during the housing crisis?

In conclusion, the effect this rule will have on the industry seems to be in direct conflict with what the U.S Treasury has recently tried to kick start with QE3. Residential mortgage lending has historically been a very safe and reliable product for banks and a way for consumers to build wealth through homeownership. Let's recognize we, including the regulators, have learned valuable lessons from the recent crisis and quickly instituted numerous remedies to improve the soundness of the mortgage industry. I strongly believe that we should be focusing on preventing another repeat of the crisis and moving all of U.S. forward by encouraging competition in the home loan arena to the benefit of consumers.

2. **Proposed capital treatment of mortgage servicing rights (MSRs)**

I believe that mortgage servicing is a viable business opportunity for CTB to continue to grow and serve our customers. At the end of 2009, CTB successfully launched a mortgage origination business. We used what the industry had learned in recent years to build a strong core franchise without residual risk as in other large mortgage originators and servicers. I consider our relationship with Fannie Mae and Freddie Mac very strong. We primarily originate mortgage loans for sale to Fannie Mae and Freddie Mac and retain the mortgage servicing rights associated with these originations. The retention of servicing provides us a complementary revenue stream in various interest rate environments and enables us to stay involved with every aspect of our customer experience. This business could become extremely challenged to the point of significant slowdown of origination activities if the capital treatment described in Basel III is implemented. As in all products and services banks are engaged in, loan servicing entails certain risks. We take these risks very seriously and diligently work with our regulators so they understand the risks and actions we take to mitigate these risks. I am not aware of MSRs as being a major contributor of the economic crisis, yet they are hardest hit by Basel III from a capital perspective.

Under the existing treatment of MSR's under Basel I, Tier 1 capital is reduced by 10 percent of the value of an institution's MSRs and the asset is risk weighted at 100%. Under Basel III, MSRs up to 10% of Tier 1 common equity are risk weighted at 250% with the remainder of the MSR value deducted from Tier 1 Common. This capital intensive requirement is similar to intangible asset treatment, however, MSRs are tangible and in fact are contractually based, marketable and valued accordingly. The risk associated with this asset is inherent within interest rate movements as rates increase, the value of the asset increases. In a declining rate environment, the value of the MSR declines. This is not that different from other rate sensitive assets like fixed rate loans or investments. We actively manage interest rate risk of all assets on the balance sheet.

Further, under Basel III, the aggregate of MSRs, certain deferred tax assets, and equity in unconsolidated subsidiaries would be subject to a limit of 15 percent of Tier 1 common equity. Any excess above that limit would have to be deducted from Tier 1 common equity. This treatment could have devastating impacts, particularly on community banks that recognize this asset, if properly managed, as a safe and profitable asset. These new rules will lead to pressure on our profitability, return on equity and therefore, access to capital.

I also believe that consumers will be negatively impacted by the changes in relationships that the proposal will no doubt necessitate. Our mortgage business model allows customers to have a long term relationship with a traditional bank. In an environment where mortgage servicing becomes a commodity for non bank servicers, consumers will most likely see their mortgage servicing traded more frequently to their detriment.

3. Gains and losses on Available for Sale (AFS) Securities will be included in Tier 1 Common Equity

Including unrealized securities gains and losses in regulatory capital calculations is misguided. These securities generally do not represent naked risk positions. Rather, the securities portfolio primarily represents the investment of funds that have long-term fixed-rate characteristics (e.g. Demand Deposits, NOW accounts, Savings accounts, long-term debt, long-term time deposits). The combination of fixed-rate investment securities and these deposits, results in a roughly matched position. Said another way, when interest rates rise, the value of the securities portfolio declines but this decline is offset by an increase in the "theoretical" value of the deposits to the bank. That's the root of the problem here. When rates rise, everyone can see the change in the value of the securities, but the offsetting change in the value of the funding, which is just as real, is not recognized in the income statement or balance sheet. To pick up only the change in the value of the securities, and not the corresponding change in value of the funding, in the regulatory capital is inconsistent; it produces an asymmetric result and results in an incorrect calculation of the value of the equity in the bank.

This incorrect approach will result in negative outcomes:

A. Banks end up holding more capital to mitigate this risk, pushing down investor returns, making it more difficult to raise capital. In addition, holding this excess capital will restrict the availability of credit to commercial and consumer clients.

and/or

B. Capital ratios will fall in a rising rate scenario restricting available credit to keep asset levels in proportion to capital. Impacting available credit at all levels of the economic spectrum, from low income families up through our commercial clients.

and/or

C. Banks will also mitigate the potential decline in capital ratios in a rising rate environment by shortening the duration of their securities portfolio, reducing income for banks. Even worse, it causes banks to fundamentally mis-match their asset and liability durations, becoming much more asset-sensitive. This will have disastrous effects for the industry in the next economic downturn. The industry will suffer both increasing credit losses and declining spread income due to being asset-sensitive in a falling rate environment.

4. **The phase-out of Trust Preferred Securities (TRUPS) as a Tier 1 instrument appears to be a regulatory rule that is in direct conflict with an act of Congress; it clearly is in conflict with the spirit of the Collins amendment, if not the letter. Congress' intent was for the treatment of hybrid capital instruments issued prior to Dec. 31, 2009 for institutions with less than $15 billion in assets to be grandfathered.**

   In 2002, TAYC issued $44 million of TRUPS as part of our Tier 1 capital base. This has been a cost effective source of Tier 1 capital that has helped our organization generate loan growth. By phasing out Tier 1 treatment of TRUPS, we would most likely replace this source of capital with more expensive and dilutive forms of capital in order to continue loan growth.

In conclusion, the specific concerns I've highlighted will have the greatest impact to our bank. CTB has worked diligently to diversify our business model, build capital, sustain earnings and provide credit to our commercial and consumer clients in various economic cycles. Basel III will cause us to move backwards, and dramatically reduce our ability to provide residential mortgages and build stronger relationships with our customers through mortgage servicing. I support regulatory oversight to strengthen the U.S. banking system, however, if adopted; Basel III will weaken CTB and the community banking system as a whole.

Respectfully submitted,

Mark A. Hoppe
President & CEO
Taylor Capital Group, Inc / Cole Taylor Bank

cc:

Rep. Danny Davis
Rep. John Dingell
Rep. Luis Gutierrez
Rep. Daniel Lipinski,
Rep. Peter Roskam
Rep. Janice Schakowsky
Sen. Richard Durbin
Sen. Mark Kirk
Sen. Carl Levin
Sen. Debbie Stabenow
Wayne Abernathy, American Bankers Association
Linda Koch, Illinois Bankers Association