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September 14, 2012

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, DC 20219

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

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").

As a $375 million community bank in the Midwest, Peoples Bank serves seven communities in Northwest Iowa and Southwest Minnesota. Similar to other community banks across the United States, Peoples Bank feels strongly that we play a critical role in the lives of the communities we serve. Historically, community bankers know and understand our small towns better than anyone else because our customers are also our neighbors and friends. We serve together on school boards, local charities, and service clubs. Our children attend the same schools, playing on the same sporting teams. It is this community spirit and community pride that allows us to believe in

[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.*

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our customers; thereby successfully and effectively providing loans and credit where large banks would not. Peoples Bank is no different. Over the past 5 years, we have been blessed with double digit loan growth; helping to expand our local economies. Unfortunately, we feel that the Basel III proposals would be a detriment to our way of doing business and would be a direct threat to the communities we serve.

While the intent of these proposals (increasing quantity and quality of capital, as well as harmonized rules for calculating risk weighted assets to enhance risk sensitivity) is well intended, unfortunately we are highly concerned with the unintended consequences that would most likely result from their implementation.

More specifically, Peoples Bank shares the following concerns in regards to the **Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions Proposal:**

Increased Capital Ratio Requirements

- Large publically traded financial institutions have an unfair advantage over smaller community banks as it relates to raising additional capital. With readily available access to public markets, large banks will be able to easily attract the new capital required. Conversely, Peoples Bank will be forced to rely on local investors and limited options. In the absence of readily available capital markets, Peoples Bank will need to limit our growth and lending, possibly even contracting, in order to maintain acceptable proposed capital levels thereby avoiding adverse impacts or regulatory scrutiny.
- Additionally, higher capital levels will automatically reduce returns to investors. This will no doubt incentivize capital to be pushed out of Peoples Bank to other industries as investors seek better returns relative to risk.
- We would respectfully ask you to consider implementing the new Basel III proposals for only the largest and more highly complex financial firms while allowing Peoples Bank and other community banks to continue to operate under Basel I rules.

Revisions to Definition of Capital

- The exclusion of trust preferred securities as Tier 1 capital would be highly detrimental to Peoples Bank. Peoples Bank has built a long term business model on the premise that trust preferred securities were acceptable Tier 1 capital. Failure to maintain this position would in effect be "changing the rules of the game" mid-stream. Our long

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term business model included two trust preferred issuances to acquire troubled financial institutions. Without access to these instruments, the FDIC would potentially have recognized losses it was able to avoid by this merger and acquisition activity. Phase out and removal of this capital will likely result in a large reduction of this activity; as previously considered well capitalized banks will immediately be taken out of the troubled bank acquisition market.

- It was equally troubling to see that the new proposals would permanently grandfather in TARP equity. The implicit message sent to community banks across the country is that government capital injected into large "too big to fail" institutions is better or more readily acceptable than trust preferred securities that community banks acquired by following the rules.
- Inclusion of unrealized gains and losses on all available for sale securities in the newly proposed Common Equity Tier 1 Capital would also have far reaching repercussions. Given the current rate environment, any security purchased would most likely reflect an unrealized loss when the rate environment changes. Current examination procedures require banks to shock test the interest rate risk models by 400 to 600 basis points, signaling that regulators have valid concern that rates could rise quickly. These large rate increases would result in large decreases to capital based on these new proposals, even if banks had no intentions of recognizing these losses but rather chose to hold the security for the income stream until maturity. As a bank that is very active in these markets, we would dramatically reduce our purchases of longer term securities. Given other community banks would most likely follow the same strategy; city, state, and local municipalities would lose affordable access to funding at a time the Federal Reserve is trying to stimulate these markets via "Operational Twist". This would certainly prove to be counter-intuitive.
- We would respectfully ask you to consider grandfathering previously issued trust preferred securities as Tier 1 capital for banks between $500 million and $15 billion in assets in the same manner the Collins amendment did in the Dodd-Frank Act.
- We would also respectfully ask you to consider striking the inclusion of unrealized gain or losses from any proposals to Tier 1 capital

Peoples Bank shares the following concerns in regards to the **Regulatory Capital Rules; Standardized Approach for Risk-Weighted Assets; Market Discipline, and Disclosure Requirements Proposal:**

- Implementation of the enhanced risk weighting of assets will result in banks around the country selectively lending only to the highest of quality credit risk customers. Those borrowers currently experiencing high loan to value ratios as a result of depressed

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home values, will no longer qualify for traditional home equity loans. Once again, at a time when the government is encouraging us to lend more, we would be enticed, or forced, to lend less and only to the best borrowers.

- It is our understanding that the new risk weighted percentages apply to loans at the time of booking and carries at that level throughout the life of the loan. This does not take into account the regularly scheduled paydowns, nor any potential large one time principal payments. Thus loans that have changed materially would still be considered "risky". Furthermore, it would not be practical or cost effective to track loans on a loan by loan basis. This would result in huge cost burdens to community banks as they would need to update software systems and add staff to accommodate any such changes.

To recap, Peoples Bank is opposed to several of the proposals included in Basel III. We do not disagree that larger complex organizations need new rules to reduce their risky behaviors. We strongly feel that this "one size fits all" approach hurts those very organizations and institutions that have diligently fought to lend, support, and better our communities. Please do not let the actions of a few negatively impact so many.

Respectfully Submitted,

Joe D Van Tol
CEO & Chairman of the Board

Al Vermeer
President & COO

Lynn Van Beek
Chief Financial Officer

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