PEAPACK-GLADSTONE BANK

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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 comment on the Basel III proposals.

Peapack-Gladstone Bank, founded in 1921 and located in New Jersey, is a $1.6 billion community bank. We have 23 branches, and lend both to homeowners and businesses. We have a simple business model, and run our bank conservatively.

We are very concerned about Basel III. <u>Importantly, our concern does not come from shyness towards capital; to the contrary, we believe capital is good</u>. Rather, our concern comes from the complex approach the proposals take toward higher capital, and the unintended consequences of this approach. This letter will focus on the two aspects of the proposal we feel are most problematic:

1. Flowing unrealized gains and losses on investments into regulatory capital; and
2. Risk weighting individual residential loans.

Flowing Unrealized Gains and Losses on Investments into Regulatory Capital

The proposals require unrealized gains and losses on AFS securities to flow into regulatory capital. When interest rates inevitably rise (perhaps suddenly) from their current, artificially-low levels, regulatory capital will (perhaps suddenly) decrease accordingly.

One of the big lessons of the financial crisis was that pro-cyclical policies exacerbate problems. Reserving less in good times, and then more in bad times, was our classic example.

Unfortunately, we have not learned from this lesson on that score. Now, by running AFS gains and losses into regulatory capital, we are asked to embed yet another pro-cyclical component (this time interest rate, not credit) into our model. Not only did we not learn on reserves, we are now asked to mimic an unfortunate habit in yet another part of our business.

In addition, this proposal carries a significant unintended consequence: the majority of community banks will manage this pro-cyclicality through a mixture of higher capital, rebalanced asset portfolios and transfers from AFS to HTM; the latter of these, surely an unintended consequence, will decrease an institution's liquidity.

Would it not be much cleaner and more effective to just raise our capital requirements and be done with it? Why introduce a significant pro-cyclical component into the community banking model? Why encourage banks to move securities to HTM, and thereby reduce their liquidity? Why not achieve the same capital results without the pro-cyclicality and without encouraging diminished liquidity by simply increasing base-line capital standards?

Risk Weighting Individual Residential Loans

The proposals require that individual residential loans are risk weighted at the time of origin and throughout the life of the loan. Implementing, managing and auditing (both internally and externally) this new mandate, and then interacting with internal and external auditors and regulators with respect to the mandate, will require significant additional structural cost, both in lost productivity and in actual cash outlays. It is unclear if it is fully understood outside of business the degree to which regulatory burden, exemplified by this mandate, gradually saps the economic energy of a firm.

The risk weighting will also carry a significant unintended consequence: community banks will either shy away from high LTV loans, or charge more than before for such loans, regardless of PMI or other mitigating factors. The result will be to shrink credit extension to an important part of our economy and hinder its struggling recovery. Importantly, this result is magnified by, and will further contribute to, the lingering of low collateral values.

Would it not be much simpler to just raise our capital requirements and be done with it? Why add further regulatory burden to the community banking model, when the same result may be achieved without such burden? Why discourage banks from making higher-LTV but money-good loans (for example, loans with PMI)? Why not achieve the same capital results without these unintended consequences by simply increasing base-line capital standards?

All history—political, economic, business—is strewn with examples of elaborate efforts by smart people to influence human behavior in some way or another. Most of the time, these complex efforts not only fall short of their inventors' intentions, but also carry unintended and unfortunate consequences. The pro-cyclicality of flowing AFS gains and losses into regulatory capital, the likely diminished liquidity such treatment will inspire, the administrative burden of risk weighting residential loans and the shifting of some credit away from higher LTV towards lower LTV loans are but four examples of the matter at hand.

At Peapack-Gladstone Bank, we feel Basel III is wholly inappropriate for our simple community banking model. A one-size-fits-all approach cannot possibly optimize capital regulation at both money center banks, on the one hand, and community banks, on the other. If Basel III intends to treat risk-weightings of individual residential loans differently, on the basis of their different characteristics, then it begs the question, why cannot Basel III differentiate between small and large banks?

And if higher capital is the goal, why not do away with all this complexity (and its unintended consequences), and simply increase capital standards? Would this not be better, more effective policy?

Sincerely,

Finn M. W. Caspersen, Jr.
EVP and General Counsel