OREGON BANKERS ASSOCIATION
The Voice of Oregon Banking • Since 1905

October 22, 2012

Sent Via Electronic Delivery

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

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

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C., 20219

RE: Basel III Capital Standards

Federal Reserve:	**Basel III Docket No. R-1442**
FDIC:	**Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, RIN 3064-AD97**
OCC:	**Basel III OCC Docket ID OCC-2012-0008, 0009 & 0010**

Dear Ladies and Gentleman:

On behalf of the Oregon Bankers Association (OBA) and our membership of Oregon's state and nationally chartered banks, we appreciate the opportunity to comment on the above-referenced rules ("Rules"). The OBA and our member banks fully understand and support the need for strong capital standards for our industry. In fact, most Oregon banks have substantially higher capital levels today than they did prior to the financial crisis. That said, we have a number of serious concerns with respect to the proposed Rules and respectfully urge you to consider our comments. Even more so, we urge you to consider the comments submitted by Oregon's banks and banks across the country, as they provide detailed, personalized comments about how the Rules as proposed would adversely impact individual banks and the customers and communities they serve.

PO Box 13429 • Salem, Oregon 97309-1429 • 777 13th Street SE, Suite 130 • Salem, Oregon 97301
www.oregonbankers.com • (503) 581-3522 • fax (503) 581-8714

General Concerns

In addition to specific concerns about the Rules, a number of which are set forth below, we have several general policy concerns that we urge you to consider.

As you know, the Basel III Rules would fundamentally change how all banks calculate their capital ratios, yet the Rules were designed to apply to larger, internationally active banks rather than community banks. We understand that the purpose of Basel III was to create capital standards to cushion against financial market upheaval, but many countries do not have the diverse banking system that we enjoy in the United States, which includes thousands of independent community banks that are managed and operated in local communities. It is these community banks, for which the rules were not contemplated, that would be most disadvantaged if the "one-size-fits-all" Basel III capital regime were adopted.

It is also important to recognize that every bank has its own balance sheet, risk model and market in which it operates. Effective regulation of a bank requires the individual, rational and complete analysis of its risk profile by its regulators at the state and national level. Implementing a more complicated and homogenous system for weighting risk within capital requirements actually serves to limit the effectiveness of the examination process in evaluating risk on a rational, comprehensive basis that takes into account important qualitative measures of risk and monitoring by bank management.

Across the country, community banks account for 40% of small business lending, yet only account for 10% of bank assets. In Oregon, as in most other parts of the country, our economy depends on these small business loans. We are concerned that the Rules will curtail or, at the very least, increase the cost of lending for two of the key activities of banks: mortgage lending and commercial real estate financing. Many community banks may even exit the business of mortgage lending altogether, and others would cease offering any flexibility in their loan products since the proposed Rules would significantly increase capital costs for portfolio lenders. It is counter-productive to disadvantage insured, highly regulated banks compared with under-regulated mortgage lenders - or even credit unions - not subject to the proposed capital Rules.

Given the enormous number of regulatory changes the banking industry has already experienced in the last several years, and will experience in the coming years, it is particularly detrimental to introduce such complex and time-consuming new capital regulations on community banks that will be challenged to meet the associated compliance and operational burdens. We already hear from several of our member banks that they are uncertain about their future viability due to challenges that include, but are not limited to, regulatory burden, access to capital, unlevel competition from non-bank entities and credit unions, restrictions on non-interest income and the overall economic and interest rate environments. There is no doubt that the Rules as proposed would exacerbate may of these concerns. The Rules should be withdrawn, and each and every new aspect of the Rules should be fully evaluated in terms of its impact on the economy, the traditional banking industry and the communities we serve - including rural areas that often depend on a single local bank to meet their financial needs.

We strongly encourage you to heed these concerns, in addition to the specific issues raised below.

Specific Concerns

The following are some specific concerns with respect to the proposed Rules:

1. The Phasing Out of Trust Preferred Securities as Capital Instruments

The Rules are inconsistent with the intent of the Collins amendment that was part of the Dodd-Frank Act. Dodd-Frank never intended for Trust Preferred Securities to be phased-out for community banks. It is extremely difficult for most independent community banks to raise capital today, and phasing out Trust Preferred Securities altogether exacerbates this challenge. When there is access to capital for a community bank, investors are focused on investing funds for growth opportunities, not to fill capital holes caused by changes in regulation.

2. The Deduction of Mortgage Servicing Assets that Exceed 10% of an Institution's Common Equity Tier 1

Under the proposed Rule, institutions would be required to deduct all mortgage servicing assets (net of deferred tax liabilities) that exceed 10% of common equity tier 1 ("CET1") or even more when aggregated with deferred tax assets and investments in common stock of an unconsolidated financial entity. The deduction of mortgage servicing assets that exceed 10% of a bank's CET1 capital, combined with higher risk weights, could severely impact many community banks, including banks in Oregon. In fact, this provision of the Rules has the potential of lowering an otherwise well-capitalized bank's capital levels to below well-capitalized status. Based on the capital treatment, some banks may choose to exit the mortgage servicing business altogether, impacting long-standing customer relationships and reducing fee income opportunities for the bank. We should be *encouraging* traditional banks to serve the financial needs of their customers in a safe, sound and accessible manner, not discouraging them from retaining servicing on loans that they've often originated for or sold to Fannie Mae, Freddie Mac and others.

3. The Substantial Increase in the Risk Weighted Asset Amount for Residential Mortgages

The Rules propose new methodologies for risk weighting mortgages that are heavily dependent on data and can increase risk weights up to 200%. These new methodologies apply not only to new mortgages, but existing mortgages currently on banks' balance sheets that were underwritten and priced with existing capital standards in mind. The proposed mortgage categories did not exist at the time these mortgages were originated, and as such, the originator might not have recorded data or other information that would allow the current holders of such mortgages to assign the appropriate risk weight. Underwriting criteria will be particularly difficult - if not impossible in some cases - to obtain. While institutions can adjust their lending practices on a going forward basis to avoid some of the more punitive risk weights, they cannot do so with respect to mortgages already made. And of course, there is the added concern that banks would be forced to cease making certain otherwise sound mortgages available to their customers altogether.

4. Credit Enhancing Representations and the Removal of the 120 Day Safe Harbor

Under the Rules, if a banking organization provides a credit enhancing representation or warranty on assets it sold or otherwise transferred to third parties, including in cases of early default clauses or premium-refund clauses, the banking organization would treat such an arrangement as an off-balance sheet guarantee and apply a 100 percent credit conversion factor to the transferred loans while credit-enhancing representations and warranties are in place. Under the current general risk-based capital framework, risk based capital charges do not apply to mortgages once they are sold to third parties, even where the seller provides representations and warranties to take back mortgages that experience very early payment defaults (*i.e.*, within 120 days of sale of the mortgages). The proposed change would result in substantial additional capital charges for a significant volume of sold mortgages.

5. The Absence of an Exemption for Small Savings and Loan Holding Companies

Under the proposed Rules, all savings and loan holding companies, regardless of size, are required to comply with the Rules. The Federal Reserve has a long standing policy statement excluding bank holding companies under $500 million from the capital rules. This policy exception was codified in Section 171 of Dodd-Frank. However, the statute did not make a similar exception for savings and loan holding companies under $500 million. The Federal Reserve's current position is that Section 171 does not allow it to make exceptions for small savings and loan holding companies.

Without an exemption, small thrift holding companies will be subject to the capital rules including the CET1 capital ratio and the capital conservation buffer. The Rules would force small bank thrift holding companies to develop costly compliance regimes and potentially raises serious concerns about the viability of the structure. Subjecting thrift holding companies to the entire Basel III capital regime will create competitive disadvantages compared to small bank holding companies.

6. Unrealized Gains and Losses Flowing Through Capital

The Rules propose that unrealized gains and losses on a banking organization's Available-For-Sale (AFS) securities "flow through" CET1. Under the current risk-based capital rules, unrealized gains and losses that exist in accumulated other comprehensive income on AFS debt securities are not included in regulatory capital.

Allowing unrealized gains and losses to flow through capital would negatively impact the ability of banks to contribute to the economic recovery in a rising interest rate environment. With the inclusion of unrealized losses of AFS securities in CET1, rising interest rates would put downward pressure on banks' capital levels, potentially causing banks to reduce the growth of or shrink their securities portfolios considerably to maintain capital ratios at desired or required levels. Because of the volatility introduced into capital ratios, banks may be forced to maintain ratios substantially above the levels that would otherwise apply in order to avoid the sanctions applicable to banks that fall into the capital conservation buffer. This has the obvious effect of curtailing lending. Moreover, the Rules would discourage banks from engaging in routine and prudent activities that are used for asset-liability management.

7. The Treatment of Cash Flow Hedges

Under the proposed Rules, banks would be required to deduct any unrealized gain and add any unrealized loss on cash flow hedges included in accumulated other comprehensive income to CET1, net of applicable tax effects, which relate to the hedging of items that are not recognized at fair value on the balance sheet. This proposed deduction would have a particularly negative impact in light of the adjustments that would require unrealized gains and losses on AFS securities to flow through capital, and would hamper a proven and reliable tool that banking organizations have used for years to manage interest rate risk in a safe and sound manner. In essence, it greatly diminishes the ability to manage interest rate risk and could increase the volatility of Tier 1 capital and distort a bank's regulatory capital ratios.

8. Exclusion from Capital of Certain Deferred Tax Assets

The proposed Rules adds complexity and restrictions on the amount of Deferred Tax Assets ("DTAs") that can be included in capital. DTAs arising from carryovers of net operating losses, and tax credits are required to be fully deducted from capital. DTAs arising from temporary differences, which cannot be realized through carryback to prior years, are subject to strict limits. Banks will be faced with a much more complex and ambiguous process for determining carryback of DTAs to prior years, which seems overly burdensome to smaller community banks.

<u>Conclusion</u>

Thank you for the opportunity to comment. We look forward to working with the banking industry regulators on this and other rulemakings to assure banks of all sizes and charters have an opportunity to maintain strong capital positions and to continue to meet the financial needs of their customers and communities. If you have any questions, please feel free to contact me.

Very best regards,

Linda W Navarro

Linda W. Navarro
President & CEO
Oregon Bankers Association &
Independent Community Banks of Oregon