STATE OF CONNECTICUT
DEPARTMENT OF BANKING
260 CONSTITUTION PLAZA – HARTFORD, CT 06103

October 19, 2012

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AD95

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington DC, 20219
Docket ID OCC-2012-0008

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1430;
RIN No. 7100-AD87

Dear Sir or Madam,

The State of Connecticut Department of Banking (CTDOB) is pleased to provide comment on the Federal Deposit Insurance Corporation's (FDIC's), the Board of Governors of the Federal Reserve System's (FRB's), and the Office of the Comptroller of the Currency's (OCC's) (collectively, "the Agencies") joint Notice of Proposed Rulemaking (NPR, proposal, or proposed rule) to implement the Basel III capital accords, entitled *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action,* as well as comments relative to the Agencies' general risk-based capital requirements for determining risk-weighted assets, entitled *Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements.*

We share the view of the Conference of State Bank Supervisors (CSBS) that the proposed rule is one of the most significant public policy matters facing the financial sector, and as such, its short, mid and long term consequences require thoughtful consideration and significant empirical analysis. We are encouraged by Comptroller of the Currency Thomas Curry's comments to the American Bankers Association on October 15, 2012 in San Diego, California and are supportive of some of the ideas he

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promulgated therein. Most importantly, Comptroller Curry seems to recognize and accept that a one size fits all solution is not appropriate in this instance. However, we would respectfully submit, that contrary to the Comptroller's view, community banks should be exempt from Basel III rules, as the Basel Committee made clear that they are only intended to apply to the same institutions covered under Basel II.[1] We, along with CSBS, support the Agencies' efforts to increase the minimum required capital for all institutions. However, we are concerned with the inclusion of community banks under the Basel III umbrella as the agreement was never intended to apply to all U.S. banks as cited above. We recommend the agencies scale back this rulemaking to make it applicable only to the intended institutions. We would support a separate rulemaking to address the minimum capital requirements for banks not covered by Basel II and Basel III. Such a rule should be appropriately set to enhance stability while serving to attract capital to the banking system and ensure economic growth and should be easy to understand and simple to manage in the community bank context.

We fully agree that increased levels of capital should be considered to enhance the resiliency of the banking sector. If this capital is effectively managed, it should allow institutions to remain sound throughout an economic cycle. That said, onerous capital requirements can lead to a number of unintended consequences such as; increased risk tolerances to drive institutional earnings and support shareholder expectations of return, a stifling of de novo banking and its usually positive effects on economic growth in the small business sectors in local markets, a slowdown in community lending as the need to conserve capital shuts down lending pipelines and the potential destruction of the mutual bank business model, a Connecticut and New England tradition. Basel III eliminates Trust Preferred Securities (TPS) as qualifying capital for all banks and bank holding companies above $500 million in assets. Historically, TPS have provided a means to enhance capital levels for Connecticut mutual banks and we are concerned that this impact will weaken the mutual model. The elimination of TPS as qualifying capital may lead to demutualization and a higher risk, shorter term focus on shareholder return for those entities. As such, we oppose the Agencies' proposed treatment of TPS for institutions between $500 million and $15 billion.

Clearly, an overly restrictive capital requirement serves as a barrier to entry, discouraging capital from entering the banking system and further driving industry consolidation, depressing local lending and potentially damaging Connecticut's economic growth.

It is critical to strike the appropriate balance to achieve a stable banking system, which is attractive to capital, and can also provide lending support to ensure a vibrant and

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[1] Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010, page 11.

diverse economy. As such, any proposed rules should be analyzed to quantify their potential impact on banks, small business and consumer credit availability, and economic growth. We encourage the agencies to not view a structure (Basel III) that was developed and intended for only the largest internationally significant financial institutions as fully appropriate for America's and Connecticut's community banks. The Agencies need to ensure that they develop capital requirements that ensure a resilient banking system that also delivers economic growth and commensurate employment in our national and local economies. As a peer bank regulator, we would further state that capital requirements must be used together with an active supervisory function to ensure we have a sound community banking system that encourages local lending and provides credit access for Connecticut businesses and consumers.

On the proposed rule to revise the risk weights for risk based capital we are highly concerned with, and opposed to the specifics contained within. We believe this is a consensus position of other state banking agencies and of CSBS as well.
The risk weighted assets issue as well as the broader Basel III capital approach was discussed with the CEO's of Connecticut community banks at a recent series of roundtables and we believe their concerns in these areas are valid. Our concerns center on the following key points:

- We believe that the approach proposed by the agencies will limit traditional community bank mortgage lending to Connecticut borrowers in spite of the fact that these products have been generally well managed in our state.
- The analytical basis for the proposed risk weights has not been clearly communicated to us or to Connecticut's community bankers.
- We believe that the supervisory process is the most effective way to ensure a strong risk management culture is in place at our community banks and this can effectively address evolving risk concentrations in future market environments.
- The proposed framework adds a layer of complexity that is not necessary in the community banking sector.
- We are concerned that this rule will stifle lending by well managed community banks leading to lower economic growth, slower small business formation and a slower recovery in our stressed housing market.
- The rule will limit choice to the consumer and place additional earnings stress on the already challenged community bankers who are striving to support their communities and their residents and business owners.

It seems that the approach taken by the Agencies is targeted at the risk factors identified for problem banks during the crisis. However, according to information provided to us by CSBS[2], while nationally over 450 institutions failed from 2008 through the present, we must remember that the majority of institutions did not fail. In fact, out of the nearly 2,300 banks identified with concentrations in commercial real estate loans in 2007, over 1,200 maintained a low level of problem assets and are profitable today. Further, no Connecticut banks failed in this period reflective of the fact that the supervisory process and a good risk management culture remain effective tools to weather a crisis. We believe that a continuous focus in Connecticut on effective risk management and a strong supervision process will allow our community banks to remain sound and grow our economy. Our Connecticut community bankers know their customers, know their communities and know how to effectively manage risk in multiple economic environments and this has been borne out through the economic crisis. We believe that institutional soundness and economic growth are not mutually exclusive and that the proposed rules will not necessarily enhance soundness while they will almost certainly suppress economic growth.

In any case, in order to truly improve the risk sensitivity of the capital rules, the categorization of exposures and risk weights would need to be supported by a comprehensive analytical process that recognizes that community banks have different levels and areas of expertise and appetites for risk than large domestic or international banks.

While we are supportive of the agencies' efforts to improve the level and quality of minimum required capital, we believe that the agencies need to be mindful that the majority of our nation's banks are non-complex, community based institutions. These community banks help to drive Connecticut's economy and support the growth of our small businesses, our communities and make home ownership a reality for countless numbers of our citizens. Connecticut community banks did not cause the financial crisis, they never were, nor will they ever be "too big to fail" and in fact not one of them did fail during the crisis, yet now they are being burdened with potential rules that do not enhance their soundness but will limit their ability to serve their customers and in some instances may even threaten their business model forcing them to consolidate and thus reduce credit availability and choice for Connecticut's businesses and consumers. As the agencies review their proposed rules we would hope that they study the consequences, intended and unintended of said proposals. We would also hope that they quantify the impact on the industry, as well as the potential negative impact on economic growth.

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[2] The Conference of State Bank Supervisors (CSBS) October 17, 2012 Comment Letter to the Agencies on Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements.

As much as we appreciate the agencies' efforts to develop the capital estimation tool for banks to analyze the potential impact of the proposed rules, we feel that this tool remains limited as it provides a static view of balance sheets that are most probably not fully reflective of normal banking conditions. We believe it is important for the agencies to understand the impact of the proposed rules over an economic cycle and to analyze how changes in the capital rules will impact the banking sector's origination of credit and the potential negative impact on communities throughout Connecticut and the country.

In conclusion, we believe it is important for the agencies to take a broad, long-term view of the impact of the proposed rules. In this regard, broad risk weights with a robust supervisory process have served Connecticut reasonably well to date. While it is certainly tempting to attempt to define the future by reacting to past crises, this may not lead to optimal public policy. The potential impact of the proposed rules will not necessarily strengthen our community banks and would most probably suppress their lending, dampen their growth and thus lessen the growth potential of our economy. An overly constricted banking industry will not be able to effectively serve consumers or grow local economies. We fully appreciate that the agencies must comply with aspects of the Basel III international accord and the Dodd-Frank Act, but the agencies should pursue a rulemaking that does not weaken our community banks or the communities they serve.

Sincerely,

Howard F Pitkin

Banking Commissioner

Cc: The Honorable Richard Blumenthal

The Honorable Joseph Lieberman

The Honorable John Larson

The Honorable Joe Courtney

The Honorable Rosa DeLauro

The Honorable Jim Himes

The Honorable Christopher Murphy