FIRST HOPE
BANK
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September 12, 2012

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

Re: OCC Docket ID OCC-2012-0008: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action

To whom it may concern:
Thank you for the opportunity to comment on the Notice of Proposed Rulemaking (NPR) concerning the changes in the regulatory capital rules. As is outlined in the NPR, this rule would apply to all "banking organizations that are currently subject to minimum capital requirements." Being such an institution, First Hope Bank will be greatly impacted by this proposed rule.

First Hope Bank, OCC Bank Number 10118, is a six branch institution with offices located in northwestern New Jersey. As of June 30, 2012, the Bank had $409.9 million in assets. Those assets consist primarily of an investment portfolio of $73.8 million and a loan portfolio, net of the allowance for loan and lease loss, of $291.8 million. These assets are primarily funded by a deposit base of $344.1 million, generated from the local community. In addition to providing traditional banking services to the community, the Bank also has a Trust Department providing investment advice and estate services. Furthermore, the Bank operates a wholly-owned mortgage subsidiary providing mortgages throughout New Jersey and several other states. The final subsidiary is an investment subsidiary, First Hope Invescorp, which owns a majority of the investments of the Bank. First Hope Bank is a wholly-owned subsidiary of First Hope Bancorp.

In reviewing the NPR and multiple commentaries by industry experts, one is struck by a particular aspect of the proposed rule. The inclusion of Accumulated Other Comprehensive Income (AOCI) in the calculation of regulatory capital ratios will have a significant, negative impact on the banking industry as a whole. This particular change will add volatility to an industry typically viewed as stable. The inclusion of AOCI should be eliminated from the NPR or drastically modified.

On the national scale, this will have a countercyclical effect on the availability of credit and the ability of a bank to grow. At the current time, the US economy is at the bottom of the interest rate cycle, hopefully. Bank balance sheets are full of investments that were purchased earlier in the interest rate cycle, and therefore, should have significant, positive AOCI balances simply due to the change in interest rates. If this rule were currently enacted, banks would see higher capital ratios, giving lenders more flexibility to make loans, at a time when decent credits are hard to

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find. This will incent lenders to make loans while they can, putting higher credit risk paper on bank balance sheets. Unfortunately, the opposite also holds true. At the top of the interest rate cycle, bank balance sheets are full of investments purchased earlier in the interest rate cycle at lower rates. This will mean negative AOCI balances, reducing capital and the ability to lend when lower credit risk paper is readily available.

In addition to capital levels being impacted over longer periods of time through a credit cycle, there will be changes to community bank capital levels on much shorter time frames. Community banks invest primarily in high quality investments, where the main driver of changes in AOCI is interest rates. Therefore, dates when the Federal Reserve Open Market Committee (FOMC) will become extremely important, as the Committee has a tremendous influence on the shape and slope of the yield curve and also the amount of AOCI on the balance sheet. Other factors also begin to play a role, depending on how they influence the bond market. Everything from what is happening in Greece and Europe to the opinion of China on the state of the US economy will end up impacting bank capital ratios. It is this sort of volatility that is detrimental to the banking system.

By including AOCI in capital, the legal lending limit is specifically impacted, as capital is the main component in the calculation. Loan deals will need to be restructured based on a decision by the Chairman of the FOMC. This will cause banks to slow deals down around the time of a meeting of the FOMC, due to the uncertainty surrounding a decision of the committee. In some cases, loan deals will not be consummated, because the bank has a suddenly lower legal lending limit, all due to the decision of the FOMC.

In fact, some banks will be forced to close as a result of this proposal. A troubled bank in a rising interest rate cycle could very well make all of the changes recommended by its regulator and improve its financial performance, but be unable to raise its capital ratios enough due to changes in the bond market. This eliminates the ability of bank management to manage itself out of a bad situation, and puts it at the mercy of the bond market. This volatility in bank capital ratios also will force credit to tighten up between correspondent banks and their customers, since a primary determinant of the lines of credit between banks is the amount of capital. Banks will face liquidity issues as other banks will be unwilling to lend to them based on a decision of the FOMC during a rising rate environment or shifts in the bond market.

AOCI due to changes in interest rate are ephemeral, and with enough time disappear with the maturity of a security. They can swing from one extreme to another in a matter of months, undermining the stability capital ratios are designed to convey and makes bank management unnecessarily more difficult during times of interest-rate change.

If the regulators are adamant on adding AOCI to the capital calculation, carveouts from the calculation should be allowed for certain high quality investments. First Hope Bank's recommendation as to these carveouts would include obligations guaranteed by the US Federal Government or a government-sponsored entity and general obligation, essential purpose municipal bonds at a minimum. Both of those categories of instruments have long and sustained histories without a default. By doing this you can isolate investments with some credit risk, and capital above 100% of the value of the asset, since there are few contractual ways for the bank to be exposed to a higher loss than the value of the asset. This may be possible with certain derivative assets and off balance sheet items. However, placing more than a 100% risk weighting on most assets owned by community banks is penalizing them more than necessary. The maximum risk weighting should be 100%, with other risk weightings adjusted downward as well.

In reviewing this NPR, First Hope Bank estimated the impact of this change in risk weighting on each of the assets owned by the bank. Management assigned each asset a call report risk weighting based on it understanding of the NPR as presented. While further clarification would be expected in some cases, First Hope Bank believes its risk weighted assets would rise between 5% and 10%, depending on how certain assets are classified, causing a similar decline in the capital ratios of the bank. This estimate is independent of any impact that may occur as a result of the tightening of credit from this NPR.

This comment letter will be submitted electronically to the OCC and the Federal Reserve. Additional copies of this letter will be sent to the individuals identified at the end of this letter. If you have any questions concerning the statement above, please reach out to Lewis R Beatty at either lbeatty@firsthope.com or 908-459-6012. Thank you again for the ability to comment on this NPR.

Respectfully,

LRB

Lewis R Beatty
Director
Senior Vice President
Chief Financial Officer and Cashier

Cc: Hon. Frank R Lautenberg, United States Senator from New Jersey
Hon. Robert Menendez, United States Senator from New Jersey
Hon. Scott Garrett, United States Representative from New Jersey's 5th District
John McWeeney, President, New Jersey Bankers Association
Hugh Carney, Senior Counsel, American Bankers Association