October 16, 2012

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies".)

I urge you to amend the proposed Basel III standards in at least a couple of areas, including (1) recognizing unrealized gains and losses on all available-for sale ("AFS") securities, both debt and equity, in the calculation of common equity tier 1 capital, and (2)increased risk weightings for certain types of residential mortgage loans. It is my opinion, that the proposed standards, particularly the two mentioned above, would have a substantial impact on community banks', their customers and their communities. Community banks are vital to consumers, businesses and communities across the state of Michigan. Michigan has just begun to recover from almost ten years of recessionary conditions. These proposals do not support the recovery.

If banks are required to recognize unrealized gains and losses in the calculation of common equity tier 1 capital, it could result in temporary changes in the market values of certain lower-risk debt securities creating substantial volatility to regulatory capital ratios. It is understandable that the banking agencies have concerns over the fair value of investment portfolios as they generally comprise a material percentage of bank assets. However, I do not agree with the view that the proposed fair value treatment would better reflect an institution's actual risk. Conversely, I believe that financial statements and disclosures of U.S. banking organization's already adequately reflect the risks from unrealized temporary losses on investment securities and that attempting to better reflect risk is not justified by including unrealized temporary losses (or gains) in regulatory capital. If there is no permanent impairment, investments will return to par given the institution has the intent and ability to hold to recovery.

The banking agencies should be concerned that banks may be left no choice but to hold highly liquid instruments with relatively low credit risk that could result in significantly lower yields or hold more securities as held-to maturity which would reduce an institution's flexibility in managing its securities' portfolio. Further, the ancillary effects of a declining demand by financial institution's for longer duration products, such as municipal bonds, could prove detrimental to smaller municipalities' ability to efficiently fund themselves.

The second most significant item impacting community banks in the proposed rule is the assignment of different risk weights to residential mortgages based on whether the residential mortgage is classified as category 1 or category 2. Specifically, I am concerned with the default treatment of all balloon mortgages as Category 2 loans, which by definition generally assesses these loans as higher risk loans. Conversely, balloon mortgages are generally originated by community banks for the benefit of the borrower/customer and, properly underwritten, they are no higher risk than a "traditional" (Category 1) loan.

Many properties in rural Michigan are ineligible for long-term fixed rate financing through Fannie Mae or Freddie Mac due to property acreage exceeding allowable limits, property use (mixed residential and commercial including, agricultural), or many properties unable to meet the strict appraisal guidelines imposed by Freddie Mac and Fannie Mae. Balloon mortgages are an option for borrowers for these type properties and meet both the lender and customer needs. As previously stated, a well managed and properly underwritten balloon mortgage may in these instances serve the bank, the community, and the customer's best interests, with no added risk to the bank.

A second area of specific concern is the use of the loan to value (LTV) as the sole determination of the risk weighting of a loan secured by a residential mortgage, and the exclusion of any consideration of the credit enhancement provided by private mortgage insurance.

There are many factors to be considered in evaluating the credit worthiness of borrowers. Over reliance on LTV ignores many effective criteria that have historically been successfully utilized by institutions to assess a borrower's dependability and credit worthiness. These include: the borrower's debt to income ratio, credit payment history, net worth, private mortgage insurance, and employment history.

I believe that judgment-based customer-tailored banking lending decisions should be protected to assure access to credit remains available to credit-worthy borrowers. Strict numerical qualifiers or thresholds should be avoided.

Lastly, the proposed treatment of **all** junior liens as category 2 loans with risk-weights 100% to as high as 200% is unwarranted. Home equity lines of credit and other junior liens are at worst unsecured lines of credit and should be risk rated no higher than unsecured commercial or consumer debt. This provision in the proposal is contrary to a bank's effort to restore consumer confidence and expand economic activity. It will unreasonably impede consumer lending.

In conclusion, I urge the rejection of certain provisions of Basel III. Its requirements will unnecessarily impede lending and negatively impact banks customers and communities.

I urge that the proposal be revised to include best practices of the finest members of the banking community.

Thank you for your consideration.

Sincerely,

Lori A. Gwizdala
Executive Vice President and CFO
Chemical Financial Corporation
Midland, Michigan