Illinois Department of Financial and Professional Regulation

Division of Banking

PAT QUINN
Governor

SUSAN J. GOLD
Acting Secretary

MANUEL FLORES
Director
Division of Banking

October 22, 2012

Mr. Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Mr. Martin J. Gruenberg
Acting Chairman Federal Deposit Insurance Corporations
550 17th Street, NW
Washington, D.C. 20429

Mr. Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
250 E. Street, SW
Washington, D.C. 20219

RE: Proposed Rule Making on Minimum Regulatory Capital and Standardized Approach for Risk-Weighted Assets

Dear Sirs:

We are writing on behalf of the Illinois Department of Financial and Professional Regulation, Division of Banking (Department) in comment to the proposed Basel III capital and risk-weighted asset rules. As an initial matter, the Department endorses and supports the comment that has been submitted by the Conference of State Bank Supervisors (CSBS). It is important to enhance the capital requirements of larger banks to safeguard against excessive risk and protect the safety and soundness of our financial system. However, we issue this comment knowing community banks are not analogous to the internationally active banks Basel III was designed to regulate. We also understand the situs of the economic downturn and birthplace of Basel III is located at the door step of systemically important financial institutions ("SIFI's"). As such, we agree with and support the Basel III proposed rules that address minimum regulatory capital and the prior weakness in the assessment of risk weighted assets as they apply to SIFI's.

Generally, the Department is in support of the increase in regulatory capital because it is a good indicator of a bank's health and ability to weather an economic downturn. However, it should be noted that regulatory capital is but one indicator of a bank's viability. As a regulatory agency, the Department also assesses a bank's asset quality, liquidity, earnings, interest rate risk and internal controls, concurrently with capital adequacy. The Department's examination is structured to gain an understanding of the challenges facing each and every bank it charters in the State of Illinois. We understand the diversity of our banking environment and the need for tailor made approaches to the examination of each and every bank we assess. Unfortunately, the proposed Basel III rules fail to appreciate this diversity and the proposal as it stands does not differentiate between the large banks with an international reach and our local community banks. The Department believes that community banks should be exempt from the Basel III proposed rules.

To the extent such exemption is not possible, the Department shares two concerns. First, the proposed risk weightings will have an adverse impact on residential 1-4 family real estate loans. For example, a community bank with balloon mortgages in its portfolio would be forced to double its capital requirements related to those loans. This increase will effectively minimize the number of balloon mortgage loans a community bank will be willing to make.

In the State of Illinois, many of our smaller and rural communities utilize balloon mortgages to make their monthly payment more affordable. In addition, due to the nature of their business, the self-employed, including farmers, utilize balloon mortgages because they are not able to qualify for a residential mortgage loan under secondary market guidelines. Furthermore, the affordability of balloon mortgage loans allows these groups the ability to invest proceeds that would have gone to a mortgage payment back into their businesses. As you know, these two groups are critical to the health and well being of the State of Illinois and national economy. If a reliable stream of residential mortgage loans is not available, small and rural communities and the businesses within them will suffer economically.

Second, the phasing out of Trust preferred Securities (TruPS) as called for by the Basel III proposed rules will adversely impact many community banks' ability to maintain capital in a challenging economic environment and pose a risk to the existence of community banks. Many of our state chartered banks have come to rely on TruPS to raise much needed capital. Forcing them to roll this capital off the books earlier than anticipated is both unfair and has a negative impact on systemic capital adequacy. To compensate for the loss of TruPS, banks will be forced to find other sources of capital, which frankly do not exist in smaller and rural communities, causing a decrease in lending activity or bank closure.

In summary, we appreciate and support the need for increased regulatory capital in the United States banking system. However, community banks should be exempt from a framework that best serves large internationally active banks - Basel III. To the extent such exemption is not possible, we welcome an ongoing dialogue so that we can develop a frame work that is fair and adequately addresses the diversity of our national banking system.

Sincerely,

Susan J. Gold

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Acting Secretary

Manuel Flores
Director