October 19, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Office of the Comptroller of the Currency
250 E St., SW
Mail Stop 2-3
Washington, DC 20219

Robert E. Feldman, Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, DC 20429

RE: BASEL III Docket No. R-1442
BASEL III OCC Docket ID OCC-2012-0008, 0009, and 0010
BASEL III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Dear Sir or Madam:

Thank you for the opportunity to submit comments regarding the recently issued notices of proposed rulemaking (NPRs) on regulatory capital enhancements. Because of the complexity of these Basel III and Standardized Approach proposals the extension of the comment period was also appreciated.

Our bank is a locally owned community bank with assets of approximately $85 million. We are located in a rural area of southwest Kansas and have served this area since 1929. The bank provides residential real estate loans, agricultural loans, small business/commercial loans, and consumer loans. The bank is committed to the communities we serve and is an integral part of supporting the financial needs, growth and economic development of these communities.

The purpose of this letter is to comment on the key provisions that have the most impact on our community bank and attempt to show the potential negative results of these proposed changes.

First, as a small community bank it appears that these proposals add significant complexity and burden to the calculation and monitoring of regulatory capital adequacy, and yet it remains quite vague on how these changes are going to improve the overall position of the U.S. banking system, in particular as it relates to banks of our size and structure. When Basel I was implemented and the risk-weighted concept added to capital adequacy, we believed this was going to be the new effective way of monitoring capital. However, it seems as though the traditional leverage capital ratio always rises to the surface and draws the most attention in capital conversations. These new proposals will add yet another ratio and more complexity to the calculations and monitoring. In a small community bank we

have limited staff, and we find ourselves spending more and more time on complex regulations and systems, and less time assessing and serving the needs of our communities.

Second, the most troubling part of the new proposals is the requirement of the banks to recognize the unrealized gains and losses on AFS securities in their Accumulated Other Comprehensive Income (AOCI) and ultimately to the Common Equity Tier I Capital. This would have a significant impact on our bank's capital and with the market fluctuations will cause great volatility to the capital. Through the development of improved tools in monitoring interest rate risk (IRR), our bank has a very vigorous asset-liability management system. To minimize interest rate risk, the entire balance sheet (assets and liabilities) are managed. To extract just the gains and losses from the investment portfolio without consideration of the offsetting position of the liabilities is a gross misrepresentation of the economic value of the capital. This part of the proposal has the potential of significantly changing the management of the investment portfolio and ultimately the performance of the bank.

Our bank has managed through some volatile interest rate cycles over the almost 20 years since AFS rules were implemented. Whether there was an appreciation or depreciation in the investment portfolio there were other dynamics taking place on the balance sheet to weather the cycle. Our current report shows that with a +300 bp move in rates, the investment portfolio depreciation after tax would drop the bank's net Tier I capital almost 2.75%, yet the economic value of our capital shows a position of capital greater than our book value capital because of the appreciation in the liability side of the balance sheet. That is a perfect example of <u>creating</u> a problem through this proposal when a problem doesn't exist.

Third, 1-4 Family residential mortgage lending is an amazing challenge for a small community bank like ours with merely the implementation of the existing rules and regulations. We have elected to continue to provide this product to our customers because it promotes housing growth and opportunities in our communities. The complexity of categorizing these mortgages into two risk categories based on certain product and underwriting characteristics will be expensive and time-consuming. The new methodologies for risk weighting mortgages is attempting to single out an area of lending that has not for our bank historically been the risky area that these proposals are targeting. Existing mortgages on our bank's balance sheet were underwritten and priced with the current capital standards in mind. These changes serve as a disincentive to mortgage and real estate lending and will at some point ultimately cause the availability of the residential lending product to be eliminated.

Of specific concern is the treatment of five year balloon residential real estate loans. Our bank has issued these loans (with maximum 15-20 year amortizations) for basically two reasons. The first is because our bank is located in a rural area and for a variety of reasons (small loan amount, lack of comparable sales for an appraisal, etc.) our customer may not meet the strict qualifications for financing in the secondary market. These customers are predominately the low and moderate income customers because high income individuals usually have the ability to qualify in the secondary market. The second reason our bank has utilized five year balloon residential real estate loans is to allow us the opportunity to offer a product to support the housing sector in our communities while not subjecting our bank to the interest rate risk associated with a longer term real estate loan. These loans have proven over time to have little or no risk of loss. Credit risks are better identified and managed through the Allowance for Loan and Lease Losses detailed analysis.

Fourth, with the new proposals on assigning proper risk-weightings to the different asset categories including the complex collection and reporting of information, a burden will be placed again on the limited staff that is already multi-tasking to carry out all of the requirements of the current laws and regulations. The new costs associated with hiring additional staff and implementing these regulations will ultimately cost the consumer and affect the performance of the bank.

In closing, I respectfully request that you give separate and serious consideration to the differences between the community banks and the large national/international banks. Community banks should be allowed to continue using the current Basel I risk weightings and capital structure. These current capital requirements will allow the community banks to continue to manage through these turbulent times and better serve their banks, customers and communities.

Thank you again for the opportunity to present this response.

Sincerely,

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