Michael D. Hagedorn
Vice Chairman
Chief Financial Officer
Chief Administrative Officer

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Ladies and Gentlemen:

We are writing to urge you not to adopt the proposed rulemaking from Basel III that would redefine the Tier 1 Capital Ratio of U.S. banks to include the unrealized gains/losses on available-for-sale securities reported in accumulated other comprehensive income (AOCI).

We believe this regulatory change would have a harmful long-term effect on the stability of U.S. banks, as well as on bank shareholders and on issuers of high-quality, long-term securities such as U.S. agency and municipal bonds. The AOCI proposal epitomizes a regulatory expansion that is likely to produce unintended negative consequences.

UMB offers these comments from our vantage point as a well-capitalized, profitable, growing bank. Maintaining a strong balance sheet, through good times and bad, is a core value for us. Before, during and after the recent financial crisis, UMB's capital position has exceeded requirements by a comfortable margin (Common Equity Tier 1 Capital was 11.63% at June 30, 2012). We have always built our business to withstand the stresses of economic cycles, and that managed position has enabled UMB to continue to increase capital organically throughout the recent economic stresses, without seeking help from capital markets or the government.

If the proposal to add unrealized gains/losses from AOCI into banks' regulatory capital were adopted as it stands, we believe it would:

- **Increase volatility in bank capital levels.** Inclusion of unrealized gains/losses would tend to overstate capital levels in low-rate environments (such as now) and understate capital when rates are higher. If interest rates moved up quickly, as experienced in 1994 and again in 2005-2006, Tier 1 bank capital would erode for many U.S. institutions, triggering distress in the market. We believe, for example, that a 300 basis point rise in rates could cause many currently well-capitalized banks to become undercapitalized.

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- **Damage public perceptions of bank safety.** Adoption of the AOCI proposal would undermine confidence and create a perception of greater risk for banks that hold securities such as U.S. Treasury and agency bonds, mortgage-backed securities (MBS) and municipal bonds. This regulation would not address the actual quality of securities held by banks, much less the underwriting of bank loans. By allowing fluctuations in interest rates to erode bank capital directly through AOCI inclusion – without any change in the actual quality of assets held by banks – it would create additional uncertainty for the capital markets and increase banks' cost of capital.

- **Cause unintended changes in the mix of bank assets.** An immediate result would be an incentive to shift holdings toward shorter-duration securities to limit unrealized gains/losses due to interest-rate fluctuations. Shorter durations typically would reduce yields, leading to reduced earnings and consequently less capital in the banking industry at a time when capital is most needed. The change also would make high-quality long-term securities such as municipal and agency-backed bonds less attractive. Banks are significant buyers of these securities, so issuers could face higher costs of capital or difficulty in raising capital. Finally, the AOCI rule would create an incentive, at the margin, to shift bank assets from low-risk, highly liquid securities into riskier loans that currently might not meet prudent underwriting standards.

UMB supports raising capital requirements for banks that embrace riskier activities and assets, such as the creation of credit derivatives, investment banking and proprietary trading. However, the reasoning that supports a greater capital cushion for institutions that engage in "Wall Street" banking activities does not apply to "Main Street" banks whose focus is traditional banking – gathering deposits and lending in their communities.

Several layers of regulation already have been added for U.S. banks since the 2008 financial crisis. Ultimately, a strong banking system and public confidence must grow out of sound banking practices: profitable operations, strong balance sheets and good credit quality. What led to the financial crisis was not a failure in AOCI accounting, but a lack of attention to sound underwriting, plus involvement in riskier capital-market activities. We believe credit quality and trading activities would be better targets for supervision.

We encourage you to retain the AOCI filter for high-quality assets such as U.S. Treasury and agency bonds, federal agency-backed MBS, and highly rated municipal bonds.

Under the current system U.S. investors, depositors and regulators all have transparency into securities portfolios through reporting of AOCI in the financial statements of banks. We do not believe any of the more than 400 banks that have failed since 2008 would have been saved by the accounting device of including unrealized gains/losses in capital ratios. On the contrary, linking regulatory capital levels to values that fluctuate with interest rates would result in excessive volatility in the "headline" capital numbers of U.S. banks.

Please feel free to contact me if we can provide any further information to assist you with your decision on this important potential change to the U.S. banking system regulations.

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