November 13, 2012

Honorable Senator Tim Johnson
Chairman
Honorable Senator Richard Shelby
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Re: Hearing on Oversight of Basel III: Impact of Proposed Capital Rules

Dear Chairman Johnson and Ranking Member Shelby:

As this Committee well knows, community banks are the economic lifeblood of Main Street America and vital to communities across our country. They do not threaten the stability of our financial system or economy like the too-big-to-fail banks and shadow banks, largely based on Wall Street. That doesn't mean community banks don't need to be regulated. They do, like all banks that are government guaranteed and backed by the taxpayers. However, they need to be regulated for the risks they pose, not for the risks posed by the too-big-to-fail banks that played such a central role in causing the financial crisis and almost causing a second Great Depression.

The very same too-big-to-fail banks that caused those conditions are now seeking to avoid sensible regulation designed to prevent them from causing another financial crisis by exploiting community banks' concerns regarding the proposed capital rules that are the subject of this hearing.

To state the obvious, community banks are not the same as the too-big-to-fail banks and, very importantly, too-big-to-fail banks are decidedly not community banks and they should not and must not be lumped all together and regulated in the same manner. While that may be advantageous to the too-big-to-fail banks, it will further injure community banks and the communities they serve across America. Thus, distinguishing between community banks and too-big-to-fail banks is essential, not just for good policy, but also to ensure that financial regulation is properly tailored to prevent the too-big-to-fail banks from causing another financial crisis and inflicting yet more damage on the country.

To prevent too-big-to-fail banks from avoiding regulation appropriate to them by hiding behind community bank concerns, it is essential to properly define a community bank.[1] If community banks are defined as those with assets less than $1 billion, then

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community banks comprise 91 percent of all FDIC insured institutions. If the asset threshold for a community bank were to be generously raised to $10 billion, then community banks comprise more than 98 percent of all banks.[2]

For present purposes, Better Markets[3] would suggest that individual banks or bank holding companies with assets of $10 billion or less should be considered community banks. Such a definition would mean that, with the exception of some small banks in multiple-bank holding companies, 98 percent of all individual banks would be considered community banks. [4]

Thus, if the concerns of community banks merit different treatment or additional time either for consideration or implementation of rules or regulations, then such different treatment or additional time should be strictly limited to community banks, i.e., those banks or bank holding companies with assets less than $10 billion. The too-big-to-fail banks, with their unique, grave, and proven threats to our financial system and economy, should not be similarly treated.

Unfortunately, without in any way distinguishing between community banks and too-big-to-fail banks, the three federal banking agencies on November 9, 2012 delayed the implementation of three proposed rulemakings that will amend current regulatory capital rules. Moreover, inexplicably, they did so indefinitely. A stated reason for the delay is that "[m]any industry participants have expressed concern that they may be subject to a final regulatory capital rule on January 1, 2013, without sufficient time to understand the rule or to make necessary systems changes."[5]

It must be remembered that these changes to the capital rules arise from the Basel III capital standards that were issued in December 2010 and subsequently updated in 2011.[6] Banks, particularly the less than 2 percent of all banks that are not community banks, have not only been aware of these changes since 2010, but have also been relentlessly lobbying in the U.S. and globally to have them gutted or weakened for several years now, long before the proposed rules were released on August 30, 2012.[7] In addition, the global effective date targeted for initial implementation of those rules has been January 1, 2013 since the initial proposal in December 2010, during which time banks have been on notice. Given such circumstances, a blanket indefinite postponement of these rules for all banks of all sizes is, at best, puzzling and largely indefensible.

If banks of any size merely needed more time to change data systems, for example, then a short postponement of the effective date would solve that problem. However, even such a postponement should be tailored to the size of the bank and the claimed difficulty in complying with the time requirements, which should be independently verified for at least the 2 percent of banks that are not community banks (which have devoted massive resources to lobbying against the rules).

If the agencies decided that they needed more time to respond to issues that are specific to community banks, then they could have and should have postponed the rules only as they pertain to the community banks. For example, in a speech on October 23, Comptroller Thomas Curry cited two issues that might merit additional consideration.[8] The Comptroller noted that "some aspects of provisions pertaining to mortgages could impose a serious burden on community banks and thrifts, particularly when applied to existing mortgages or if phased in too quickly." He also said that the proposed treatment of unrealized gains and losses on available for sale securities could create volatility in regulatory capital that would be difficult to manage for banks that "...do not regularly access the short term capital markets." Also, a speech by Federal Reserve Governor Elizabeth A. Duke on November 9 made a detailed case for providing a separate set of rules for mortgage lending by community banks.[9]

A desire to account for the specific circumstances of community banks, however, is no reason to delay the implementation of these rules for the 2 percent of banks that are not community banks. This is all the more important because banks with more than $10 billion in assets hold about 80 percent of the assets of the entire banking system. Thus, the 2 percent of banks that are not community banks hold 4/5 of all banking assets. Those banks should not avoid regulation due to concerns raised by community banks.[10]

Moreover, large parts of the proposed rules do not apply to community banks. For example, by definition community banks are exempt from the "advanced approaches" risk rules, because these rules apply only to banks with assets of at least $250 billion or $10 billion in on-balance sheet foreign exposure.

Strengthened capital requirements will make individual banks less likely to fail and will reduce the risk of another systemic financial crisis. These requirements need to be put in place as soon as practicable. Any delay in implementation should under no circumstances apply to all banks regardless of size, risk or circumstances. If concerns expressed by community banks merit a delay or possibly a revision to the rules or their application -- and Better Markets believes they do -- then community banks and community banks alone should be granted such a delay.

Sincerely,

Dennis M. Kelleher
President and CEO

Marc Jarsulic
Chief Economist

CC: Members, Senate Committee on Banking, Housing and Urban Affairs

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[1] Researchers often define community banks as those that serve limited geographical markets, depend on retail deposits for much of their funding, and have assets of $1 billion or less. *See*, e.g., G. Kahn et al. (2003). The Role of Community Banks in the U.S. Economy, Economic Review, Federal Reserve Bank of Kansas City, Second Quarter, 17; T. Critchfield et al. (2004). Community Banks: Their Recent Past, Current Performance, and Future Prospects, FDIC Banking Review, 2.

[2] *Id.*; *see* also, Remarks by Elizabeth A. Duke, Member Board of Governors of the Federal Reserve System, at the Community Bankers Symposium, November 9, 2012, *available at* http://www.federalreserve.gov/newsevents/speech/duke20121109a.htm (using an asset threshold of $10 billion to identify community banks).

[3] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

[4] See the data in the attached Appendix. The data in the Appendix cover individual banks. Some banks may be subsidiaries of holding companies that control more than one bank. Hence the number of holding companies would be somewhat smaller than the number of individual banks, and the distribution of holding company assets will differ somewhat from the data presented hereData on smaller bank holding companies are not readily available.

[5] "Agencies Provide Guidance on Regulatory Capital Rulemakings", Joint Press Release of the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, November 9, 2012, *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20121109a.htm They also noted the "volume of comments received and the wide range of views expressed during the comment period."

[6] Basel Committee on Banking Supervision. "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking System," 2010 (revised June 2011), *available at* http://www.bis.org/publ/bcbs189.htm.

[7] *See* Federal Register, Vol. 77, No. 169, 52792, 52888, 52978.

[8] Remarks by Thomas J. Curry, before the Florida Bankers Association, October 23, 2012, *available at* http://www.occ.gov/news-issuances/speeches/2012/pub-speech-2012-151.pdf.

[9] *See* E. Duke (2012), Op. Cit.

[10] See the attached Appendix.

Appendix

	All FDIC Insured Institutions	Less than $100 Million	$100 Million to $1 Billion	$1 Billion to $10 Billion	Greater than $10 Billion
number of institutions reporting	7,246	2,342	4,244	553	107
total assets (in billions)	14, 031	135.4	1274.7	1425.9	11, 195.0
percent of all banks		32.3	58.6	7.6	1.5
percent of total assets		1.0	9.1	10.2	79.9

Banks with assets of **$1 billion or less** comprise **91** percent of all banks and hold **10** percent of total assets

Banks with assets of **$10 billion or less** comprise **98.6** percent of all banks and hold **20.3** percent of total assets

Source: FDIC Quarterly Banking Profile, Second Quarter 2012