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January 30, 2013

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

cc:

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

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Re: Regulatory Capital Rules: Docket No. R-1439 and RIN No. 7100-AD87

Dear Secretary Frierson:

In connection with my representation of community banks, I write to provide additional comment on the Basel III capital proposals that were issued for public comment in 2012 by the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB) and the Office of the Comptroller of the Currency (OCC). Specifically, my comment addresses the notice of proposed rulemaking titled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action" that was published in the Federal Register on August 30, 2012 (the Regulatory Capital NPR).[1] In the Regulatory Capital NPR, the bank regulatory agencies used the discretion permitted them by the Collins Amendment to set the incremental percentages at which non-qualifying capital instruments must be phased out of depository institution holding companies' tier 1 capital. This same discretion should be used by the bank regulatory agencies to mitigate the problem whereby certain community banks are subject to the incremental phase-out percentages mandated for large, complex financial institutions, as will be described subsequently in this comment letter.

As a result of the large number of comments submitted and issues raised to the bank regulatory agencies, the agencies recognized that a number of changes were necessary to the

[1] 77 Fed. Reg. 52792 (Aug. 30, 2012).

Regulatory Capital NPR and so delayed finalizing it until a date still to be determined. In the absence of the finalization of the Regulatory Capital NPR as of January 1, 2013, banks will continue to follow existing law. But in counseling banks as they prepare for the impending capital treatment changes, I have encountered a provision of the Regulatory Capital NPR that will permit some community banks to phase non-qualifying capital instruments out of tier 1 capital at rates that are lower than those permitted for similar community banks. I wish to identify the provision creating this inequity, explain how it will result in unequal treatment of similarly situated community banks and suggest a change to the Regulatory Capital NPR that I ask the bank regulatory agencies to include in the revised Regulatory Capital NPR to correct this inequity. Please accept this late-filed comment in light of the delay to the effectiveness of the Regulatory Capital NPR.

The response to the Regulatory Capital NPR from all levels of the banking community has been overwhelming in calling for changes to relieve community banks of burdensome requirements that should apply only to larger, more complex financial institutions. For example, a bipartisan group of fifty-three senators, including members of the Senate Banking Committee, joined together in a letter urging bank regulators to acknowledge the negative impact that the Regulatory Capital NPR will have on community banks' roles as capital providers in local communities by granting them relief from the burdensome regime that is designed to respond to larger and more complex risks principally from larger institutions. Community bank executives and organizations, who submitted many of the thousands of comments to the Regulatory Capital NPR, concurred with the Senators and requested that the bank regulatory agencies revise the Regulatory Capital NPR to include differing levels of regulation to accommodate community banks.

The importance of adopting the banking community's requests to provide relief for community banks and their holding companies from complex regulations is already acknowledged in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and its implementing regulations, which in many instances structure requirements that are less complicated and more appropriate for the nature and size of financial institutions with assets less than \$10 billion. First, Dodd-Frank grants the Consumer Financial Protection Bureau direct compliance examination authority over insured depository institutions and credit unions only with \$10 billion or more in assets.[2] Second, Dodd-Frank's stress test requirements apply only to financial institutions with average total consolidated assets greater than \$10 billion.[3] Third, Dodd-Frank's Durbin Amendment governing interchange fees contains an exemption for card issuers with less than \$10 billion in assets.[4] And finally, Dodd-Frank requires an increase of the Deposit Insurance Fund reserve ratio from 1.15 percent to 1.35 percent by September 30, 2020;

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[2] 12 U.S.C. § 5515.

[3] 12 C.F.R. Parts 46, 252 and 325.

[4] 12 C.F.R. Part 235

however, the FDIC is required to offset the effect of the reserve ratio increase with respect to institutions with total consolidated assets of less than $10 billion.[5]

The FDIC and the FRB, as the lead federal regulators for community banks, have recognized that community banks are challenged to comply with complex regulations and so have undertaken community bank initiatives that include reviewing rulemaking processes to determine how to improve those processes to best tailor the requirements for the supervisory purposes related to community banks. These responses and the delayed implementation of the Regulatory Capital NPR suggest that the bank regulatory agencies intend to revise the Regulatory Capital NPR to grant community banks relief from certain of its provisions. I would like to call attention to a specific provision of the Regulatory Capital NPR to ensure that the bank regulatory agencies consider this provision's impact on community banks and provide them relief from it consistent with the level of relief to be granted elsewhere.

I call attention to the provision in the Regulatory Capital NPR that requires an incremental 25/50/75 percent phase-out over a three-year period for non-qualifying capital instruments from certain depository institution holding companies' tier 1 capital (the Large Bank Phase-Out).[6] The Large Bank Phase-Out applies to depository institution holding companies with total consolidated assets greater than or equal to $15 billion as of December 31, 2009 (the Phase-Out Threshold), as mandated by Dodd-Frank. Depository institution holding companies with assets less than the Phase-Out Threshold are subject to an incremental ten percent per year phase-out over a ten-year period for non-qualifying capital instruments from tier 1 capital (the Community Bank Phase-Out).[7]

I understand that the Phase-Out Threshold is intended to provide relief to community banks with assets less than $15 billion relative to larger, more complex financial institutions by permitting them to phase non-qualifying capital instruments out of tier 1 capital in smaller increments over a longer time period per the Community Bank Phase-Out. Let me raise one example where this does not appear to work. Specifically, the unique circumstances of New York Private Bank & Trust Corporation (hereinafter "Emigrant") the parent of Emigrant Bank, demonstrate that, despite the Phase-Out Threshold, some community banks with assets substantially less than $15 billion will be unjustly subject to the Large Bank Phase-Out, rather than the Community Bank Phase-Out.

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[5] 12 U.S.C. § 1817. A rule implementing this requirement will be proposed when the DIF reserve ratio approaches 1.15 percent, which the FDIC estimates will occur by the end of 2018. As of June 30, 2012, the reserve ratio was 0.32 percent.

[6] Proposed § ___.300(d)(1).

[7] Proposed § ___.300(d)(2).

Emigrant is a depository institution holding company that has maintained asset levels less than $15 billion for nearly its entire existence. But as the financial crisis escalated in 2008, out of an abundance of caution and given the unprecedented uncertainty of the economic environment at that time, Emigrant borrowed $2.3 billion from the Federal Home Loan Bank of New York for a two-year period to ensure that it maintained liquidity in an amount that exceeded its customers' deposits over $100,000, which were uninsured by the FDIC. The amount borrowed was primarily held on deposit at the Federal Reserve for liquidity purposes. This borrowing increased Emigrant's asset size on a short-term, one-time basis to slightly more than $15 billion as of December 31, 2009. By March 31, 2010, which was several months prior to the final enactment of Dodd-Frank, Emigrant had repaid the borrowing and reduced its assets to its historical levels of less than $15 billion. Today, Emigrant's assets are less than $10 billion.

Although Emigrant today maintains assets less than $10 billion and is operating as a community bank, it would be subject to the Large Bank Phase-Out because on December 31, 2009, solely as the result of the prudent steps it took to solidify its liquidity and ensure its safety and soundness during the financial crisis, its assets were brought up to slightly in excess of $15 billion. Therefore, Emigrant would have to phase non-qualifying capital instruments out of its tier 1 capital in the same increments and over the same time period as large, complex financial institutions. This would mean that certain community banks would be subject to shorter phase-out periods than others. This inequitable situation would impose a burden on Emigrant and negatively affect its ability as a community bank to provide loans in the New York City banking market that is dominated by large, complex financial institutions. The inequity stems from the language of Dodd-Frank, included in the Phase-Out Threshold, that banks' assets be measured as of December 31, 2009. And while this date and the date by which non-qualifying capital instruments must be phased-out of tier 1 capital are mandated by statute, the increments at which the phase-outs must occur is not inflexible; bank regulatory agencies have the authority to determine these increments.

I respectfully request that the bank regulatory agencies use their authority to determine the increments at which non-qualifying capital instruments are phased-out of tier 1 capital to resolve the inequitable situation whereby some community banks are subject to the Large Bank Phase-Out and others are subject to the Community Bank Phase-Out by implementing an exception to the Large Bank Phase-Out. The exception would be narrowly tailored to allow community banks with assets less than $10 billion yet subject to the Large Bank Phase-Out to apply the phase-out increments provided in the Community Bank Phase-Out for the calendar years 2013 and 2014. I suggest the exception be adopted as follows (the Community Bank Exception):

> "A depository institution holding company with total consolidated assets greater than $15 billion as of December 31, 2009 but with total consolidated assets less than $10 billion as of December 31, 2012 may include in tier 1 capital for the calendar years 2013 and 2014 the percentage of non-qualifying capital instruments that depository institution holding companies with total consolidated assets less than $15 billion as of December 31, 2009 are permitted to include in tier 1 capital for those calendar years."

Importantly, because of the bank regulatory agencies' authority to determine the increments at which non-qualifying capital instruments are excluded from tier 1 capital, the Community Bank Exception will comply with the language of Dodd-Frank. And those community banks subject to the Large Bank Phase-Out but with assets less than $10 billion will be permitted to phase-out non-qualifying capital instruments from tier 1 capital in the same increments permitted community banks under the Community Bank Phase-Out in 2013 and 2014. This relief is appropriate to provide those community banks vital time to make arrangements for the treatment of non-qualifying capital instruments. It is also consistent with the regulatory and legislative intent of the Regulatory Capital NPR to provide community banks relief from certain burdensome capital requirements more appropriately imposed on large, complex financial institutions. By adopting the Community Bank Exception, the bank regulatory agencies will prevent community banks' non-qualifying capital instruments from being subject to differing phase-out increments, achieving a fair result that ensures that community banks are subject to consistent regulation.

I appreciate the bank regulatory agencies receiving my comment and trust that they understand the many challenges facing community banks posed by the new regulatory capital rules. The suggested addition of the Community Bank Exception to the Large Bank Phase-Out is an important revision that I respectfully request the bank regulatory agencies implement to prevent undue hardship on certain community banks faced with an inequitable situation.

Sincerely,

Timothy R McTaggart

Timothy R. McTaggart
Pepper Hamilton LLP