Burke & Herbert Bank
At Your Service Since 1852

Jeffrey L. Stryker
Executive Vice President & Cashier

October 19, 2012

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

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

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

Sent Via Email

Ladies and Gentlemen:

Burke & Herbert Bank is pleased to have the opportunity to comment on the Basel III proposals that were recently proposed by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Burke & Herbert Bank was founded in 1852 and has served the Northern Virginia marketplace for 160 years. We are the "oldest bank in the Old Dominion" and we have a strong commitment to our customers, employees and stockholders. The bank has survived a civil war, two world wars, several economic downturns, including the latest one, and has grown to over $2.5 billion in assets and 25 branches in our region, and employs about 400 people. We are consistently ranked as one of the strongest and best performing banks in our peer group. Our concerns with the proposals include potential impacts on capital, effects on managing liquidity and interest rate risk, increased complexity and cost of regulatory compliance, and the imposition of new regulatory structures that will affect the availability of credit without improving bank safety and soundness.

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Adequate capital is the foundation of sound banking. Burke & Herbert Bank supports strengthening capital standards and is itself a very well capitalized bank, with over 10% tangible equity capital. The proposed capital regime in the Basel III proposals is very complex and will impose unreasonable compliance demands on community banks. Some observers have commented that these rules have not been well thought out, and seem to add complexity that might be appropriate to larger institutions with complex capital structures but not to community banks. The goal of stronger capital is unlikely to be served by the rules in their proposed form. We believe that simpler capital standards are more likely to result in better capitalized banks. The history of the effect of the risk based capital standards to date is not encouraging and making them more complex is unlikely to make them better.

Part of the capital proposals would require banks to include unrealized gains and losses on available for sale securities in "common equity Tier 1 capital." Burke & Herbert Bank has an investment portfolio valued in excess of $1 billion, substantially all of which is classified as available for sale. This classification allows flexibility for liquidity management purposes. Requiring a capital adjustment for unrealized gains and losses introduces volatility in capital measures that is likely to be harmful. The current impairment rules provide a reasonable framework for recognizing losses in income and capital when justified by the particular conditions of affected securities. Introducing a mark-to-market regime for bank capital serves no useful purpose and may result in adequately capitalized institutions finding themselves affected adversely because of security market conditions. Would regulators want to see bank capital severely impaired only because of a sharp movement in market interest rates? Such a rule might encourage banks to shift securities to the held to maturity classification, making the portfolio less of a liquidity buffer. Banks might begin to emphasize shorter term, less interest-rate sensitive investments, thus reducing future earnings and growth of capital. All of these effects would be negative. We don't see the benefit of this provision for either regulators or banks.

Several adjustments are proposed for the risk weighting of loans. These changes include increasing risk weights for past due loans and certain other commercial loans. In the computation of the loan loss allowance there is already consideration of delinquency and loan quality, so we question whether adding to risk weights is redundant.

The new residential mortgage lending provisions are very complex and taken together have the potential to reduce the availability of credit to qualified borrowers. Burke & Herbert Bank makes mortgage loans with level amortization schedules that provide for balloon payments. This type of loan gets an increased risk weighting, even though such loans have had very low loss levels over the years and serve to enhance the bank's ability to control interest rate risk. We believe this kind of lending should be encouraged and not penalized. Community banks need structures that provide protection against interest rate risk and also meet customer needs and regulation should encourage rather than discourage the use of such products.

Revised rules for securitization exposures are included in the proposals. We believe that purchase discount is an important consideration when evaluating the credit risk of a securitization exposure. Purchase discount creates another level of credit protection that is often material when evaluating the risk of loss for a given security. We think that the proposals should be revised to take this into account.

We are concerned that the overall effect of the proposals will be to increase the cost and complexity of regulatory compliance without materially improving the safety and soundness of community banks. In addition, there is the potential that credit availability for qualified borrowers will be reduced, affecting the economic health of our community. We hope that all those responsible will consider this letter and other comments from interested community banks in reshaping and improving the proposals.

Yours truly,

Jeffrey L. Stryker
Executive Vice President and Cashier

cc:
Senator Mark Warner
Senator Jim Webb
Congressman Jim Moran
Congressman Frank Wolf