From: Joshua M. Guttau [mailto:jguttau@tsbank.com]
Sent: Monday, October 15, 2012 12:36 PM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

October 15, 2012

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Thank you for 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 represent the interests of Treynor State Bank, a $250 million bank headquartered in Treynor, Iowa. I am writing this letter today to express concerns about both the Basel III proposal as well as the “Standardized Approach” proposal.

I understand the overall goal in the Basel III proposals of strengthening capital requirements so banks can weather the storms of downturns economic cycles inevitably bring, but these rules in their entirety are more appropriate for large complex financial institutions competing in a global marketplace than for the business practices of our local bank. We respectively ask that both the Basel III and the Standardized Approach proposals be repealed for the following specific reasons:

Basel III:
1. Requirement that gains and losses on available for sale securities (AFS) must flow through to regulatory capital. This proposed rule requires all unrealized gains and losses on AFS to “flow through” to common equity tier 1 (CET1) capital – which is a new category of tangible capital within the rule. Even daily changes in AFS securities must technically be accounted for in regulatory capital. Because interest rates, particularly on debt securities, can fluctuate frequently, the proposed rules will introduce significant volatility into capital calculations.

The timing of this proposed rule is also greatly compounding the problem, since we are now at a period of historically low interest rates. As interest rates begin to rise, capital under this proposal will move rapidly in a negative direction, as while nothing will have changed regarding the bank’s tangible equity, regulatory capital ratios could be reduced rapidly. A 300 basis point rise in interest rates for example would reduce the value of many bank’s securities portfolios and reduce CET1 significantly – our bank could possibly see a 50% decrease. This proposal therefore will introduce a significant amount of volatility into the system which is the opposite of what the goal should be. This will also cause our bank to reduce our balance sheet as the economy improves, simply because of the upward movement in interest rates.

As for credit risk taken in the investment portfolio, existing rules for other-than-temporarily-impaired (OTTI) investments provide a mechanism for credit losses to be reflected in capital. A natural reaction to this new proposal will be for our bank to either hold fewer securities or reclassify existing portfolio assets to hold-to-maturity (HTM). This conversion may reduce the volatility of the proposal, but it comes at the enormous cost of eliminating our ability to manage our investment portfolio through different interest rate and economic cycles – and is a core tool to offset the interest rate risk in our loan and investment portfolios. We would respectfully ask this section of the proposal be eliminated.

2. Elimination of trust preferred securities (TPS). Many financial institutions hold these instruments as a very cost effective source of capital, as most community banks have much more limited access to capital markets than larger regional or national financial organizations. This rule also is a complete re-write of the Collins Amendment to the Dodd-Frank Act (DFA), which would have grandfathered TPS for institutions between $500 million and $15 billion. The DFA never intended for this type of instrument to be completely phased-out for community banks - and will reduce our ability to grow our balance sheet to better serve our customers if we have to concentrate on filling capital holes caused by changes in regulation, instead of focusing on funding of growth opportunities in our communities. This proposal seems to lie in direct contradiction to not only the statute, but also our national goal to spur job growth. We would ask this section to be made consistent with the requirements under the DFA.

Standardized Approach:
3. Proposal to increase risk weights on delinquent loans. Like many banks, we are fortunate with careful underwriting to have a very low delinquency rate currently – but this could change quickly based on economic conditions. This rule, which drastically increases the risk weights for past due loans, causes concerns as our bank already sets aside reserves for delinquent loans. By proposing to also increase capital we hold on past due loans, we are basically being required to

set aside capital twice. Risk regarding past due loans should continue to be managed through loan loss reserve guidance and not by layering on an additional capital requirement.

This rule if finalized would require us to increase our aggressiveness in moving loans past 90 days delinquent off of our balance sheet – and make us much less likely to pursue loan workout strategies and instead proceed directly to foreclosure sale.

Conclusion:
In conclusion, there are other aspects of the BASEL III proposal that we are concerned about, but for our specific bank the three listed in this letter are those at the top of our list. Our bank has no way to completely ascertain the full impact of this massive proposal because of the amount of work it will take to understand the rules and how they apply to our balance sheet. We will likely be required to hire a team of consultants to implement the re-assessment of each individual loan in our portfolio with the new risk weights, re-program our core processing software to handle the new coding requirements and then create the necessary reports to analyze the data.

As I stated above, while I support the overall goal of strengthening the financial system by increasing the level and quality of capital that banks hold, these rules are designed much more for large multi-billion dollar global financial institutions than for the business practices of community banks. We urge the agency to repeal this proposal so we may continue serving our communities and help strengthen our local economies.

Sincerely,

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