Farmers & Merchants State Bank
Scotland, South Dakota
Hometown Banking With Your Neighbors & Friends

Dick D. Behl, President
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October 22, 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 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.

I would like to thank you for the opportunity to submit this comment letter in the Basel III NPR and the Standardized Approach NPR.

I represent a small community bank in a community with a population of 850. Our bank is a single location with 25 million in assets with eight full time employees. Our bank is owned by a holding company of which the majority is owned by my family. I am a third generation banker with our bank being in our community for 92 years. As I try to understand the implications on our bank, I am alarmed at the potential effect the Basel III rules will have on this bank. First and foremost, is the complexity of the 500 pages of these two NPRs. These new rules are difficult to understand and there are many variables that can have negative impacts on our bank. Second, we raise capital through retained earnings so it will be difficult to raise capital quickly if needed. I do not believe that using Basel III capital rules for all banks is fair or in the best interests of our communities in which banks like ours serves. I would ask that small community banks would not be subjected to these unnecessary and burdensome rules and would be allowed to continuing under Basel I Standards.

<u>Including the AOCI as an adjustment to Common Equity Capital</u>
Due to low loan demand, our bank has a securities portfolio which is 44% of total assets. For liquidity and regulatory safety and soundness reasons, we carry these securities as available for sale even though generally, we have not needed to sell any for liquidity purposes. In an increasing interest rate environment the fair market value of our bond portfolio will decrease. Under the current capital rules these fluctuations of fair market value have no or very little effect on our capital levels. I ran the tool, provided by the FDIC, and entered the data for what a 100, 200, and 300 basis interest rate increase would do to the fair market value of our securites portfolio and found that under a 300 basis rate increase our Tier 1 leverage ratio would lower by 5.79% to 5.12% under the Basel III rules. Even though under the Basel III rules 5.12% is adequate, we do not. We have historically tried to keep this ratio at around 10%. As stated before, we raise capital through retained earnings which is a year by year basis and will not be able to keep up with the changing interest rate market. With interest spreads compressing along with increasing operating expenses, it will be very difficult to raise capital when needed. This may require our bank to merge with a larger bank.

<u>Impact of Changes to Risk Weights Under the Standardized Approach NPR</u>
Generally, this area of the Basel III capital rules will be difficult to analyze for reporting purposes and will be subject to criticism during the exam process.

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The area most affected for our bank would be the risk weighting for our mortgage loans. We offer mortgages in which we process and service with in the bank. Due to asset/liability management decisions, we offer mortgages with amortizations up to twenty years with a balloon of five years for re-pricing reasons. All of these loans would fall into the Category 2 bucket with risk rates of between 100 and 200 percent. We have not had a loss in our mortgage loan portfolio in over ten years and therefore do not believe that these types of loans have a higher risk of loss and certainly would not be accurately reported. The higher capital needs of these types of loans along with the ever increasing compliance burden will force our bank to leave this very important market. Our community has many homes that sell well below the minimums set by the secondary market and the larger banking organizations. Our bank serves as a funding source for these types of loans.

In closing, our bank is a community bank serving in a small community. During the past several years we have been in our community doing business as usual. We have not asked for tax payer bailout to keep us going like some. We are in the relationship business serving our customer's needs. Our family owns the majority interest in this bank. When there is a gain or loss in the capital levels of this bank, it represents our families gain or loss. Our relationship with this community and the ability to run a well capitalized bank is much different than it is for the much larger institutions. The complexity of our bank and banks like this one are not like the larger banks that have foreign holdings or have more complex funding and assets on their balance sheets. Therefore smaller community banks should have a different set of capital rules and should be exempted from Basel III.

I look forward to the day when there will be a level playing field. Reducing the burden of these regulations on community banks would be a good start.

Sincerely,

Dick D. Behl, President
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