Mechanics Bank®
Commitment That Lasts Generations

Steven K. Buster
President and Chief Executive Officer

October 31, 2012

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
Via email at comments@FDIC.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington D.C. 20551
Via email at regs.comments@federalreserve.gov

Office of the Comptroller of the Currency
250 E Street, SW Mail Stop 2-3
Washington D.C. 20219
Docket ID 2012-0008 and 0009
Via email at regs.comments@occ.treas.gov

**Re: Basel III Capital Proposals**

Dear Sirs/Madam:

Mechanics Bank, a $3 Billion asset community bank located in the San Francisco Bay area of California, appreciates the opportunity to offer its comments on the Basel III Notice of Proposed Rulemaking issued jointly by the federal bank regulatory agencies (the "Agencies") implementing the requirements of the 2011 international Basel III Accord and the "Standardized Approach" for the weighting and calculation of risk-based capital requirements under the earlier Basel II Accord (collectively, the "Proposal").





1111 Civic Drive · Walnut Creek, CA 94596
925.482.8000 PHONE · 925.627.3274 FAX
steven_buster@mechanicsbank.com
www.mechanicsbank.com

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Mechanics Bank respectfully disagrees with the approach taken by the Agencies to cover community banks in the Proposal. The Basel II and Basel III international accords were designed to apply to large, internationally active banks, not to local United States community banks. Applied to community banks, the Proposal's complex rules and high reporting expenses will unnecessarily increase the cost of doing business for community banks, resulting in an even greater competitive advantage for the larger, systemically important banks. The Agencies should strive to strike an appropriate balance to achieve a stable banking system which is attractive to capital and can serve as the backbone to a vibrant and diverse economy. The Proposal would establish overly restrictive and volatile capital requirements that would discourage capital from entering the banking system and further drive industry consolidation. Community banks would be more competitive and in a far better position to serve their local economies if capital requirements factor in the existence of an active supervisory function and a resolution regime that have worked as designed for the vast majority of banks.

One example illustrates our concerns. The treatment of Available for Sale ("AFS") securities under the Proposal could cause significant swings in the Bank's reported tier 1 capital levels even though the changes likely would be temporary. The Proposal requires that unrealized gains and losses on AFS securities flow through Accumulated Other Comprehensive Income, which will result in an increase or decrease to the new Common Equity Tier 1 capital level. The Agencies themselves acknowledge that fluctuations in the market value of debt securities that banks commonly hold could inject volatility on regulatory capital ratios because banks must immediately adjust changes in the value of an AFS security (often a daily occurrence). In the case of Mechanics Bank, using our tangible common equity ratio as of September 30 as a proxy for the new Common Tier 1 capital level, a 200 bps upward rate shock would reduce our regulatory capital level from 10% to close to 8%. Many community banks find it difficult to raise capital so they will choose to shrink their balance sheets to mitigate the impact to the proposed treatment of AFS securities. As these banks reduce their lending in their markets, either the larger systemically important banks will increase their share of these markets or economic growth in the markets will slow. Further, because regulatory lending limits are based on bank capital ratios, significant swings in capital could cause disruptions in important customer relationships and lead to loss of business to the larger systemically important banks. Finally, the impact of the treatment of unrealized





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gains and losses in the AFS securities portfolio will be exacerbated by the Proposal's treatment of Deferred Tax Assets ("DTAs"). Reducing the allowable deduction for DTAs for regulatory capital purposes will result in an even greater swing to the downside in an upward rate environment. In the Mechanics Bank example above, the fully phased-in loss of DTAs would result in an additional decrease to our regulatory capital level to under 7%.

In conclusion, Mechanics Bank believes that the Proposals are complex and will be burdensome to apply, particularly for community banks. They will raise certain capital ratios and refine the risk weightings of numerous classes of bank assets in ways that will have a profound effect of the U.S. banking industry. The larger systemically important banks will be able to deploy the resources necessary to comply with the complex rules. These large banks also have the scale to absorb the costs of compliance with the new rules. Many community banks will chose to shrink their balance sheets, sell themselves, or simply go out of business because they will determine that continuing in business is uneconomic. Many local economies will suffer if the community banks in their market disappear. Mechanics Bank believes that the Proposal should apply only to the larger systemically important banks and that simpler capital rules that take into account an active supervisory function will better serve the broader banking industry and the U.S. economy.

Sincerely,





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