WOOD & HUSTON BANK

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September 26, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E. Street, SW
Mail Stop 2-3
Washington, D.C. 20219

Re: Basel III Capital Proposals

Ladies and Gentlemen:

I would like to take this opportunity to comment on the Basel III capital proposals that were recently approved by your three banking agencies.

Our bank was chartered in 1874. We have our roots in Marshall, Missouri, a small agriculturally based community. We have also branched out to four other distinct communities in Missouri. Our bank has been successful and grown to approximately $500 million and we are strongly capitalized. Our success mirrors the success of the communities that we serve.

I am sure you will hear this from many community bankers, but I am going to say it as well, we are the lifeblood of the communities that we serve. I believe nearly all prudent bankers agree with strengthening capital requirements to make our industry stronger in the future. I know that I do. However, the Basel III proposals go too far. It is my fear, like that of many other community bankers, that these proposals are going to severely restrict our ability to provide the capital to our customers and potential customers to keep our economies strong and growing.

There are several areas of the proposals that concern me, as follows:

- **The requirement that unrealized gains and losses on available for sale securities must flow through to common equity.**

  Accumulated Other Comprehensive Income (AOCI) for Wood & Huston Bank is comprised almost completely of unrealized gains and losses on securities held as available-for-sale, predominately municipal securities issued in our home state and contiguous states. Inclusion of AOCI in Tier 1 capital calculations could subject us to increased capital volatility from unrealized gains and losses due to changes in benchmark interest rates. However, such unrealized gains and losses should be from credit risk and not primarily from fluctuations in a benchmark rate. This exposure to regulatory generated volatility will likely drive us to hold an extra cushion against the Tier 1 capital and cause us to require higher return hurdles from state and local issuers. The impact from this on all financial institutions could cause total demand to decrease, the market to become less liquid, and rates to increase for state and local issuers.

  Currently, interest rates are at historic lows and many community banks have positive AOCI resulting from net unrealized gains. These net unrealized gains are primarily due to the low interest rates and will become net unrealized losses as rates rise. This will "create" millions of dollars of regulatory volatility in capital to Wood & Huston and untold billions to the banking system. This is true even though most community banks do not actively trade these portfolios and, although available-for-sale, will hold the securities to maturity without a gain or loss realized. Through accounting method and regulation, banks will have excess capital in low rate environments and understated capital when rates are higher.

  The inclusion of AOCI in the Tier 1 capital calculation could negatively impact our asset and liability management by discouraging our investment in liquid securities with appropriate durations to match our balance sheet. The accounting methods are highlighted while liquidity and interest rate management best practices are discounted. A few strategies that could be "rational" for banks under the proposals are limiting investments in longer duration assets, including Fannie and Freddie mortgage-backed securities, shortening the maturities of debt securities, and avoiding municipal debt offerings. There are even examples where a bank would be required to hold more than twice as much capital against a 10 year U.S. Treasury note as it would against a 10 year, fixed rate, private commercial and industrial loan. This is a clear distortion of risk due to accounting method and regulation.

  Given the inherent volatility and clear negative impacts on risk and balance sheet management that would result from including AOCI in the Tier 1 capital calculation and the potential for unintended consequences, I urge you to retain the AOCI filter.

- **Increased risk weighting for residential mortgage loans.**

  Our bank, like most community banks, provides a significant amount of mortgage loans in the communities that we serve. We often provide ARM loans and balloon loans to customers that either don't want or don't qualify for 15 year or 30 year fixed rate mortgages. Normally the reason that the loan doesn't qualify for the fixed rate market has nothing to do with credit quality or the customer's ability to repay. It has to do with the type of property being financed or a lack of comparable sales to support an appraisal. These ARM and balloon loans are not any more risky that the "conforming" loans described in the proposals. Of course one of the most important reasons that we make these types of loans is that we want to manage our interest rate risk by not placing 15 to 30 year loans on our books.

  Increasing the risk ratings on ARM and balloon loans, as well as restructured loans (that actually improve the bank's chances of collection), and not giving credit for private mortgage insurance (PMI) will all have negative unintended consequences on customers and communities. Due to the onerous requirements in these proposals, banks like ours will have to limit the types and numbers of mortgage loans made in the communities that we serve, thus reducing credit availability in an area that is critical to our economic recovery. The ironic thing is that ARM and balloon loans have typically been a low risk lending area for our bank.

  Finally, the newly proposed risk weights for residential mortgage loans will create an enormous amount of work and expense for community banks, with no clear benefit to the safety and soundness of the banking industry. Our bank, like most others, will have to hire additional staff just to keep up with the requirements to risk weight individual loans. No affordable automated process to accomplish this task exists for community banks, and even if it did, initially risk weighting the loans is just the first hurdle. The risk weightings will have to be continually reevaluated for each loan based on changes in collateral values, loan pay downs, and past due status. These increased costs will undoubtedly be passed on to customers.

- **Change in risk weighting for home equity and second lien loans.**

  Our bank has been providing junior lien loans to customers in the markets that we serve for decades. These loans have resulted in very few losses and very low past due ratios, and they are an important funding source for our customers who want to use the equity in their homes to their advantage. Applying risk weightings of 150% to 200% on these loans will restrict funding and increase costs to our customers.

The task of just identifying which loans will be classified as Category 2 loans in our portfolio will require many man hours. Applying the Category 2 loan definition to loans that we carry both the first and junior liens on will be even more onerous. It will require a manual review of all of our mortgage loans to determine the appropriate category designation. Given the narrow definition of Category 1 loans, it is likely that most of our first lien mortgages in which we also have a junior lien loan will be classified as Category 2 loans. This will limit our ability and desire to make junior lien mortgages, and again, we will have to pass the increased costs on to the customer.

- **Increasing risk weights on delinquent loans**

  Increasing the risk weight of a nonresidential loan over 90 days past due to 150% is a double dipping of required capital. We now address the additional risk of these types of loans through allowance for loan and lease losses. This proposal would have us provide additional capital over and above the reserve.

  The effect of this part of the proposal will be less of a willingness for banks to work with borrowers that become over 90 days past due, thus increasing our potential for a larger loss and reducing the number of these situations that end up working out positively for the bank and the customer.

As I wrote earlier, we are in support of strong capital requirements for all banks, but as I have pointed out, the Basel III proposals are very expensive, hard to implement, and will be a detriment to our customers and communities. Community banks did not cause the "great recession" and we should not continue to punished as if we did. I urge you to either scrap Basel III and go back to the drawing board or to exempt community banks under $10 billion from these rules.

Sincerely,

Barry R. Randolph

Barry R. Randolph
President & CEO

cc: Senator Roy Blunt
Senator Claire McCaskill
Representative Emanuel Cleaver
Representative JoAnn Emerson
Representative Billy Long
Mr. Wayne Abernathy, American Bankers Association
Mr. Max Cook, Missouri Bankers Association