INDEPENDENT COMMUNITY BANKERS of AMERICA®

April 16, 2010

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH04002
Basel, Switzerland

Re: Basel Committee's Consultative Proposal to Strengthen the Resilience of the Banking Sector

Dear Secretariat of the Basel Committee on Banking Supervision:

The Independent Community Bankers of America[1] (ICBA) welcomes the opportunity to comment on the Basel Committee on Banking Supervision (the "Basel Committee") proposals dated December 17, 2009, to strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector. The Basel Committee is proposing to (1) raise the quality, consistency and transparency of the capital base, (2) strengthen the capital requirements for counterparty credit risk exposures arising from derivatives, repos and securities financing activities, (3) introduce a leverage ratio as a supplementary measure to the Basel II risk based framework, (4) introduce a series of measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress, and (5) introduce a global minimum liquidity standard.

ICBA's Position

ICBA applauds the overall goal of the Basel Committee which is to improve the banking sector's ability to absorb shocks arising from financial and economic stress and thus reduce the risk of spillover from the financial sector to the real economy. The global economic crisis that now confronts us originated from the reckless lending of a handful of a few large U.S. banks and unregulated mortgage lenders. Community banks in the United States did not contribute to the economic downturn and now are just as much

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

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victims of this crisis as other small businesses and consumers around the globe. They have suffered not only from the global recession but also from steps the government had to take to deal with the crisis-especially steps taken to subsidize the too-big-to-fail institutions.

As the Basel Committee points out in its proposal, one of the main reasons the economic and financial crisis became so severe was that many large financial companies had built up excessive on- and off-balance sheet leverage. This was accompanied by a gradual erosion of the level and quality of the capital base. The banking system therefore was not able to absorb the resulting systemic trading and credit losses nor could it cope with the re-intermediation of large off-balance sheet exposures that had built up in the shadow banking system.

ICBA strongly supports the Basel Committee's proposal to introduce a leverage ratio as a supplementary measure to the Basel II risk-based framework. A leverage ratio will help contain the build-up of excessive leverage in the banking system and introduce additional safeguards against attempts to game the risk based requirements by the large banks. The details of the leverage ratio should be harmonized internationally, fully adjusting for any differences in accounting, and should take into account the forthcoming changes to the Basel II framework.

More than a year before the outbreak of the current economic crisis, ICBA warned in a comment letter to the U.S. banking agencies on Basel II that "it is very important to our economy that regulators maintain a minimum capital cushion for our largest financial institutions that pose the greatest risks to our financial system. If a trillion dollar financial institution were to become significantly undercapitalized or fail, the consequences to the Deposit Insurance Fund, the rest of the banking industry, and our economy would be enormous."[2] Unfortunately, our warning proved to be prophetic, and now community banks in the United States just like other small businesses and consumers around the world are paying the price because some of our largest financial institutions were undercapitalized.

If there been a strong leverage ratio requirement in place that included both on and off-balance sheet items (using a 100% credit conversion factor) prior to the collapse of Citibank, Lehman Brothers, and Bear Stearns, ICBA believes the current economic crisis would not have been nearly as severe and could even have been averted. Particularly for those countries like the United States that are allowing its largest banks to use the Basel II internal ratings-based approach to compute capital, it is imperative that the leverage requirement on the large banks be as rigorous and as broad a standard as possible and that it include not only all off-balance sheet items, but all securitizations and derivatives. Capital requirements under Basel II depend heavily on the answers to questions that vary from bank to bank and have no objectively best answer. No matter how refined a risk-based capital framework the regulators come up with, it cannot capture all risks. Accordingly, there will always be a need for minimum capital requirements or a "backstop" to ensure adequate minimum capital levels and a base level of capital for safety and soundness in all economic conditions.

[2] See ICBA's comments to the banking agencies on Basel II dated March 26, 2007.

ICBA also strongly endorses the establishment of a buffer range above the regulatory minimum capital requirements for large, internationally active banks so that capital distribution constraints would be imposed on the bank when capital levels fall within this range. As the Committee has noted, at the onset of the financial crisis some large banks continued to pay out dividends even though their individual financial condition and the outlook for the sector were deteriorating. Much of this activity was driven by a sense that discretionary reductions in distributions could be seen as a sign of weakness. We agree that these actions made individual large banks and the sector as a whole weaker.

ICBA also supports raising capital requirements for the trading book and complex securitization exposures, a major source of losses for many large, internationally active banks, and for strengthening the capital requirements for counterparty credit exposures arising from derivatives and securities financing activities. We agree that banks should determine their capital requirement for counterparty credit risk using stressed inputs. This will address concerns about capital charges becoming too low during periods of compressed market volatility and will help address pro-cyclicality. ICBA also supports strong standards for central counterparties and exchanges and endorses a global liquidity standard for large, internationally active banks.

With respect to the Committee's recommendations regarding raising the quality, consistency and transparency of the capital base, ICBA thinks it is important that the Committee clarify that these proposals are focused on the large, internationally active banks and not on the smaller, less internationally active banks. For instance, while we agree that the predominant form of capital for the large, internationally active banks should be common shares and retained earnings and that the required features for instruments to be included in Tier 1 capital outside of common equity should be strengthened, we would not like to see these restrictions apply to community banks or bank holding companies since these restrictions would eventually disallow the inclusion of trust preferred securities as tier 1 capital. Trust preferred securities have proven to be a reliable source of capital for community banks and holding companies and to be sufficiently loss absorbent on a going-concern basis. The Committee's proposed restrictions would also require community banks to deduct goodwill and other intangibles from the common equity component of Tier 1.

ICBA still maintains that the U.S. agencies should reevaluate its use of the Basel II Advanced Approach. The largest financial institutions in the United States that are now considered "too big to fail" should be subject to a more rigorous set of leverage and risk-based capital requirements than other institutions and that are not determined by the institutions themselves based on internal risk-ratings formulas. Eventually, we believe Congress will pass legislation directing one of the banking regulators or a new systemic risk regulator to impose higher leverage and capital requirements on systemically important institutions. ICBA looks forward to the results of the impact study that the Basel Committee is now conducting to see if the larger, internationally active banks will be subject to significantly higher capital and liquidity requirements under the proposed rules.

Conclusion

ICBA strongly supports the Basel Committee's proposal to introduce a leverage ratio as a supplementary measure to the Basel II risk-based framework. It is important that the leverage requirement be as rigorous and as broad a standard as possible and that it include all off-balance sheet items, securitizations, and derivatives. ICBA also strongly endorses the establishment of a buffer range above the regulatory minimum capital requirements for large, internationally active banks so that capital distribution constraints would be imposed on the bank when capital levels fall within this range. ICBA supports raising capital requirements for the trading book and complex securitization exposures of large banks, a major source of losses for many large, internationally active banks, and for strengthening the capital requirements for counterparty credit exposures arising from derivatives and securities financing activities.

With respect to the Committee's recommendations regarding raising the quality, consistency and transparency of the capital base, ICBA thinks it is important that the Committee clarify that these proposals are focused on the large, internationally active banks and that smaller, less internationally active banks be exempted. If these rules were applied to community banks and bank holding companies, an important source of Tier 1 capital—trust preferred securities—would be disallowed. ICBA still maintains that the U.S. agencies should reappraise its use of the Basel II Advanced Approach and that the largest financial institutions in the United States that are now considered "too big to fail" should be subject to a more stringent set of leverage and risk-based capital requirements than other institutions.

ICBA appreciates the opportunity to comment on the Basel Committee proposals. If you have any questions about our letter, please do not hesitate to contact me at 202-659-8111 or Chris.Cole@icba.org.

Sincerely,

/s/ Christopher Cole

Christopher Cole
Senior Vice President and Senior Regulatory Counsel