FirstBank & Trust

Barry Orr
Chairman & CEO

August 22, 2012

Mr. Richard Fisher
President
Federal Reserve Bank of Dallas
200 N. Pearl Street
Dallas, TX 75201

Re: Comment on proposed capital rules under Basel III Accord

Dear Mr. Fisher:

Under separate cover dated August 20, 2012, we have addressed concerns regarding the impact of BASEL III on residential construction, residential lending and the impact on business and consumers in our local communities served by **Community Banks.**

Our purpose today is to address the concerns and provide comment on the impact BASEL III will have on **Community Banking.**

It is widely established that the "shadow banking" system, in concert with large national/international banks, created a disastrous consequence for our economy and national banking system, through derivatives, hedging, subprime mortgages, and credit default swaps. It is imperative that a clear understanding be established that **Community Banks** did not participate in the creation or utilization of these instruments. To this day, I must admit I have no idea what a "credit default swap" is, nor do I intend to learn.

I would respectfully request that a tiered approach be recognized as the most equitable solution to properly differentiate **Community Banking** and the Wall Street national/international banking institutions.

Increased capital standards to 8.5% Tier 1 and 10.5% risk weighted capital is understandable and I believe will be embraced by the **Community Banks** across the country.

Many other proposed new rules are unreasonable and unjustified as follows:

<u>Trust Preferred Securities (TRUPS)</u> – Congress proposed a "grandfather" of TRUPS for Banks under $15 billion, which is prudent. The BASEL III Accord is over-reaching and proposes an elimination of TRUPS as Tier 1 Capital over a ten year period. The regulatory proposal is totally unfair and changes the rules in the "middle of the game".

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Community Banks have limited capital sources as compared to the large publicly traded banks with access to the capital markets. TRUPS is virtually the only capital instrument available to Community Banks outside their existing stockholder base. It has proven to be an efficient, inexpensive solution for well run **Community Banks** seeking expansion in the markets they serve.

Assets Sold with Recourse – To apply a 100% risk weighting to all loans sold with recourse in the due course of providing home loans for sale into the secondary market is excessive. Any **Community Bank** participating in a mortgage lending program maintains a record of repurchase on any loan sold with recourse and there has never been anywhere close to 100% in repurchases, the average on repurchase is less than 1%. Some small percentage of loans, 5% to 10%, sold with recourse should be risk weighted or better yet requiring a small reserve against loans sold with recourse would be the most palatable solution. Applying a 100% risk weighting to 100% of loans sold with recourse is clearly excessive, especially when considering the short term nature of the recourse period in these types of loans.

Unrealized Gains/Losses on AFS securities – The consideration of applying the "mark to market" value of securities available for sale (AFS) to the Tier 1 capital will introduce potentially serious volatility in the regulatory capital ratios for **Community Banks**. Under Basel III, regulators are proposing a "mark to market" accounting application to our securities portfolio; including the impact of unrealized gains and losses of our securities portfolio in Tier 1 capital (FASB 115). Today, due to the historically low interest rate environment, most **Community Banks** would enjoy a windfall to their capital through unrealized gains in our AFS portfolio which, post Basel III would be included in Tier 1 capital. However, long term rates will eventually rise as the economy gets back on its feet. These same securities will have an adverse impact on Tier 1 capital in a rising rate environment and significantly reduce Tier 1 capital under the BASEL III proposal.

If these rules were applied to our bank today, in this low rate environment, we would receive a 3.6% increase in our Tier 1 regulatory capital ratios; however, if interest rates were to spike up by 300 basis points, today our Tier 1 capital would decrease by 14% on a securities portfolio with 3.5 year average duration.

To mitigate this impact, our bank would be forced to move all securities from AFS to Held to Maturity (HTM). The consequences of this type of move will be reduced liquidity and reduced availability to meet loan demand as economic stability returns. The big loser once again is the small business owner and consumers who will find it difficult to obtain credit from their local **Community Bank**.

Again, **Community Banks** did not participate in credit default swaps. **Community Banks** did not enter into derivative trading schemes. **Community Banks** do not "trade" securities, but **Community Banks** do maintain a majority of the portfolio in AFS in order to change their positions in their investment holdings as interest rates and volatility dictate. Our investment portfolios are a method of managing interest rate spread and not a trading business. The proposed available for sale accounting treatment could be a single death blow to any **Community Bank** maintaining securities to pledge to public funds.

In closing, I respectfully request that you give separate consideration to **Community Banks**, below a determined asset size, to remain under BASEL 1 capital standards. The proposed BASEL III rules will place community based organizations in a significant disadvantage which will further impair **Community Banks'** ability to serve their local markets.

Thank you for your time and attention in this matter.

Sincerely,

Barry Orr
Chairman/CEO

BHO/md

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cc: Mr. Chris Williston
The Independent Bankers Association of Texas

Mr. Eric Sandberg
Texas Bankers Association

Mr. Francis Keating
American Bankers Association

Mr. Cam Fine
Independent Community Bankers of America

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Barry Orr
Chairman & CEO

August 20, 2012

Mr. Richard Fisher
President
Federal Reserve Bank of Dallas
2200 N. Pearl Street
Dallas, TX 75201

Re: BASEL III Capital Rules as proposed for 1-4 family residential lending;
Residential construction and home ownership

Dear Mr. Fisher:

The basic business model for community banking is the backbone of economic prosperity. The repeal of Glass-Stegall has enabled large, complex financial institutions to evolve; thus creating the financial meltdown this country has experienced. Four large banks currently control over 55% of this nation's banking assets. This monopoly has created additional barriers to small business accessing necessary credit to operating their business, while allowing these large banks to participate in derivatives, subprime mortgages and default swaps. Community banks did not participate in the creation or utilization of these instruments; however with the implementation of Basel III we are being penalized for such. **Community banking maintains the highest capital levels in the banking industry.** Our capital is utilized to meet the needs of our community, consumers, and small business who create jobs, buy and sell inventory and pay taxes. Basel III is another impediment of regulatory interference with free enterprise and will only serve to further stall the economy.

A tiered approach should be recognized as the most equitable solution to properly distinguish the differences between Community Banking and the Wall Street national/international banking institutions. Community Banking should be held to the current standards of BASEL 1. Perhaps a different standard should be applied to large financial institutions in excess of $25 billion based on risk appetite.

I urge you to evaluate the impact of the new risk weighting guidelines for single family residential lending. The proposal under BASEL III "will bring the housing industry to its knees" in this country. The housing market has slowly begun to stabilize, coming out of the economic collapse of 2008. The new capital rules as proposed will set the housing industry back to a 1930's era of demise.

The proposed asset risk weighting standards will have significant adverse unintended consequences in the residential construction, lending, and sales markets as follows:

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GSE's - Under BASEL III, U.S. Government guaranteed loans will receive the lowest risk rating (most favorable). At a time that Congress is trying to phase out GSE in the mortgage lending spectrum, the BASEL III Accord virtually assures that the government is in housing for the long haul. Private capital funding for home loans face an extreme disadvantage under the proposal.

Single Family Construction Loans - Requiring a risk weighting increase of 50% in capital requirements for SFR construction unless the home builder pays 15% of appraised value in cash equity down, will create liquidity deterrents for virtually any homebuilder. In today's construction lending, the standard is 80% loan to value of the appraised completed home. The proposed rules increase the standard to 65% LTV. Only large publicly held homebuilders with access to the public capital markets would be able to attain these standards.

Balloon Type Mortgage Loans - Additionally, balloon type mortgages loans, which have been a long time stalwart asset for community banking for managing interest rate risk (rather than going the way of thrifts with thirty year fixed rate loans that eventually put them out of business) receive a punitive risk weighting under Basel III.

Second Lièn Equity Purchase Loans - Second lien loans for equity purchase interest in homes receive the most drastic risk weighting increase of 100% to 200%. This type of lending has been crucial to assist homebuyers in obtaining the most favorable interest rate pricing.

The process for qualifying under today's secondary market rules, restrictions, and credit score requirements eliminates any form of high risk lending. Furthermore, any loan exceeding 80% LTV receives mortgage insurance **if** you can pass the litmus tests required by today's mortgage insurance underwriters. Thus, those second liens are not high risk lending. It is smart business, favorable for the consumer and the Community Bank.

A homeowner purchasing a $750,000 home will obtain a maximum conventional loan of $417,000, taking advantage of the low rate secondary market FNMA or FHLMC pricing, they pay 10% to 20% down ($75,000 to $150,000) and obtain a second lien purchase money equity loan for the balance of $150,000 to $250,000 from their local Community Bank.

Land Acquisition and Development - The increase in risk weighting on land acquisition and development for lending on one to four family residential properties further weakens the outlook for the housing market because of significant increased capital standards placed on Community Banks to finance these types of projects. In smaller communities across the country, Community Bank financing of these projects is the only source of funding. The additional risk weighting of this type of loan creates an obstacle cannot be overcome in the financing of those projects.

The risk weighting on capital under BASEL III, as it applies to single family construction and home loans is extremely onerous and will impact businesses and consumption across a wide spectrum, including but not limited to realtors, title companies, surveyors, home furnishing stores, sub-contractors, building material suppliers, Banks, mortgage lenders, will all experience the adverse implications as financing for construction and home ownership becomes more restricted and more expensive as Banks apply the cost of additional capital to support this type of lending. The end result will be:

- Community Banks will reduce their participation in home lending, forcing the business to the "shadow banking system".
- Community Banks will reduce their participation in home construction due to higher capital requirements to support construction lending.
- Pricing for construction loans and home loans will increase to justify the additional capital requirements placed on banks, thus increasing the cost of home ownership.

Bottom line, the consumer loses again................

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Lastly, the premise of measuring and maintaining risk weighting capital standards based on loan to value for residential lending will create an insurmountable cost to Community Banks in terms of personnel resources, appraisal costs, monitoring, software, technology programming, and a continuous burden of regulatory costs. An alternative solution must be created to measure high risk lending. Loan to value has no application to the ability of borrowers to repay a loan. I would present that today's mortgage loan underwriting guidelines mitigate high risk lending. A method of measurement of risk through credit scoring maintenance would appear to be the more sensible approach for defining a "high risk loan".

We respectfully request that the unintended consequences effecting the housing industry be given consideration before any significant capital rule changes are placed on Community Banking.

Thank you for your attention in this matter.

Sincerely,

We need your common sense to prevail! Thanks

Barry Orr
Chairman/CEO

BHO/md

cc: David Miller
Texas Homebuilders Association

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Texas Association of Realtors

Leslie Midgley
Texas Land Title Association

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