1st

FIRST NATIONAL BANK

McHenry • Island Lake • Richmond

October 20, 2012

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

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

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

As a $158 million community bank located in far northern Illinois, The First National Bank of McHenry has long been a reliable source of mortgage credit to McHenry County, Illinois families and businesses for more than 40 years. We have taken pride in holding more than 98% of all mortgage loans originated in our four offices simply because our customers prefer banking locally.

I have studied the proposals and find it difficult, if not impossible, for community banks such as ours to continue to thrive under these new and burdensome regulations. The availability of mortgage credit will likely be rationed in our bank due to a doubling and in some cases tripling of capital required to hold mortgages with balloon payments. Recent attempts at regulation, such as the Wall Street Reform and Consumer Protection Act have increased the cost of credit for our borrowers. Increasing capital requirements to originate and hold balloon mortgages and mortgages with higher loan-to deposit ratios will only further escalate those costs. The proposed risk weight framework under Basel III seems inconsistent with principles of safe and sound banking. Higher risk weights for balloon loans will further penalize our bank for mitigating interest rate risk in our asset-liability management. We will be forced to originate only 15 or 30 year mortgages with durations that will make our balance sheet more sensitive to changes in long-term interest rates. On this point alone, our board of directors has seriously considered completely exiting this line of business. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will further penalize our customers and deprive them of several financing options for residential property. Second liens will become more expensive for borrowers we may choose not to allocate additional capital to these balance sheet exposures. Ideally, community banks should be allowed to continue the current Basel I risk weight framework for residential loans. Lastly, we will be forced to make significant software upgrades and other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for our mortgage portfolio.

While I am sure the framers of this regulation were well intentioned, they failed to understand its resulting impact on our community bank relationship model. There have been numerous regulatory attempts to save our industry from itself. Healthy community banks have been and continue to be well capitalized using of a practical, common sense approach to risk management. A substantial majority have somehow managed to survive and thrive without the need of additional onerous international capital calculation regulations. Community banks clearly did not engage in the highly leveraged activities that severely depleted capital levels of the largest banks and created chaos in financial markets. In the end, management and not complicated capital requirements make the ultimate difference.

Sincerely,

William J. Busse
President & CEO

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*