HEARTLAND BANK

September 24, 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 first like to state that our bank embraces the general concept of increased capital requirements for the overall banking industry. It is only prudent that our industry maintain higher levels of capital than currently exist for unknown market corrections. Our bank chooses to maintain tier one capital levels in excess of 12% with risk based in excess of 16%. As a bank, we are very troubled with several of the Basel III proposals.

Heartland Bank is a community bank serving four locations for over 100 years by same ownership for five generations. Our asset base is $110 million. Several generations have relied on our bank to supply capital and banking services to primarily the agricultural sector. In my opinion, Basel III was designed to apply to the largest, international banks and not community banks. I believe that all community banks should be allowed to continue to use the current Basel I method for computing their capital accounts which has served us well over the years. Our customers and communities will be negatively affected if Basel III is allowed to proceed under the current proposal. Specifically, the areas of concern for implementation of the proposal are:

P.O. Box 147
Callender, Iowa 50523
(515) 548-3223 • Fax: 548-3228

P.O. Box 67
Gowrie, Iowa 50543
(515) 352-3181 • Fax: 352-3841

P.O. Box 730
Manson, Iowa 50563
(712) 469-2800 • Fax: 469-2509

P.O. Box 1
Somers, Iowa 50586
(515) 467-5561 • Fax: 467-5791

www.heartlandbanks.com Member FDIC EQUAL HOUSING LENDER webmaster@heartlandbanks.com

1. Incorporating AOCI as Part of Regulatory Capital.

   If allowed, inclusion of accumulated other comprehensive income (AOCI) in capital for community banks will result in a material effect on our bank's balance sheet. Because interest rates are at historic lows and we currently carry high levels of unrealized gains for securities, inclusion of the AOCI into our capital account will force us to restrict growth of our balance sheet which will undermine our ability to serve our customers and the overall general community. This event will probably occur during the beginning of interest rate cycles increasing which usually indicates a recovery. This is exactly the time when banks should be expanding their balance sheets to assist our local economies.

   The bank currently has an investment portfolio of $32 million with approximately an unrealized gain of over $1 million. In calculating interest rates up environment of 300 basis points, this unrealized gain would be reduced to a $2 million dollar loss which is equivalent to a year's pretax earnings. In addition, it would reduce our tier 1 capital ratio almost 2%. With this type of adjustment to our capital account, management would most likely tighten lending requirements resulting in decreased loan availability for our communities.

   Should this proposal move forward and given the size of our institution, we will most likely move towards utilization of the hold to maturity category for the majority of our investment purchases. This strategy would be implemented in an effort to mitigate the fluctuation of our capital account as a result of the AOCI. The consequences of using the HTM category will result in a decreased liquidity posture for the bank. It would also eliminate another tool for reducing and managing our interest rate risk of our loan and investment portfolio.

2. New Risk Weights

   The proposal for changing risk weights for real estate loans is overly complicated and will cause a delay in our already weak housing recovery. Over half of our originated real estate loans do not qualify for standard secondary market originations. Thereby, we must offer real estate loan terms that do not place our bank's balance sheet in an adverse interest rate risk position. Our current bank products include balloon loans, adjustable rate loans and second lien loans. If community banks are penalized by placing higher risk weightings on these loan products, many banks such as ours will discontinue originating our current in-house loans and only offer the secondary market 15 and 30 year fixed real estate loans. Again, our communities will be in jeopardy of losing the much needed in-house financing products to continue with increased economic activity. Since my 29 years associated with Heartland Bank, I can count on one hand the number of foreclosures initiated by the bank for the non-secondary in-house real estate loans. Customers and the bank have been served very well by these types of products. Increasing the risk weighting would serve no purpose other than to create significant operational costs to track the proper mortgage loan-to-value ratios in order to determine the proper risk weight categories. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans that has served us well over the years.

3. Capital Buffers

While increasing capital conservation buffers in itself sounds prudent, many community banks will have extreme difficulty due to the limited access to the capital markets. The primary method for community banks to increase capital is through the accumulation of retained earnings over time. Community banks continue to be integral in the slow economic recovery currently in place. Requiring community banks to retain earnings for capital buffers will restrict and hamper economic growth at time when it is vital for our economy to grow. Should it be determined that community banks must be part of the capital buffer proposal, an acceptable extension of five years past the 2019 timeframe should be made available to allow retained earnings accumulation.

4. Subchapter S Community Banks

Community banks with the Subchapter S election as a basic necessity must approve distributions from local bank earnings to allow shareholders the ability to pay income taxes on earned income. Not allowing distributions to shareholders is a major conflict for Sub S banks to allow the payment of income taxes on earned income. Subchapter S banks should be exempted from the capital conservation buffers to allow it's shareholders the ability to pay accrued taxes on income earned by the bank and not violate the Internal Revenue Code. It is our recommendation that any capital buffers be eliminated where the Sub S shareholder must meet taxable obligations as a result of bank taxable income.

Our bank is not opposed to some level of increased capital for the banking industry. However, the consequences of the cumulative effect that Basel III would impose, in my opinion, would be highly detrimental to the overall community banking industry and weaken the economic recovery that currently exist. The community banking industry has served our nation extremely well for many decades. I strongly urge you to consider the exemption of community banks from most if not all the proposed Basel III requirements. If enacted in its current form, community banking will again be a victim of the large bank entities and investment firm missteps. Community banks should be allowed to continue to serve our nations small businesses and help strengthen our local communities.

Thank you for you consideration on this important matter.

Sincerely,

Kevin M. Black
President/CEO

cc: Senator Tom Harkin
Senator Charles Grassley
Senator Steve King
Congressman Tom Latham