FIRST STATE BANK
HAWARDEN

October 15, 2012

To: Federal Deposit Insurance Corporation

To Whom It May Concern:

Please accept this letter as formal comment concerning the Notices of Proposed Rule Making: Regulatory Capital, more specifically Basel III and Standardized Approach NPR. We strenuously ask that community banks be excluded from these proposed rule changes as we believe that they will be extremely detrimental to the existence of the local community bank model and thus have a dramatic impact on the smaller businesses and rural markets to receive effective financial services.

We believe these proposed rules, if implemented, will have a devastating impact on our ability to complete our organization's mission of creating perpetually locally owned banks that focus on economic and culture growth within small rural communities. We have been successful in returning our rural $46 million bank to local ownership. The ownership structure has been modeled after early banking structures where community members and community bankers have pooled their resources to provide the capital for the bank. This model has been successful because it relies on the expertise of local bankers to serve the rural market as well as returning profits to the community ownership for reinvestment back into the community.

In 2010 our holding company furthered its mission by partnering with other rural community members and bankers to acquire the bank located within their communities. The result is two community banks with four total locations, all in communities under 2500 population. There are several key factors that make this mission achievable and those key factors are threatened by the proposed capital rule changes.

BASEL III

A major premise of this structure is that local investors can provide capital and get a reasonable return on investment while investing in the future of their community. Increased capital requirements will reduce return on equity and make it more difficult to acquire local capital. Local capital is critical to our economy as the return on that capital stays local, which we desperately need in rural communities. We were successful in 2010 in raising $5,000,000 in local capital under the Basel I rules. As a result, we were able to keep a rural $60 million bank under local ownership and management and from becoming a branch of a much larger bank. Under Basel III, return on equity would be greatly reduced putting our capital raising ability in jeopardy.

Another critical piece for our model is the Subchapter S structure. Our great hope is to further community banking by providing continual opportunity for local bank ownership to younger members of the community and bank management. In order to transfer the ownership from older shareholders to younger shareholders, older shareholders need to be willing to sell their shares of stock. A C corporation structure adds another layer of taxation in the event of sale of shares. Under a C corporation, shareholders

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can avoid this layer of taxation by holding their shares until they die, thus creating a hold vs. sell mentality. Under an S corporation structure, older shareholders can sell their shares to younger local persons without the fear of double taxation.

Under BASEL III, Subchapter S corporations are disadvantaged when compared to similar C corporations. For instance, a profitable C corporation bank with a Capital Conservation Buffer of 1.82% will be able to meet their federal tax obligations and still have availability to be able to pay dividends and/or discretionary bonuses equal to 40% of the bank's eligible retained income.

By contrast, a Subchapter S bank with the identical Capital Conservation Buffer of 1.82% will be allowed to meet its federal tax obligations on the bank's pass through income by paying a dividend which could use up the available 40% allowed dividend amount. The Sub S bank would not be able to pay additional dividends or discretionary bonuses. We believe that this is an unlevel playing field that damages the bank and holding company's ability to transition the bank to younger ownership.

We also believe that the Capital Conservation Buffer and possible dividend/discretionary bonus limitations will affect our bank holding company's access to credit. Whereas large banks do not rely heavily on bank stock loans for growth and expansion, small rural banks do.

Under the current rules, our bank holding company is able to obtain credit for bank stock loans with loan covenants that focus on cashflow ability and maintaining a 'well capitalized' bank. This system has worked and worked well. The proposed Capital Conservation Buffer and possible dividend/bonus restrictions will likely cause bank stock lenders to require capital levels that are even higher than the buffer.

In all likelihood, bank stock lenders will recognize that if a bank temporarily drops below the 2.5% Capital Conservation Buffer, dividends that are required for debt service could be limited. The result will likely be that bank stock lenders will require that capital exceed the 2.5% Capital Conservation Buffer so that dividend cashflows are not disrupted. More capital requirement will reduce ROE and make capital raising even more difficult. Again, this concern is compounded for Sub S banks for reasons previously addressed above.

We also believe that the BASEL III proposal will have a dramatic impact on the ownership succession plan of our bank organization. As previously mentioned, we have established a mission to perpetuate local ownership in rural communities. Beyond the economic benefit of profits staying local, there is tremendous benefit of having the bank service providers vested in the bank's ownership. There is a higher level of commitment to providing services successfully when bank management has skin in the game. No one will know or care about the local consumers and their success more than vested community bankers.

Additionally, one of our great dilemmas in rural communities is aging bank management. Under our model, we are striving to involve younger members of the banks' management in active ownership. The hurdle that we face is helping these younger members of management to gain the financial wherewithal to be succeeding owners in the bank. We have chosen to share bank profits with these younger members of management using discretionary bonuses. BASEL III puts this method in jeopardy. While we understand that there have been abuses in payment of discretionary bonuses, it seems unfair to limit all discretionary bonuses when some may actually assist in elevating prudent management.

Because of these items discussed, we see BASEL III as a great hindrance to the community banking model. We also see the proposal as being especially favorable to those larger banks that want to absorb market share in rural areas at the expense of the struggles of rural community banks

STANDARDIZED APPROACH

Concerning the Standardized Approach proposal, we believe the proposal will also be very damaging to our bank's ability to function and compete effectively. Our bank will be impacted by the proposal's approach to 1-4 family residential real estate lending and past due exposures. Depending upon final rules, the banks may also be impacted by the proposal's handling of off balance sheet items (primarily purchased participations).

Of primary concern is the proposal's handling of 1-4 family residential real estate mortgages. Our bank historically has served our local rural market by offering residential real estate financing. Most of these loans are loans that are not of ample size to attract most secondary market lenders. Bank officers/decision makers meet directly with borrowers to discern a proper loan structure, beneficial for both bank and borrower. More times than not, the structure includes a balloon feature with the loan.

First State Bank of Hawarden has been making 1-4 family loans with balloon features for over 20 years. During this period, interest rates have both increased and decreased. During the past 10 years, First State Bank has made 81 local balloon mortgage loans averaging $67,668.00 per loan while suffering only one loss on a 1-4 family real estate loan. That individual loss resulted in a charge off equal to .15% of the 1-4 family residential real estate portfolio. We believe that is a high standard of success for both the bank and our local borrowers.

The bank's success in residential real estate lending has been the result of meeting its customers face to face and balancing what is good for the bank and the customer. The standardized approach, as proposed, will make it very difficult to tailor loans that meet the customers' and bank needs in a market that will get little attention from larger and more complex lenders. The additional capital required to fund 1-4 family mortgages with balloon features will likely drive small rural banks away from residential real estate lending and thus restrict access to credit for rural consumers.

In addition, the complexity of the proposed Category 1 vs. Category 2 and risk weighting schedule will create an increased burden for tracking and monitoring required capital levels. We also believe the risk weighting schedules based upon loan to value may not truly reflect the risk in the loan or the need for more or less capital. In some cases, the bank may tailor a loan by taking additional collateral to offset a limited down payment. The actual exposure or risk to capital may be less on this type of loan than a qualifying Category 1 loan with less than 60% loan to value. We believe prudent lending can be done without boilerplate standardized loan products.

Concerning past due exposures, the Standardized Approach treats each past due loan as if there is a standard risk or impairment to capital. Our experience has been that not all non-performing loans pose the same amount of risk to capital. Well collateralized loans that pose no risk of loss to the bank may be held in delinquent status until certain issues can be resolved. On the other hand, under collateralized loans that pose great risk to capital may be renewed or restructured to avoid the additional capital requirement. In this comparison, the result of the Standardized Approach would not meet its mission of requiring more capital when higher risk is present.

Further, the proposal is not clear concerning the treatment of some off balance sheet exposures. Our bank, along with many rural banks, supplements their loan portfolio with purchased loan participations from other rural banks. Many times these participation loans are interests in operating lines of credit. Participation commitments are made in lines of credit to aid the originating bank to comply with legal lending limit regulations. Therefore, the participation certificates are not cancelable. However, the underlying line of credit offered by the originating bank to the borrower may be unconditionally cancelable. It does not appear that the proposal is clear as to whether the participating bank will need to apply the credit conversion factors for the non-cancelable participation in an unconditionally cancelable line of credit.

If the participating bank is required to apply the Off Balance Sheet Credit Conversion factors, it will likely lead to a reluctance by small rural banks to assist one another with overline participations. We see this as favoring larger banking institutions and the Farm Credit System at the expense of local banks because of their larger legal lending limits.

In summary, we believe that BASEL III and Standardized Approach will be bad for our bank and bad for most rural community banks. In effect, these proposed rules, will limit rural banks ability to raise capital and serve its markets well. It is our understanding that these rule changes were originally designed to mitigate risk of failure of large complex financial institutions. However, we believe that if these rules are implemented, these very institutions will be the ones that gain in the market place.

The advantage of the small community bank is the ability to meet its customers face to face and tailor its product offerings to the best benefit of customer and bank. From our vantage point, the breakdown in the financial industry has been the movement to securitization and homogeneous product offerings that move the risk taker and customer too far apart. We believe that these proposed rules will advance that problem and force community banks to operate more like larger financial institutions.

We are convinced that a 'one size fits all' capital structure will not truly address the need for capital. We would hope that what could be adopted is a regulatory system with varying standards based upon complexity and risk. We believe that BASEL I standards with adequate regulatory oversight would be most beneficial and prudent for community banks.

Thank you for considering these comments. Please do not hesitate to contact me concerning any of this information.

Sincerely,

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Board Chairman

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