Simsbury Bank

October 22, 2012

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

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

Re: Basel III and Standardized Approach NPRs

Dear Ms. Johnson and Mr. Feldman:

Thank you for the opportunity to provide comment on the Basel III and the Standardized Approach Notices of Proposed Rulemaking that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

By way of background, Simsbury Bank is a state chartered, FDIC insured, publicly held community bank serving businesses and households. It is based in the Farmington Valley town of Simsbury, Connecticut and opened in March, 1995. The Bank has four branches and a nine town core market area in Central Connecticut. With approximately $350 million in assets, Simsbury Bank is second only to Bank of America in total deposits in the four towns in which we have branches. We are the largest bank as measured by deposits in our home town of Simsbury. This year to date, we have originated more residential mortgages in both our four town branch market and nine town core market areas than any bank or nonbank competitor. Our residential mortgage business is statewide in Connecticut, and we have been approved to originate mortgages by Massachusetts and Rhode Island. Our commercial banking business is focused on Central Connecticut.

The banking consolidation following the New England banking crisis of the early 1990's motivated the Bank's founders to organize Simsbury Bank to ensure that local loan decision making and respectful customer service were available in its market area in good times and bad. Very successful in the good economic times, the Bank's mission has truly been fulfilled since the financial market crisis of 2008. We have been a reliable source of loans to businesses and households through the crisis period, recession and slow economic recovery. We increased our lending steadily since September 30, 2008. From that date to June 30, 2012, Simsbury Bank's net loans have increased by 24%, deposits by 52%, and capital by 81%. We were positioned well for the financial market crisis as we have always been careful to have a diverse and low cost core deposit funding base and to manage investor/developer commercial real estate loan exposure closely. At 9/30/08, our non-owner occupied commercial real estate exposure as a percentage of capital was well below our peers at 75% and has since declined to 37% at 6/30/12. Our combined construction and development and non-owner occupied commercial real estate loans as a percentage of total loans were also well below peers at 12% at 9/30/08 and has since declined to 6% at 6/30/12.

As a public company respectful of our shareholders' need for a competitive return on their investment, we have always sought to manage our capital at "well capitalized" levels, yet at a level commensurate with our risk profile. As such, we entered the financial market crisis time period without the excess capital necessary to support faster than anticipated growth that we were prepared to accommodate due to the industry issues. As the financial markets from late 2008 through 2011 were generally closed to smaller banks, we chose to participate in the TARP capital program. We redeemed our TARP preferred stock last year through the Small Business Lending Fund program and have increased our qualifying small business lending by 25.7% over our baseline as of 6/30/12.

Regarding the proposals, I commend the FDIC in its efforts to provide information and analysis of the proposals to community banks. In July, I was fortunate to attend a session in New York led very ably by Dan Frye. Further, the information available on the FDIC website was very helpful in our analysis of the impact of the proposals on our bank.

Simsbury Bank's general view of the Basel III and Standardized Approach Notices of Proposed Rulemaking is that they are excessively complicated for traditional banks, especially community banks. They appear to have been designed to address the complexity of large, multinational, universal banks with commercial banking, investment banking and insurance risk exposures. To impose this approach to capital adequacy on banks focused simply on traditional deposit taking and lending will add a compliance burden that does nothing to mitigate risk. Further, to establish equal baseline capital requirements on all banks irrespective of their complexity is fundamentally flawed. Complex, systemically risky banks should have a higher baseline capital requirement than simple community and regional banks. Finally, I do support the concept of requiring higher capital levels to support investor/developer commercial real estate loans.

Complexity: The complexity of the proposal appears to result from the complexity of the world's largest universal financial institutions. It is wholly excessive for most American banks. A much more direct way to address the failures that led to the financial market crisis would be to address them directly. Commercial banking, investment banking and insurance must once again be separated. Our experiment beginning in 1999 with Glass Steagall's repeal ended extraordinarily badly. It is time to accept that we lack the human and technology frameworks to manage the risks of three such different businesses under one roof. The core problem is that commercial banking is usually a "buy/hold" business, investment banking is a "buy/sell" business and insurance requires a fundamentally different risk management approach than either commercial or investment banking. Two of the major contributors to the financial market crisis arose due to the belief that all financial businesses could be managed effectively under one roof.

First, investment banks like Bear, Lehman and Merrill, and the investment banking units of European universal banks decided to hold large volumes of CDOs and MBS backed by junk mortgages that they manufactured in order to earn spread income like traditional commercial banks. Beyond the fact that these holdings were high risk, they were funded by commercial paper and other funding much less stable than traditional bank core deposits. The SEC's 2004 Net Capital Rule change permitted five investment banks – Bear Sterns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley - to leverage themselves to 40 to 1. This change invited those institutions to venture aggressively from their historic trading activities focus into building large portfolios of securities and other investments. However, the institutions were run by leaders whose risk management framework was informed by their historic focus as traders, brokers and arrangers. Their mentality was built on investment banking's revenue model based upon earning a fee for trading services rendered. By contrast, traditional commercial banking requires a risk management approach that balances the credit and interest rate risk profiles of their loan assets and funding sources. Commercial banking's revenue model is tied strongly to spread income. The failure of Bear, Lehman and, but for its ill-timed acquisition by Bank of America, Merrill, starkly illustrates that the leadership and management of a trading based organization requires a fundamentally different risk management approach than a commercial bank that holds its inventory over the long term. Leaders and managers of investment banks are different from those of commercial banks and our experience from 1999 to 2008 shows that information technology based risk management tools are inadequate to mitigate that core difference.

Second, investment banks, large commercial banks and some insurance companies held enormous credit default swap risk without adequate capital to cover losses. These swaps continue to be treated as trading assets rather than insurance contracts. It is breathtaking that we find ourselves in 2012 with so little progress on creating an appropriate framework to avoid the consequences of institutions inadequately reserving against potential credit default contract losses. The "bail out" of the financial system was very much tied to the potential domino effect of AIG's inability to cover its CDS losses and the impact of that failure on its counterparties. Any institution holding CDS positions that obligate it to pay certain amount in certain circumstances – sounds a lot like insurance – should be required to maintain adequate capital against those positions.

As these real life examples illustrate, there are fundamental differences between the three financial services. Better to regulate them under individual roofs. This would allow regulatory approaches tailored to the specific risks of the industries which would be more direct and simple. Complexity would be far lower.

Baseline Capital Standard for Community Banks: The Basel III NPR continues the historic practice of treating all banks the same when it comes to Prompt Corrective Action capital requirements and introduces the new Capital Conservation Buffer requirement to all banks equally. When you consider the changes in the banking industry that have occurred in the past twenty years thanks to legal and regulatory changes and technology, this approach exacts an extraordinary penalty on smaller banks that look a lot like banks looked twenty years ago while the nation's largest banks have grown enormously in size, complexity and, by virtue of Graham Leach Bliley, extension into investment banking and insurance activities.

The Basel III NPR PCA requirements are based on an assumption that the baseline risk of Simsbury Bank is the same as that of JP Morgan Chase. Simsbury Bank is a simple bank taking deposits and lending to businesses and households. It is not systemically risky. It does not participate in the credit default swap market. It has neither investment nor insurance businesses. Its primary risk disadvantage compared to JP

Morgan Chase is that it lacks the advantages of product, geographic, industry, and business line diversification. However, Simsbury Bank manages its relative lack of diversification through careful management of credit and deposit concentrations, interest rate sensitivity and other typical banking risk management practices. The baseline risk of Simsbury Bank is much lower than that of JP Morgan Chase, even considering the diversification advantages that Chase enjoys. Chase's systemic risk alone should require a baseline risk premium over a community bank like Simsbury Bank.

I realize that the vast majority of bank failures in this cycle were community banks. Yet, like the S&L crisis of the 1980's and the New England banking crisis of the early 1990's, the vast majority of bank failures since 2008 were due to unhealthy concentrations of investor/developer commercial real estate loans. For this reason, I support the concept of requiring a higher capital level to support High Volatility Commercial Real Estate (HVCRE) loans. Commercial real estate is cyclical thereby exposing commercial real estate lenders to losses when the cycle turns. History has shown that loan loss reserve setting processes do not yield adequate reserves during good times to cover the losses when the real estate market turns. Therefore, an adjustment to capital requirements for HVCRE loans is an appropriate way to ensure capital adequacy of those banks with large acquisition and development and non-owner occupied commercial real estate loan portfolios. While I endorse the HVCRE capital supplement concept, I am not sure that the factor proposed is appropriate. I would hope that the factor results from careful analysis of losses in the event of default of loans by banks with concentrations of these types of loans.

Finally, a baseline capital requirement for traditional banks, with appropriate requirements for added capital for HVCRE, should end up being close to current capital standards. By raising standards on banks focused on traditional banking activities, we further discourage new bank formation. This removes healthy competition from the marketplace that ultimately hurts our economy, consumers and businesses.

<u>Treatment of Accumulated Other Comprehensive Income (AOCI):</u> The Basel III NPR would require that AOCI, including unrealized gains and losses on available for sale securities (AFS) must flow through to the newly defined common equity tier 1 (CET1). This proposal would unnecessarily burden banks with volatility in their capital unrelated to their management decisions about how to deal with changing interest rates. Changes in the market value of securities holdings have nothing to do with capital adequacy to support credit losses. The proposal would particularly penalize publicly held banks that balance capital, risk and shareholder returns.

Under the proposed rule, if at 6/30/12 Simsbury Bank had a $2.0 million unrealized loss in our investment portfolio instead of having a $1.5 million unrealized gain, the Bank's Tier One Leverage Capital Ratio would have fallen from 7.8% to 7.2%. While arguably, the Bank's market value to an investor had changed, there was no change in the actual amount of capital available to support the risk in our business.

Imposition of this proposal could have the effect of forcing bank management to take actions that may not be in the long term best interest of the bank's safety and soundness. Banks that might otherwise hold strong securities with unrealized losses due to market interest rate changes might instead sell them and thereby realize the loss and reduce capital.

In summary, this proposal would introduce unnecessary volatility and influence management decisions that may not be in the best interest of the bank's safety and soundness.

Home Equity Loan Capital Requirement: The Standardized Approach NPR introduces a complex assessment routine for treatment of home equity loans from a capital perspective. It appears that we would have to reclassify our HELOCs as Category 2 for purposes of capital adequacy assessment. With approximately 20% of Simsbury Bank's gross loans being home equity loans, both the complexity of this approach as well as its penalty on home equity loans will have a significant impact on our interest in offering this product. As many other banks may come to the same conclusion, consumers will be hurt by a lowering of competition as interest rates will likely increase and availability will be constrained. This proposal is overly complex and unnecessarily hurts consumers.

I started my banking career in 1981 at Continental Illinois National Bank and Trust Company of Chicago. At the time, it was recognized in the business media not only as one of the best run banks in the country, but as one of the best managed companies of any type. As we all know, Continental failed in 1984 as management had effectively "bet the bank" on oil and gas related industries. So, I learned early that in traditional banking, unhealthy concentrations of assets or liabilities (in Continental's case, it was both) can be fatal. As such, I fully support legislative and regulatory efforts to ensure that banks have appropriate risk management practices to manage these basic risks. Most banks in the US, including some very large ones, are fundamentally traditional banks. A handful of the largest banks, however, have become so complex and taken on risk in so many ways that they are arguably too big to manage and too big to regulate. Rather than imposing Basel III and its companion NPRs on any US bank, our country would be better advised to bring back Glass Steagall. Breaking up the universal banks would allow better targeted legislative and regulatory answers to the failures that led to the financial market crisis in 2008. Basel III and the companion NPRs would impose a crushing burden on traditional banks of all sizes. Community banks like Simsbury Bank would be particularly burdened and new bank formation would be discouraged. American small businesses, half of which obtain their financing from banks $10 billion and smaller, and consumers would be hurt by the imposition of Basel III and its companion NPRs.
Thank you very much for the opportunity to comment on the proposed NPRs. I would be happy to offer any assistance and support to your efforts to ensure that our banking system has appropriate capital standards.

Sincerely,

/s/ Martin J. Geitz

Martin J. Geitz

President and Chief Executive Officer

Cc: Howard F. Pitkin, Commissioner, Connecticut Department of Banking
Richard Blumenthal, US Senator
Joseph Lieberman, US Senator
Christopher S. Murphy, US Congressman

Lindsey R. Pinkham, President, Connecticut Bankers Association