From: Jim Wayman [mailto:JIMW@esbtrust.com]
Sent: Friday, October 19, 2012 12:47 PM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Dear Sir:

ESB Financial is a community bank with assets of $165 million and located in two communities of 25,000 people and 50,000 people in eastern Kansas. Since we are located in smaller communities, we are limited in the financial products that we are able to offer based on the needs in our communities. We are a Subchapter S corporation, and so we rely on dividends to distribute federal income payments to our small base of shareholders. The proposals in Basel III will restrict our ability to make loans in our communities, lower our profits and harm the economic growth in our communities.

The bulk of our profits are based on our net interest margin from making loans in our communities. The majority of the loans that we originate are small business loans and 1-4 family residential loans. A small percentage of our profits are earned from fees, and the current environment is making it more difficult to charge our clients fees. We are gradually growing our capital from retained earnings, and that is really the only way we have to grow our capital. We cannot access the capital markets like the internationally active, highly interconnected financial firms for which Basel III is designed to govern.

<u>1-4 Family Residential Mortgages</u>
Our losses from these loans in the last few years during the recent economic downturn have been very minor. Placing a 35% risk weighting on these low loan-to-value mortgages (or even a 50% risk weighting on 60-80% LTV loans) does not represent a true picture on the risk to our bank. I cannot believe that these low-LTV loans represented any significant factor in bank failures system-wide. In order to track individual loan-to-values on our system will require large changes in our bank processes, adding to our overall overhead costs. In our opinion, this overall requirement will add little to the safety of our community banks.

<u>Loan Loss Reserves</u>
The higher risk weights for nonperforming loans only duplicate the purpose of allowance for loan losses and are pro-cyclical. The allowance for loan losses inclusion in total capital should not be capped at 1.25% of assets. The allowance for loan losses should be included in tier 1 capital since it represents the first line of defense against capital-absorbing loss.

<u>Accumulated Other Comprehensive Income</u>
The inclusion of the net unrealized gain/losses on available-for-sale securities in tier 1 capital introduces volatility in our capital that is driven by interest rates and external credit spreads. These additional factors that community banks have no control over will make it very difficult to implement a capital planning program. Larger banks, for which Basel III was designed, can hedge the impact of interest rates for these factors, but community banks have no such ability. Community banks will be forced to hold additional capital to compensate for increased volatility, thus creating even more of a competitive disadvantage to our larger “too-big-to-fail” competitors. This move will force us change more of our investment portfolio to “hold to maturity”, which will hurt our liquidity. This resulting lower liquidity will itself introduce higher risk in the banking system. As interest rates move higher in future years, community

banks will see significant capital reductions. Since the only real way we have to grow our capital is from growing our retained earnings, our bank will definitely experience a decrease in our capital when including this accounting entry into our tier 1 capital. Right now our unrealized gain on available-for-sale securities would represent over 12% of our capital if it were included.

Community banks need a simpler approach for measuring their risk. They serve a completely different market than the largest banks for which Basel III is designed. Our country's community banking system is much different from the large banks located across the world. Our community banks serve the small markets in our nation. The small markets in our nation are not the first priority of the largest banks for which this regulation is designed. The community banking system in our country is unique. Community banks must have a different approach for measuring their risk from the largest bank in the world. If we want to encourage economic stability for small businesses and individuals in our country, we cannot use the approach that Basel III takes. Basel III will have a detrimental effect on our nation's small businesses and residential mortgage market.

I urge you to take a much simpler approach for community banks than the much more complicated approach of Basel III. Basel III tends to follow the lead of other countries in measuring the risk of the banking system of other countries in the world. The United States banking system needs to take an approach that is designed for its own banks, not the approach that other countries want to use. The risks that Basel III measures are not what caused the failures of our nation's community banks.

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