Banesco
HERE WITH YOU

October 22, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429
**Delivered via email comments@fdic.gov**

Re: Basel III Capital Proposals

Dear Mr. Feldman:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

Banesco USA, a minority-owned bank located in Coral Gables, Florida focuses on small- to medium-sized businesses, small entrepreneurs and serves individuals who invest in our local community. Since being chartered in 2005, the bank has grown to over $700 million in assets and has a network of seven branches including one in Puerto Rico.

Banesco USA, like most other community banks in our country want to make sure we are able to continue serving our communities in the same ways we have in the past. A strong economy is dependent on job growth, and job growth is dependent on the availability of capital, which banks provide, to fund these small businesses in our community.

The following items are areas of the proposal in which I have concerns:

**I. Requirement that gains and losses on available for sale securities must flow though regulatory capital.**

Most community banks have significant gains in their investment portfolios as we are in a period of unprecedented low interest rates. This proposal would have a short term impact by increasing our regulatory capital. As interest rates begin to rise, this short term positive impact to regulatory capital would be quickly

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

eliminated causing a dramatic change in regulatory capital due to market conditions and not representative of the bank's actual equity. This proposal will introduce a significant amount of cyclicality and volatility into the banking system which is contrary to the intended goal of the proposal.

Like many other banks, Banesco USA could be forced to reduce the size of our balance sheet as the economy begins to improve, simply because of a rising interest rate environment. This could serve to undermine an economic recovery as community banks reduce lending and concentrate on pulling back to manage and maintain acceptable capital ratios. The most affected customers will be the small businesses and consumers by the reduced availability of credit.

As of June 30, 2012, our Tier One Capital was 17.30%. Banesco USA has always believed in maintaining strong capital to fund diversified prudent growth for sustained profitability. Based on a 300 basis point increase in interest rates, our Tier One Capital would drop to 11.20%. Even though this may be deemed well capitalized, it is definitely headed in the wrong direction and would potentially cause regulatory scrutiny and reduced lending activities. The resulting change to capital represents nothing except change in the interest rate environment.

Additionally our capital is related to our legal lending limit. Generally stated, a bank's legal lending limit increases and deceased in relation to capital. In smaller community banks such as Banesco USA, many customers borrow close to our current legal lending limit. Under the scenario explained above, the significant decrease in capital would have a significant effect on the bank's legal lending limit. The bank would be vulnerable to losing customers to larger financial institutions and thereby reducing our income and ability to replenish capital through retained earnings.

The most probable reaction of Banesco USA will be to sell all of our AFS securities and to place all future purchases in HTM. This will eliminate the cyclicality and volatility of the proposal, but it would also eliminate our ability to manage our investment portfolio through different interest rate and economic cycles, a core tool to offset the inherent rate risk in our loan and investment portfolios.

## II. Increased risk weighting for residential mortgage loans

Banesco USA provides a significant number of mortgages in the community we serve. This proposal will make mortgages more difficult to obtain in most markets, such as those typically served by community banks like Banesco USA. The mortgage loans Banesco USA usually has in its books must be variable in some form or another. Either ARMs or balloon terms are necessary as a tool to enable us to manage interest rate risk. The typical community bank like Banesco USA cannot book and maintain a 15 or 30 year fixed rate loan due to the interest rate risk inherent in those loan types. Requiring higher risk ratings for those loans and therefore requiring more capital will increase the cost of the credit and reduce the availability of the credit in our markets.

## III. Change in risk weighting for home equity and second lien loans

Home Equity lending is one of the only remaining consumer lending functions that has not been taken over by non-bank or shadow banking system. The punitive risk weights of up to 200 percent will both increase the cost of the credit to the consumer and have the effect of restricting the availability of consumer credit. The risk weights in excess of 100 percent are intended to have the bank hold additional capital buffer against the risk associated with the respective loan. This capital buffer is not necessary; the Allowance for Loan & Lease Losses analysis includes analysis for all risk factors including LTV, the impact of credit scores, delinquencies and local market conditions. Basel III will cause community banks to have higher capital levels, which are already at historically high levels, and will reduce return on capital and make raising capital next to impossible.

## IV. New rules regarding "High Volume Commercial Real Estate"

This rule will tighten up underwriting and structuring of these transactions between banks. However, it will reduce the number of development projects nationwide and may cause many community banks, including Bansco USA to turn away from deals that it might have been able to participate in before. Banesco USA will strive to make sure that every development project that we book on our books falls in the 100% category. The administrative burden of assigning a risk rating to every single loan based on all of the criteria and the exceptions provided in the rule is a concern for management. To accomplish this task the bank will have to increase staff and implement systems enhancements, which will reduce return on capital.

## V. Proposal to increase risk weights on delinquent loans

Due to Banesco USA prudent underwriting standards it is fortunate to have very few delinquencies at this time that would cause this rule to affect the bank. That could change based on economic conditions. With this rule banks are being asked to set capital aside twice because banks already set aside reserves for loans that fall into a past due status of this severity. The risk related to the problem loan should continue to be managed through the loan loss reserve guidance and not by adding additional capital requirements. With this rule the bank will increase its aggressiveness to move loans that become 90 days past due off the balance sheet and reduce the willingness to work with the borrower to remediate issues.

In Conclusion, the proposal as it is currently written will greatly impact Banesco USA in the following ways:

1. It will significantly increase the amount of capital Banesco USA will need to hold above and beyond the increase, which would occur as a result of the increased

"capital ratios". Each item I have detailed above will either increase the bank's risk based assets or it will decrease the amount of bank capital and reduce lending capacity. This is with no change in the way Banesco USA does business.

2. Banesco USA does not have the ability at this time to ascertain the full impact of Basel III because of the amount of work that will be required to understand the rules, train staff on how to apply the rules to our balance sheet, implement the coding of each individual loan in our portfolio with the new risk weights, reprogram our core processing software to handle the new coding requirements and then create the necessary reports to analyze the data. Banesco USA will be required to hire consultants to help work through the front end of the process to assure that we have accurate data and to assure that our staff fully understands how to code loans properly.

The cumulative effect of each of the items reflected above will have a severe impact on most of the community banks in our country. I strongly urge you to consider this impact and possible exemption for most community banks from these rules. Community banks need to be able to continue to serve their local communities and to help strengthen their local economies.

Thank you for your consideration.

Sincerely,

M. Escotet

M. Mercedes Escotet
Chief Financial Officer &
Executive Vice President