



September 25, 2012

Robert E. Feldman, Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429  
Via email at [comments@fdic.gov](mailto:comments@fdic.gov)

Re: FDIC RIN 3064-AD95, FDIC RIN 3064-AD96, and FDIC RIN 3064-AD97

Dear Mr. Feldman:

This letter is in response to the proposed Basel III Notices of Proposed Rulemaking issued in June, 2012 requiring all banking organizations to comply with Basel III pronouncements and standardized approach NPR.

First, I would like to emphasize that I am in favor of strengthening the quality and loss absorption safeguards in the financial institutions sector. Our bank presently has more than 8.40 percent tier 1 capital, risk-based capital of more than 12.4 percent, and we are building our loan loss reserves (capital conservation buffer) to above 2 percent of total loans. Our intentions are to hold capital well above the minimum required levels even when loan demand recovers. I don't have a problem with the proposed increases in minimum capital requirements. However, several areas are troubling and I believe unworkable, especially for community banks that have limited access to capital and, in most cases, have high concentrations in certain asset types.

A major area of concern is the inclusion of gains and losses on available-for-sale debt securities in the common equity tier 1 computation. Currently, our bank has a \$108 million bond portfolio with approximately \$2 million of unrealized gains. In a "rates up" 3 percent shock test, this would mean we would have a \$6 million loss. This loss from bonds would effectively negate 2 years of earnings addition to capital. In the years in which the capital buffer restrictions are employed, our bank would not be able to pay dividends or disburse any discretionary bonuses. In addition, increases in the rate cycle generally correspond to increases in economic activity (loan demand). Therefore, with increased loan totals and losses in "available for sale", a bank could shrink its capital ratios for several years. (Obviously, a bank would then cease lending entirely, causing our local economy and community to contract).

Further outcomes could be as follows:

- In order to avoid market swings, banks will "shorten up" durations of their investments. The outcomes will be less yield and thus lower earnings.
- A bank will have to understand how different asset classes react to interest rate swings (i.e., mortgage-backed securities versus Treasuries or municipals versus Treasuries). This will cause stress in certain markets and may shut off credit completely to certain groups and maturities. Our bank is a big purchaser of nonrated, bank-qualified, local municipal bonds. Many times we purchase the longer-term, 10- to 15-year bonds. If the troubling provisions stay in place under this proposal, a likely scenario would be to no longer support "long maturity or local bond issuances."
- Given the precarious position our government is in, a downgrade in the federal government credit rating appears likely. The result could be devastating on bank capital.
- Non-recognition of the "tax effect" of both gains and losses distorts the true gains or losses as they relate to capital.
- Banks may elect to reclassify to "held to maturity." Liquidity and liquidity ratios would be distorted if this occurs.

One issue that continues to befuddle me is the limitation of 1.25 percent of risk-based assets in the loan loss reserve. Why would limitations be placed on an allocation of capital that serves as a “capital conservation buffer”? Banks should be encouraged to act in a countercyclical fashion, building reserves with pretax dollars during good times. This entire proposal is about more capital. For community banks, this is the best way to accumulate total capital. It should be encouraged, not discouraged.

The capital conservation buffer and its restrictions are probably the most devastating to community banks and the communities in which they operate. I am going to utilize the fully implemented transition period of 2019 which requires a total capital ratio of 10.5 percent in my scenarios. The following are some observations and likely scenarios for community banks.

**Scenario #1:**

As to increased risk weighting for residential mortgage loans:

Our bank provides a significant number of mortgages to people living in the 7 communities we serve. We are one of the largest community bank providers of mortgages in these markets. This proposal along with some of the proposals being considered by the Consumer Financial Protection Bureau threaten to significantly reduce or even drive our bank away from this very important business segment.

Our underwriting has been very strong as opposed to many of the non-bank mortgage lenders who were the real culprit in the housing crisis. However, the community banks are being forced to pay dearly for the sins of others. The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that would be considered much riskier in our experience. This one section of the proposal will definitely reduce the number of loans that we are able to provide in our markets.

**Scenario #2:**

As to requirement to hold capital for credit enhancing representations and warranties on 1-4 family residential home loans which have been sold into the secondary market:

In the 10 years we have been involved in the mortgage loan business, we have never had to repurchase one loan. This rule as presently drafted threatens to drive every community bank in the country out of the mortgage lending business. It probably means that all of the business would move to the big banks assuming they have a way around the rule. I can't bring myself to believe that is what is intended.

**Scenario #3:**

The majority of community banks in Missouri have major concentrations in agriculture. Today, agriculture is in a boom phase. In fact, several regulators have expressed concern that agriculture may be the next bubble. Any change in the risk rate would be devastating to our banks and communities. A change in risk rate from 1 to 2 would double the size of a bank's portfolio. Therefore, a \$100 million bank with 9 percent, or \$9 million, in tier 1 capital, a 12 percent risk-based ratio, and a \$50 million agriculture portfolio would be devastated by the change. By increasing the risk rate from 1 to 2, the bank then would have \$100 millions in risk-weighted assets. The bank's capital ratios would be cut in half and would no longer be considered “well-capitalized”. The bank's reaction would be to shut off agriculture loans and reduce its exposure in this area. Obviously, this would hurt rural communities and the entire agricultural industry.

**Scenario #4:**

Twenty percent of our loan portfolio is in balloon mortgages. We make these loans to people in our communities who, for some reason, cannot qualify for traditional secondary mortgage loans. We have never had any significant risk issues with these types of loans. Under the proposed capital restrictions whereby, balloon loans are weighted double, we would have to quit making these loans in our communities. These borrowers are good borrowers. The new rule would eliminate the ability for this niche market to buy a home. We are in a rural market. The secondary market cannot loan as readily on larger tracts of land. The balloon loan “penalty” will dry up the major source of funding for borrowers who don't fit secondary market guidelines.

**Scenario #5:**

A bank could have a great year, growing loans with record profits, but under the capital conservation restrictions, the bank would be unable to pay bonuses or pay its stock loan or, in our case, being an S-Corporation, pay dividends to pay taxes. This would be bad not only for the bank stock lender or shareholders, but also for key employees in the bank. Our ability to attract and retain good employees is difficult enough in today's environment. Why put another serious impediment in front of us?

The requirement for more capital with restrictions on growth, dividending, and bonuses coupled with bond volatility will have a negative long-term effect on earnings, attracting and retaining quality personnel, and capital formation. We do not want to move in this direction. Community banks are the heart and soul of our local communities. Restricting their activities will have a seriously negative impact on our communities.

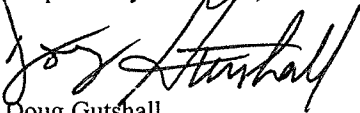
Lastly, risk-rating and asset groups are picking winners and losers. I don't believe regulators should be determining which sectors receive funding.

As stated at the opening of this letter, I am not opposed to increasing the minimum capital requirements. I also acknowledge that each bank can have different risk profiles and should have sufficient capital to provide the safeguards needed. I also think our examiners have done a reasonably good job identifying problem areas and management deficiencies. Having been in the banking industry for more than 33 years, I have seen several severe business cycles and I can tell you that in some cases having more capital would not have helped. When you have values chopped in half over night, you are going to lose some banks. Basel III was meant for large complex banking structures, not smaller community banks. The proposed restrictions are too punitive and the timing could not be worse. Right now, we need banks to lend, not restrict lending.

After experiencing the last downturn and the resultant and current slowdown, I am sure the majority of banks are overcapitalized, which may lead one to conclude that most banks are in compliance and the NPR to revise and replace current capital rules should not be a problem. I believe, however, that this viewpoint is very short-sighted as we all have built capital at the request of our regulators. We are also at a low point as it relates to loan demand. A better scenario would be to review past recoveries to help determine what is needed to get our economy moving again and to measure necessary restrictions against more robust economic times.

In summary, the implementation of Basel III as proposed would significantly and negatively alter the way community banks serve their customers and communities and is unacceptable as we strive to improve and grow the American economy. Thank you for your time and consideration.

Respectively submitted,



Doug Gutshall  
Regional President/Co-CEO  
Platte Valley Bank of Missouri

Cc: OCC  
Federal Reserve Board

DG/lt