IOWA SAVINGS BANK

www.iowasavingsbank.com

October 19, 2012

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

Dear Sir:

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 am the CFO/Cashier of the Iowa Savings Bank, a $173 million bank headquartered in Carroll, 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, but these rules in their entirety are more appropriate for the large financial institutions that use a business model consisting of a complex array of loan and investment products than for our local community bank serving the rural area of West Central Iowa. I am most concerned about the following aspects of the Basel III proposal and respectively ask that both the Basel III and the Standardized Approach proposals be repealed for these reasons:

Basel III Comments

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, and while nothing will have

P.O. BOX 967 510 W US HIGHWAY 30 CARROLL, IA 51401 712-792-9772 FAX 712-792-6773 • P.O. BOX 465 705 ARIZONA ST. GLIDDEN, IA 51443 712-659-2372 FAX 712-659-2345 • P.O. BOX 75 118 5TH AVE. COON RAPIDS, IA 50058 712-999-2271 FAX 712-999-2909 • P.O. BOX 306 401 N. MAIN ST. BAYARD, IA 50029 712-651-2274 FAX 712-651-2016 • 106 NORTH ILLINOIS LAKE CITY, IA 51449 712-464-3153 FAX 712-464-1026

changed regarding the bank's tangible equity, regulatory capital ratios could be reduced rapidly. Using our September 30, 2012 investment portfolio of $52,633,419, it has been calculated that a 300 basis point rise in interest rates could reduce the value of our bank's securities portfolio by $4,236,605, thus reducing our currently calculated Tier 1 capital account by 17%. 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. Our small business, consumer, and mortgage customers will be adversely impacted by the reduced availability of credit under this proposal – as it will reduce our central focus of making loans to members of our communities.

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 (and many others) 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.

Standardized Approach – Notice of Proposed Rulemaking

Increased risk weighting for residential loans. Under this proposal, the federal agencies can assign risk weights to residential mortgages based on whether the mortgage is a "traditional" category 1 mortgage or a "riskier" category 2 mortgage. Risk weights under the proposal run from 35% up to 200%. Under current law, most prudently underwritten residential mortgages are risk weighted at 50%.

These proposed residential mortgage rules raise several issues. First, mortgages must be re-assessed after a loan structuring or modification (Home Affordable Mortgage Program loans are exempt). Therefore a "category 1" mortgage could become a "category 2" mortgage if the bank does not modify the loan under HAMP. Many banks, including ours modify loans under non-HAMP methods and have a very successful track record for those borrowers who qualify by keeping them in their homes. Why should we be penalized from a capital standpoint for offering these modifications?

Secondly, similar to the agencies proposal for a "Qualified Residential Mortgage" (QRM) the proposed rules do not recognize private mortgage insurance (PMI) at all to reduce loan to value requirements – so mortgages may be subject to higher risk weights even if PMI reduces the risk on these loans. For example, a bank originating a balloon mortgage (which is now an automatic "category 2" mortgage at any LTV) at 90% LTV would have to risk weight the loan at 150% for capital reservation purposes despite having PMI. This does not reconcile at all with the loan performance we have experienced and may cause us to discontinue balloon mortgages and any loans with PMI. This will have a negative impact on loans to first time homebuyers, as PMI has been used successfully by banks in Iowa for decades with hardly any resulting losses for prudently underwritten loans.

Third, the proposal has no grandfather provision, so all residential mortgage loans on the bank's books would be subject to the new capital requirements – forcing banks to review all existing files to determine the appropriate category and LTV for each loan file. This approach is going to put enormous pressure on our bank to implement systems for calculating these new reporting requirements, or whether software vendors could possibly even implement this new requirement in a timely manner. Further complicating the issue, we will not be able to just "assign" a weighting when the loan is booked, but would have to continually re-evaluate the risk weightings based on changes in collateral values, past due status and other risk factors. As our bank's strong underwriting has led to a very small loss history on residential real estate loans, this new re-evaluation approach on an asset by asset basis is completely unnecessary and should be eliminated from the proposal.

Change in risk weighting for home equity and second lien loans. This part of the proposal classifies all junior residential liens, such as closed-end home equity loans and HELOC's, as "category 2" exposures with risk weights ranging from 100-200%. More importantly and as is the often the case in our bank, if we hold both the 1st and 2nd mortgages on the same property we would be required to treat both mortgages (even the 1st mortgage) as category 2 exposures (much higher risk weight). The exception where both mortgages could be placed into a category 1 mortgage – where the combined exposure meets all of the requirements of a category 1 mortgage, is far too narrow and most of our home equity loans and their accompanying 1st mortgage would likely fall into category 2 classifications. This proposal will cause our bank to seriously consider our approach to home equity loan programs which have been a popular borrowing instrument for many of our customers. We also ask this portion of the proposal be eliminated.

Proposal to increase risk weights on delinquent loans. Like many Iowa 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.

Conclusion

In conclusion, 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, notwithstanding the efforts to reclassify and determine each loan's new risk weight. If the rule is implemented, we will likely be required to re-program our core processing software to handle the new coding requirements and then create the necessary reports to analyze the data. Both of which would incur considerable costs and effort.

For all of the above reasons, I urge the agency to repeal this proposal so we may continue serving our communities and help strengthen our local economies.

Sincerely yours,

Richard Fulton

Richard Fulton
CFO/Cashier