Citizens
Bank & Trust

Federal Deposit Insurance Corporation
Washington, D.C,

October 17, 2012

Re: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Ladies and Gentlemen,

Citizens Bank & Trust Company (CB&T), Chillicothe, Missouri appreciates the opportunity to submit comments on the above-referenced notices of proposed rulemaking (NPRs).

CB&T recognizes the difficult task that the Agencies face in developing a system that accurately reflects risk across the broad and diverse universe of financial institutions that make up the United States banking system. CB&T is providing comments on several of the key components of the current proposed rules that we believe, in practice, could run counter to the Agencies' objective of providing a better mechanism of managing capital risk within the banking system. The comments provided below reflect specific aspects of the proposals that, in our view, will have the most significant impact on CB&T and the majority of community banks.

Proposed Rule: Accumulated Other Comprehensive income (AOCI) as a component of Tier 1 capital

CB&T Comments: CB&T has a significant concern about the inclusion of AOCI as a component of Tier 1 capital. The Agencies themselves have recognized that the inclusion of unrealized gains and losses on securities could "introduce substantial volatility in a banking organization's regulatory capital ratios." A typical community bank balance sheet composition includes 25% investment securities with an average duration of the investment portfolio of 3.5 years. The example below illustrates the material impact to the regulatory capital given a modest change in the rate environment.

Typical Community Bank	(in 000's)
Total Assets	500,000
Investments	125,000
Duration	3.5
Change in rates	2.00%
Change in Portfolio Value	8,750
Tax	3,063
Net Impact $ to Tier 1 Capital	**5,688**
Net % Impact to Tier 1 Capital	**1.14%**

While we recognize the appropriateness for AOCI inclusion in a tangible capital ratio from a market valuation perspective, the introduction of a similar structure to the regulatory capital metric has the potential to create confusion over the adequacy of recorded ratios and could lead to flawed, uneconomic, and even unsound decisions regarding an institution's asset-liability management and investment options. Some of the more troubling aspects of this proposal include the following:

1. Inclusion of AOCI in the standardized regulatory capital ratios would force regulators and financial institution managers to calculate alternative ratios to determine an effective capital position, exclusive of AOCI. Capital ratios bolstered by market appreciation would most certainly be discounted to reflect the potential volatility that might exist in a rates-up environment. At the same time, market depreciation would be counted against capital, even though a rates-down scenario might significantly improve the institution's capital position. In the latter case, institutions would need to hold greater levels of common equity capital to comply with a ratio requirement that reflects a potentially temporary adjustment.

2. To avoid recognition of AOCI, institutions may be incentivized to hold more securities in the held-to-maturity (HTM) account. While the move to the HTM account would no longer require gains and losses on those securities to be recorded in Tier 1 capital, the operational restrictions imposed on the HTM account would greatly reduce management's ability to properly adjust its portfolio for liquidity and funds management purposes. Additionally, when different institutions place identical securities in AFS or HTM, it creates differing capital treatments even though the relative risks involving the securities are the same.

3. To avoid capital ratio volatility, institutions may also be inclined to make shorter-term investment decisions that reduce volatility and increase liquidity. This may help to reduce market risk, but it also could reduce the ability of the investment portfolio to produce income and generate capital appreciation. As a result, banks would be forced to pursue other options to generate yield, which could include diverting investment to other asset classes, with higher levels of credit risk and/or greater levels of unrecorded market volatility.

4. The AOCI inclusion for AFS securities applies mark-to-market treatment to only one set of assets on an institution's balance sheet. Other balance sheet components that are economically very similar do not receive the same treatment, such as loans, structured liabilities, and HTM securities. We find two difficulties in this inequivalent treatment. First, this appears to violate the basic accounting principle of consistency. Second, it would in effect weaken an institution's asset-liability management; specifically, it adds a potential capital penalty on using the securities portfolio, the most flexible tool at ALCO's disposal, to reduce overall asset sensitivity while leveling no such penalty on any other balance sheet component.

5. The negative impacts of these effects would fall disproportionately upon community banks, due to their limited access to capital markets for funding and temporary equity enhancements.

CB&T strongly recommends that the Agencies exclude any AOCI adjustments from the regulatory capital calculations and continue to include an addendum in the Call Report to reflect ongoing gains/losses in the AFS portfolio. In our view, the concerns addressed about market value appreciation/depreciation are best managed through a strong liquidity and funds management function. While the impact on capital should be considered, financial institution capital ratios cannot be effective measurements of risk when only one class of assets among many is required to recognize ongoing market value adjustments.

The Agencies have suggested a potential exclusion of the capital charges for debt obligations to U.S. government, U.S. agency, and U.S. Government Sponsored Entities. The Agencies have also suggested a similar exclusion on general obligations issued by states or other political subdivisions. CB&T supports these exclusions and agrees that they would help to minimize the impact of the proposed AOCI treatment. However, to minimize risk and properly diversify the investment portfolio and total balance sheet, institutions should also be able to make informed investments in securities that contain some level of credit risk without an inequitable capital volatility penalty. If there is a need to hold higher levels of capital against these investments, that need should be addressed through an appropriate adjustment to the standardized risk weight measurement, not through an ongoing fluctuation in the Tier 1 capital ratio.

Proposed Rule: Minimum Capital Ratios, Capital Conservation Buffer, and Prompt Corrective Action Requirements –

CB&T Comments:, It is unclear why the Agencies would create a capital conservation buffer that would exceed the minimum thresholds for "well-capitalized" under the PCA framework. In essence, the proposal suggests that an institution needs a 2.0 percent buffer to be "well-capitalized', but it would need a 2.5 percent buffer be "resilient" throughout different financial cycles. By establishing this framework, an institution could be "well-capitalized" and free from any restrictive covenants under the PCA framework, e.g., limitations on brokered deposits, but at the same time still have restrictions on capital distributions and discretionary bonuses if it did not exceed the requirements for the Capital Conservation Buffer. This staggered and somewhat parallel layer of restrictive covenants above the PCA "well-capitalized" framework will create a confusing and contradictory set of standards.

In reviewing the Agencies' justification for Capital Conservation Buffer, it was not clear how the Agencies empirically developed the specific 2.5 percent ratio or how that level, over and above a "well-capitalized" level, would help to "bolster the resilience of banking organizations throughout financial cycles." It was also unclear if the Agencies considered the impact of the proposed changes to risk-weighting requirements in their determination of the 2.5 percent buffer. If the proposed changes to the Standardized Approach NPR create a risk-weighting mechanism to better reflect balance-sheet risk, it would seem that the revised capital ratios would automatically be more resilient and better able to absorb cyclical risks at the "well-capitalized" level.

The proposal also did not appear to address the authority that currently exists within the Agencies' enforcement powers to restrict capital distributions when appropriate. If, through the examination process, an Agency determines that capital distributions need to be restricted because of the specific financial condition of the institution, the Agency has the power to restrict those distributions through existing enforcement authority. Codifying this type of restriction in a regulation over-simplifies this issue and could impact the ability to exercise appropriate regulatory flexibility.

CB&T Recommendation: In the interests of clarity, flexibility and simplicity, we believe the Agencies should eliminate the Capital Conservation Buffer altogether in favor of the Prompt Corrective Action (PCA) framework. The Agencies should continue the PCA framework, with existing requirements still in force for organizations that fall below the statutory definition of "adequately-capitalized" applying existing enforcement authority to restrict capital distributions as circumstances warrant.

CB&T supports the Agencies' effort to improve the quality of regulatory capital and to build additional capacity into the banking system to absorb losses in times of economic stress. In our view, the provisions that we commented could create significant volatility and inconsistency in reported capital ratios. We believe these provisions could impact the effectiveness of the proposal and have negative consequences for the banking system as a whole.

We appreciate the opportunity to comment on this proposal.

Jon Appleby
Chief Financial Officer