



WILLIAM A. LOVING, JR.
Chairman
JOHN H. BUHRMASTER
Chairman-Elect
JACK A. HARTINGS
Vice Chairman
NANCY A. RUYLE
Treasurer
TIMOTHY K. ZIMMERMAN
Secretary
JEFFREY L. GERHART
Immediate Past Chairman
CAMDEN R. FINE
President and CEO

May 2, 2013

The Honorable Joe Manchin
United States Senate
Washington, D.C. 20510

The Honorable Dean Heller
United States Senate
Washington, D.C. 20510

Dear Senators Manchin and Heller:

On behalf of the 7,000 community banks represented by the ICBA, I write to express our support for the Basel III Commonsense Approach for Small Entities Act (S. 731), which would require the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency to conduct a quantitative, empirical impact study prior to finalizing proposed rules under the International Basel III agreement on risk based capital standards.

ICBA seeks a full exemption for all banks with less than \$50 billion in assets from all new capital rules under Basel III in order to avoid even greater industry concentration that would jeopardize credit for consumers and business borrowers, especially in small communities. We expressed our strong support for a Basel III exemption in our October 22, 2012 comment letter to the banking agencies and outlined our views in a statement for the Banking Committee's hearing on the Basel III proposed rules (attached below). Such an exemption is by far the best outcome and we believe a compelling, empirically-based case for it currently exists.

ICBA fully expects that a quantitative, empirical study, if carried out properly, it would lend further support to our call to exempt community banks, which should never have been included in Basel III in the first place.

Thank you for acting on your concerns with the Basel III proposed rules and their potential impact on the banking industry, consumers, and business borrowers.

Sincerely,

/s/

Camden R. Fine

Attachment: ICBA Statement for the Record, U.S. Senate Banking Committee Hearing,
"Oversight of Basel III: Impact of Proposed Capital Rules." November 14, 2012

Basel III Should Exempt Community Banks

On behalf of its nearly 5,000 community bank members, ICBA is pleased to submit this statement for the record for the Senate Banking Committee hearing titled: "Oversight of Basel III: Impact of Proposed Capital Rules." We appreciate the opportunity to share the community bank perspective on this issue. ICBA urges the banking regulators to exempt all banks with less than \$50 billion in assets from the proposed rules in order to avoid significant unintended consequences including further industry consolidation that would harm small business lending, consumers and small communities.

ICBA supports strong capital requirements that will make the banking system more resilient and help deter another global financial crisis. However, Basel III and the standardized approach introduce drastic changes to both the definition and calculation of regulatory capital that will negatively impact a fragile housing recovery and the overall economy. For community banks, Basel III and the standardized approach are regulatory overkill and will have a devastating impact on small communities and rural areas.

ICBA strongly believes the complex risk weights and capital requirements of Basel III and the standardized approach should not be applied to financial institutions in the United States with consolidated assets of \$50 billion or less. These institutions are not deemed to be systemically important financial institutions (SIFIs) under the Dodd-Frank Act and are not subject to enhanced prudential standards. Applying Basel III and the standardized approach to banks beneath this threshold will lead to large scale consolidation in an industry already overly concentrated. Without a vibrant community banking system, consumers will be left with fewer choices and communities and rural areas across the country will be deprived of the credit needed to sustain and grow local economies.

Absent a total exemption, ICBA strongly favors the following modifications to Basel III to simplify the rule and better align the proposed capital standards to the unique strengths and risks of community banking:

- Banks under \$50 billion in assets should be exempt from the standardized approach for risk weighted assets. The standardized approach's complex and punitive risk weighting for residential mortgages could force community banks out of this line of business.
- Unless it can be empirically shown that these assets are risky, the proposed substantially higher risk weights for balloon mortgages and second mortgages should be reduced to their current Basel I levels. Basel I risk weighting better reflects the high-quality nature of this asset class.

- Accumulated other comprehensive income (AOCI) should continue to be excluded from the calculation of regulatory capital for banks under \$50 billion in assets to avoid harmful and unnecessary volatility in capital adequacy.
- If AOCI is not excluded from the calculation of regulatory capital for community banks, then changes in the fair value of all obligations of the U.S. government, mortgage-backed securities issued by Fannie Mae and Freddie Mac, and all municipal securities should be exempt.
- Consistent with the Collins Amendment of the Dodd-Frank Act, bank regulators should continue the current Tier 1 regulatory capital treatment of TruPS issued by bank holding companies with consolidated assets between \$500 million and \$15 billion. This change would reflect Congressional intent and reduce the capital burden for community banks.
- Consistent with the proposal for bank holding companies, the Federal Reserve should exempt all thrift holding companies with assets of \$500 million or less from Basel III and the standardized approach or provide a policy rationale for why they are not exempt.
- The allowance for loan and lease losses (ALLL) should be included in Tier 1 capital in an amount up to 1.25% of risk weighted assets and the remaining balance of ALLL should qualify for inclusion in Tier 2 capital so that the entire ALLL will be included in a community bank's total capital. This treatment will give proper recognition to the loss-absorbing capacity of the ALLL.
- Mortgage servicing assets should be subject to the current higher deduction thresholds because they do not pose a risk to community bank capital.
- Community banks should be exempt from the provisions of the capital conservation buffer. This is particularly important for Subchapter S banks. Alternatively, the phase-in period for the capital conservation buffer should be extended by at least three years to January 1, 2022 to provide community banks with enough time to meet the new regulatory minimums.
- The proposed risk weights for equity investments should be substantially simplified so community banks will not be discouraged from investing in other financial institutions such as banker's banks, which are key business partners in community bank lending.
- In the absence of a full exemption from the standardized approach, any changes to the risk weights should be applied prospectively to give community banks enough time to comply.
- Regulators should make accommodations to ensure Basel III and the standardized approach do not negatively impact the nation's minority banks and the diverse communities they serve. Minority banks should be preserved and promoted.
- If Basel III and the standardized approach are to apply to community banks, then they should also apply to credit unions to limit their competitive advantage.

Again, the most sensible and prudent policy, the policy that would avoid severe unintended consequences, would be an outright exemption for financial institutions with assets of less than \$50 billion. Basel III was originally intended to apply only to large, complex, and internationally-

active institutions. Applying Basel III more broadly in a one-size-fits-all manner would harm all consumers and businesses that rely on credit and the impact would be especially harsh in small communities and rural areas not served by larger institutions.

ICBA encourages this committee to consult our October 22 comment letter to the banking regulators for more detail substantiating the above views. (The ICBA letter is available at: <http://www.icba.org/files/ICBASites/PDFs/cl102212.pdf>)

ICBA thanks this committee for convening this important hearing and helping to raise the profile of a significant economic policy issue with far reaching implications. We appreciate the opportunity to present the views of the community banking industry.

One Mission. Community Banks.