

1341 Pilot Grove Rd.  
P.O. Box 5 • Pilot Grove, Iowa • 52648

September 24, 2012

Jennifer J. Johnson, Secretary  
Board of the Governors of the Federal Reserve System  
20<sup>th</sup> 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

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

Re: Basel III Capital Proposals

Dear Ladies and Gentlemen:

I appreciate the opportunity to provide comment on the Basel III Proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I understand your responsibility to ensure the banking industry can weather future financial storms and the role of increased capital requirements. However, I have concerns about some of the proposals which have been approved by the agencies and placed out for comment.

Pilot Grove Savings Bank was founded in 1911 in Pilot Grove, Iowa, an un-incorporated village with a current population of less than 25 people. We have grown to over \$400 million in assets and employ 75 full-time people in the eight surrounding communities we serve. Our bank shares are widely held in our community. Our largest shareholder is an Employee Stock Ownership Plan which owns 25% of the shares. No individual shareholder owns more than 5% of the stock. Our loan mix is approximately 40% agricultural and 40% residential real estate and consumer. The balance is commercial loans. We are dedicated to the people and communities we serve and realize they are the reason our business continues to grow. Our bank and our employees are an integral part of our communities and our communities are the life blood of our bank.

We are no different than most of our peers in community banks throughout the country. We want to serve our communities in the manner they expect and rely on. Our communities are dependent on Pilot Grove Savings Bank to provide the funding that leads to increased opportunity and a better quality of life for our friends and neighbors. Proposals to change the capital requirements are very concerning. While they appear to have no effect on the safety and soundness of our community bank, they at the same time will ultimately limit our ability to support our communities.

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

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<i>Pilot Grove</i>	<i>Houghton</i>	<i>Donnellson</i>	<i>West Point</i>	<i>Mt. Pleasant</i>	<i>Packwood</i>	<i>Winfield</i>	<i>Ft. Madison</i>	<i>Ft. Madison</i>	<i>Ft. Madison</i>
319-469-3951	319-469-6151	319-835-5131	319-837-6121	319-385-3822	319-695-5461	319-257-3321	<i>County Market</i>	<i>Downtown</i>	<i>West</i>
888-283-2265				888-385-2265	866-695-2265	800-943-3321	319-376-1336	319-372-1134	319-372-1545

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## **I. Increased risk weighting for residential mortgage loans.**

Our bank provides a significant number of mortgage loans to people in our markets. We are one of the largest providers of residential mortgage loans in our communities. Real estate values in rural Iowa are limited and the unique characteristics of each community we serve does not lend itself to a stringent standardized approach. As community lenders, we know the communities and the people in them. This personalized approach allows us to effectively and safely provide credit in markets others ignore. We have served this market successfully while maintaining non-performing loans in this category of less than 0.20%, an enviable asset quality standard by any measurement.

Our underwriting has been very strong as opposed to the many non-bank mortgage lenders who were the real culprits in the housing crisis. We lenders, who have every incentive to maintain asset quality because we hold those loans on our books, and have "skin in the game," are now being severely penalized for doing so. The new capital proposals relative to risk weighting of residential mortgages are much higher than other loan types which would, in our experience, be considered much riskier. This one section of the proposal will definitely reduce the loans we provide in our communities and it accomplishes nothing in reducing risk.

## **II. Proposal to increase risk weights on delinquent loans.**

We are fortunate. In spite of having one of the highest unemployment rates in the State of Iowa, we have few delinquencies at this time that would cause this rule to affect us. However, that could change as economic conditions change. Our agricultural market is dealing with the effects of an historic drought. Siemens Corporation, one of our leading employers, recently announced a lay-off of over 400 employees. The impact of this rule will provide us less flexibility to work with struggling borrowers and force us to be more aggressive in moving loans that become 90 days past due off our balance sheet.

We currently set aside reserves for loans which fall into a past due status of this severity. By also increasing the amount of capital we hold based on past due status, we are being required to set aside capital twice. The risk related to problem loans should continue to be managed through the loan loss reserve guidance and not by adding an additional capital requirement.

This rule would directly impact our ability to work with our struggling borrowers and because of the existing loan reserve would have no effect on the safety of our institution. Loan losses must be charged against the reserve and recognized as soon as they are identified. Reducing the ability of community banks to work with struggling past due borrowers when no loss is expected harms the borrower and nothing is gained.

## **III. Requirement that gains and losses on available for sale securities must flow through to regulatory capital.**

We are in an unprecedented period of low interest rates. We, like most banks, have significant gains in our investment portfolio. This proposal would increase regulatory capital for us in the short term. However, as interest rates begin to increase, this inflated capital would be reversed and could move dramatically in the other direction. Although nothing will have changed in our

bank's equity position, our regulatory capital ratios would change drastically. This proposal will introduce a significant amount of volatility into the system which is undesirable.

We have recently acquired two relatively large deposit accounts in our market – one for a county and the other for a city. Although we have excess deposits at this time, we are happy to have the business and provide a service to our local government entities. However, there was no competition for their accounts. Most banks are in the same position we are – excess deposits, insufficient loan demand, and a challenge to prudently invest additional deposits. This proposal will result in significant risk being associated with purchasing securities in the current low rate environment. If we can't invest the additional deposits we acquire, we will be forced to curtail growth or reduce the size of our balance sheet. Our communities would suffer if we are forced to discourage deposits, reduce lending and concentrate on shrinking to maintain capital ratios under the new proposal

We manage and analyze our AFS securities portfolio with an understanding of the implications of various interest rate change scenarios. We model and quantify the effect of rate changes on our balance sheet and income statement. Reducing our ability to hold our AFS securities until maturity, when its prudent to do so, provides no additional safety net for the bank. It will provide incentive, solely for the sake of the newly calculated regulatory capital ratios, to limit deposit growth and our securities portfolio. If we limit growth we limit our ability to invest in our communities.

I appreciate your desire and responsibility to enhance the financial strength of our industry. I support an increase in the amount of capital that banks hold as an important component of that goal. However, I don't believe the contrived regulatory calculations outlined in the proposals I have discussed will strengthen our industry as it relates to community banks. The unintended consequences will do real harm. Harm not just to our bank, but to our employees, our customers and our communities. I strongly urge you to be conscious of this impact and reconsider the Basel III proposals.

Sincerely,



Ted J. Vonderhaar  
President/CEO

cc: Senator Charles Grassley  
Senator Tom Harkin  
Congressman Dave Loebsack