October 18, 2012

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Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (the "Basel III Proposal") and Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (the "Standardized Approach Proposal")

Ladies and Gentlemen;

The Ohio Bankers League appreciates the opportunity to provide input on the proposals referenced above on behalf of our member institutions. For the reasons outlined below, we believe the proposals as initially filed will have serious unintended consequences on the economy as well as local banks. For this reason, we urge the banking regulators to withdraw and resubmit the proposals when they are fully vetted. A proposal that was designed in Basel, Switzerland for large multi-national banks has no applicability for the overwhelming number of Ohio banks. If for some reason it is not possible to withdraw the proposals, we urge you adopt a simplified approach for vast majority of banks that have a traditional banking business and easily understood risk profiles.

The Ohio Bankers League is well positioned to provide you with meaningful input from the banks doing business in Ohio. The OBL is a non-profit trade association that represents the interests of Ohio's commercial banks, savings banks, savings associations as well as their holding companies and affiliated organizations. The Ohio Bankers League has over 200 members, which represent the overwhelming majority of all depository institutions doing business in this state. OBL membership represents the full spectrum of FDIC insured depository institutions from small mutual savings associations owned by their depositors, community banks that are the quintessential locally owned and operated businesses, up to large regional and multistate holding companies that have several bank and non-bank affiliates and conduct business from coast to coast. Ohio depository institutions directly employ more than 130,000 people in Ohio. All of our members will be adversely impacted by the initial Basel III proposals. As the primary lender for business and consumers in our state, proposals that will harm Ohio banks will also harm the Ohio economy and employment.

Issue 1: The standards as proposed are unnecessarily complex and expensive to implement.

The Federal Reserve and other federal regulators have gone on record that almost all Ohio banks will meet the new capital standards.[1] While that is good news, the real burden of the proposal will be in the cost of compliance. The proposal is so complex that just to comply will require significant investment in new software and personnel. In fact, the software community banks currently use to manage capital is useless in understanding the impact of the new Basel III regulations, making it difficult to even provide thoughtful input.

This proposal is data driven down to the level of individual loans and existing loans are not grandfathered. Since the information required to comply with this proposed regulation was not required or captured at the inception of the loan, banks will have to go back manually to analyze their portfolio to properly assign risk weighting to each loan. This is a monumental task. Banks may not even have sufficient data to assign loans to the proper category. Thus, if this proposal is not withdrawn, it would be of some help if this part of the analysis were to apply prospectively only.

In implementing any new capital requirements, we would urge all of the banking regulators consider their proposals in the context of the other regulatory costs that community banks are currently spending as a result of the Dodd Frank Wall Street Reform and Consumer Protection Act. This proposed regulation will be more difficult and expensive to implement than initially realized by policy makers. The additional level of safety and soundness implied by these expensive models and complex formulae is illusory and simply not worth the additional cost.

Issue 2: The proposed regulations ignore standards recently stated by Congress in Dodd-Frank.

The Basel III Proposal phases out trust preferred securities from consideration as Tier 1 capital. While we appreciate the phase out period, the OBL believes that the legislative intent expressed in Dodd-Frank to permitting institutions with less than $15 billion in assets to retain trust preferred securities should be respected.

It is clear that Congress made a reasoned choice to provide relief for smaller institutions. To then adopt a regulation that goes beyond that exclusion is to ignore that decision. As a result of the new policy reflected in this proposal, we believe that several banks in Ohio

[1] As an initial concern, we are uncertain how the regulators would have access to the highly individualized loan data that is required to make this assessment.

will need to find replacement sources of capital. Generally speaking, institutions below $15 billion in total assets have far less access to capital markets than larger institutions.

We see no reason to phase out the eligibility of proceeds from the issuance of trust preferred securities as Tier 1 capital in advance of the stated maturity of those securities.

Issue 3: Requiring unrealized gains and losses from a bank's available-for-sale investment portfolio will not increase safety and soundness and will in fact introduce increased volatility to bank capital levels

The Basel III proposal requires unrealized gains and losses from the available-for-sale portfolio to flow through to common equity tier 1 capital. While current standards require unrealized gains and losses be shown as a part of "accumulated other comprehensive income" it is not included in regulatory capital. We cannot see any safety and soundness benefit from introducing this volatility to the debate of capital adequacy.

These gains and losses are of course a function of changes in interest rates, not credit risk. We are currently in a period of historically low interest rates. Rates have one way to go and that is up. If unrealized portfolio gains become losses and flow through to capital, banks that the Federal Reserve believes currently meet the new enhanced capital levels could quickly fall underwater. Please keep in mind that these sharp fluctuations in capital adequacy standards will occur even though the risk profile of the bank will not change.

This segment of the Basel III proposal could have several unintended consequences, which we can only begin to anticipate. For example, this will adversely impact asset liability management and some banks will shorten maturities even though it will put additional pressure on income. Further, this will undermine the ability of financial institutions to support the purchase of local municipal issues and swings in regulatory capital will adversely impact lending limits.

This additional volatility will require banks to keep additional capital just to make sure they stay above the new well-capitalized levels (plus any buffer). One way to raise this additional capital will be to restrain loan growth or even cut back on lending. Perversely, a rising interest rate environment will usually signal an expanding economy, which is when additional credit is especially vital.

Issue 4: Punitive capital charges on all but standardized "plain vanilla" loans strike at the heart of the community banking model. This will have unintended adverse consequences for the economy and for banking

Perhaps the Basel III proposal that will have the widest impact on banks is the new treatment for first mortgages. For example, the proposal has created punitive treatment for mortgages that contain balloon payment provisions. These provisions are very important features that allow banks retain mortgage loans on their balance sheet and at the same time serve credit worthy customers that may not fit the profile for traditional loans.

The Standardized Approach Proposal divides residential mortgages into two categories for purposes of determining risk-weighting. Category 1 exposures are generally viewed as having less risk and therefore are assigned more favorable risk weights. Balloon payments are prohibited in category 1 loans. This will have an unanticipated and unnecessary impact on bank balance sheets, particularly those of smaller banks.

As an interest rate risk management tool, most community banks structure their residential mortgage loans on the basis of a 15-, 20-, or 30-year amortization of principal with a balloon payment at the end of three or five years. The balloon payment structure allows the lender to shorten the duration of the asset, which allows the bank to better match the durations of its liabilities. That concept of matching durations is critical in managing a bank's interest rate risk. The other methods of mitigating interest rate risk such as the use of swaps and other derivatives are not practically available to community banks. As a result, smaller community banks have only three practical alternatives to avoid the punitive risk-weighting associated with category 2 mortgages: (1) Accept interest rate risk by making mortgage loans with longer durations so that they can be fully amortizing; (2) Enter into derivative transactions or rely more heavily on longer-term "non-core" sources of funding to manage interest rate risk on the liability side of the balance sheet; or (3) Stop making residential mortgage loans that will be held in the banks' portfolio.

None of these are attractive, but possibly the worst alternative is the third: reducing or eliminating residential mortgage loans from banks' portfolios. This will prevent several non traditional but credit worthy borrowers from getting a loan. This undermines a key activity of community banks. Examples of borrowers who may not qualify for traditional mortgages include consumers who are self-employed and therefore do not have consistent documented income, notwithstanding the fact that the borrower clearly has the financial wherewithal to repay the loan. We believe the economic impact of the proposed change to the risk-weighting of residential mortgage exposures would be real and would directly impact the consumers who need these loans that would otherwise not be available in their market.

If the residential mortgage exposure rules in the Standardized Approach Proposal are adopted without eliminating the balloon structure exclusion from the category 1 exposure definition, the majority of mortgage loans held by community banks will be deemed to be category 2 exposures. As a result, community banks will be required to hold more capital against those loans, thereby reducing the bank's capacity to make other loans and/or requiring the bank to increase the pricing of those loans substantially, which would have a direct impact on the borrower. We do not believe this outcome is the intent of the regulators.

Issue 5: The New Regulation deducts mortgage servicing assets that exceed 10% of an institutions common tier 1 equity.

The Basel III Proposal limits the inclusion of the value of mortgage servicing assets to ten percent of the institution's CET1. Also, deferred tax liabilities, mortgage servicing rights and investments in the stock of an unconsolidated financial entity may not exceed 15% of CET 1. Worse, the amount of mortgage servicing assets below 10% of CET 1 is assigned a risk weighting of 100% and is phased up to 250% by 2018, adversely impacting capital twice. There is simply no evidence that mortgages servicing rights (or deferred tax assets for that matter) have the inherent risk justifying this punitive treatment.

Several banks in Ohio originate mortgages to sell in the secondary market, but retain the servicing rights. The servicing rights not only provide a future stream of income, but also maintain the relationship with a valuable local customer. Whether it was intended or not, we believe this proposal will cause banks to exit the servicing business to the detriment of their local communities.

Issue 6: In the future, banks will be penalized for working with troubled borrowers.
The proposals as released require banking organizations to apply a 150% risk-weighting to assets that are 90 days or more past due or on nonaccrual status to the extent that those assets are not secured or guaranteed. This ignores the existing processes by which financial institutions account for past due exposures. We believe the risk inherent in past due assets is already reflected on the balance sheets and in the capital ratios of financial institutions under applicable accounting rules.

Under current standards, if a loan is deemed to be impaired, management makes a judgment as to the amount collectible with respect to the asset. To the extent that the full carrying amount of the asset is not anticipated to be collected, the bank makes the appropriate accounting entries, increasing the provision for loan losses which is charged directly to earnings. A specific reserve is added to the institution's ALLL. CET1 would be reduced under the Basel III Proposal.

Given that accounting framework, we believe that adding to the risk-weighting of past due assets constitutes unnecessary double-counting of the risk of the assets.

Issue 7: Whether it is intended or not, these proposals will impact the competitive marketplace
First, as currently constructed, the enhanced capital requirements do not apply to credit unions. Because these institutions are not subject to federal or state taxes, credit unions already have a 40% head start in the marketplace. In addition credit unions are exempt from other regulatory burdens like the Community Reinvestment Act, further enhancing their government imposed competitive advantage. It is simply unreasonable to add additional capital requirements and substantial cost burdens on banks unless all depositories are treated equally.

Second, under the proposal, all savings and loan holding companies, regardless of size, are required to comply with the Basel III requirements. Banks with total consolidated assets less than $500 million are exempt under the Small Bank Holding Company Policy Statement. The OBL does not believe there is a valid policy reason for this distinction. Smaller savings and loan holding companies face the same challenges that smaller bank holding companies do with respect to raising capital. They generally do not have access to public equity markets and therefore need to rely on alternative sources of capital, such as debt. Further, because these companies have not previously been subject to consolidated capital requirements, many of them do not presently have capital structures that would allow them to comply with the requirements of the Basel III Proposal. Therefore, should this proposal not be withdrawn, the OBL recommends including an exemption for savings and loan holding companies with less than $500 million in total consolidated assets. To fail to do so would unfairly tip the competitive scales against small savings and loan holding companies.

Conclusion

To completely appreciate the risk these proposed capital standards pose for community banks, they need to be considered in the context of other costs imposed on banking through new regulations. According to the House Financial Services Committee, there are already 7,365 pages of new regulations that Ohio bankers have to read, understand and educate staff. Together with the new capital rule, these requirements will make community banking a losing business model for some, unnecessarily encouraging further consolidation.

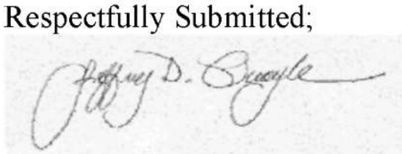
The current proposal needs to be withdrawn and resubmitted to recognize the reality that most banks are operating with risk profiles that do not justify either the additional capital or the large additional expense of tracking assets to the degree required by these new standards.

Many of the issues the proposals seem intended to address would be far better dealt with through the supervision process on a bank-by-bank basis, instead of a uniform one-size-fits-all approach. The net effect will be to make investment in community bank stock less attractive.

Alternatively, regulators should consider carving out banks that either present very small risk to the financial system or that have a traditional, straight forward, low risk balance sheet. At the very least banking regulators should develop a simplified capital requirement for such institutions that will not require the extensive and expensive recordkeeping required under the current proposal. Banks that are not "too-big-too-fail" should be given additional time to phase in any new proposed minimum capital levels because these depositories do not have easy access to capital markets. Finally, Examiners should not be allowed to apply these standards prior to the effective date based on a "best practices" theory.

The Ohio Bankers League thanks you for the opportunity for input.

Respectfully Submitted;



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