Bank Midwest

October 15, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W. Washington, D.C. 20551
Delivered via email: regs.comments@federalreserve.gov

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Delivered via email: regs.comments@occ.treas.gove

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429
Delivered via email: comments@FDIC.gov

Re: Basel III Capital Proposals

Ladies and Gentlemen:

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 currently serve as a Class A Director at the Federal Reserve Bank of Chicago and am the Chairman of the Iowa Bankers Association. I am proud to serve as a member of the board of directors of Bank Midwest – a $685 million community bank headquartered in Spirit Lake, Iowa. As the CEO, I am accountable to our customers, my coworkers, and the communities in which we operate. Our shareholders are patient and realize without the other three, our company would have little value. Our bankers make business, agricultural and consumer loans, collect deposits and our professionally licensed team offer wealth management and insurance services and product to our customers from 10 offices located throughout northwest Iowa and southwest Minnesota. Our brand statement is "Great Experience-One Place" and we take those words very seriously.

I understand the Basel III goal of strengthening the financial system by increasing the level and quality of capital that banks are required to hold, however, these rules are more appropriate for large complex financial institutions than for the relatively simple business practices of small banks. Let me take this opportunity to say that it was not the community banks that brought about the financial crisis of 2008. While some large banks and mortgage companies were selling and securitizing loans of questionable value, Bank Midwest was steadily making sound mortgage loans to our local customers. During the years of 2008, 2009 and 2010, the worst three years of the crisis, our bank originated over $32 million in residential mortgage loans that we held in our portfolio. The actual loss experience on these loans was less that 0.19% per year. In addition, we originated another $73 million in residential mortgage loans with similar underwriting characteristics that were subsequently sold to Fannie Mae. So, like most community banks throughout the U.S., our institution functioned as a source of stability by originating and delivering high-quality assets to the financial system during a very volatile period.

Further evidence of our role in providing stability has been the bank's increasing capital ratios since the end of 2008. Bank Midwest's total tier 1 risk-based capital ratio has climbed from 10.07% as of December 31, 2008 to 12.17% as of June 30, 2012. This increase in capital came during a period of asset growth, and it came without the benefit of a capital raise. Please do not interpret any of this as braggadocio; I am simply making the point that this type of performance is typical of most community banks.

As to some of the specific portions of the Basel III rules, I have some areas of concern:

1. **Requirements that gains and losses on available for sale securities must flow through to regulatory capital.** This rule will have the undesirable and unnecessary affect of adding volatility to a bank's capital position. The investment portfolio at Bank Midwest is approximately $165 million representing 25% of total assets. We estimate that a 300 basis point rise in interest rates would translate into a decline in the market value of the

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portfolio of nearly $14 million. Such a move would reduce the bank's tier 1 capital ratio by more than 2 percentage points. This new rule does not take into consideration a bank's overall sensitivity to interest rate

movements and therefore cannot provide any insight into a firm's level of interest rate risk. As for credit risk taken in the investment portfolio, the existing rules for other-than-temporarily-impaired (OTTI) investments provide a mechanism for potential credit losses to be reflected in capital. Most banks use the investment portfolio as a source of liquidity and to manage interest rate risk. A natural response to the new regulation will be for banks to hold fewer securities or to reclassify existing portfolio assets as held-to-maturity (HTM). How can it be in the best interest of the financial system to ratify a rule which provides no improvement in measuring a bank's ability to sustain losses and at the same time would reduce liquidity system-wide?

2. **Increased risk weighting on delinquent loans.**
   The agricultural economy in our area has been strong for many years; but we also remember the 1980's agricultural crisis. During that time when agricultural lending became tough, our bank, like many, had situations where we had to hold loans in past due status for some time. In our bank's case, we minimized our risk of loss by carrying a larger balance in our loan loss reserve. The proposal of increasing the risk weighting on past due loans has the double effect for most banks of decreasing capital while at the same time we are holding large amounts in our loan loss reserve. Managing the loan loss reserve would seem to be a more prudent and effective way of handling the situation.

3. **Elimination of Trust Preferred Securities.**
   Our bank secured $10 million in Trust Preferred Securities in 2004 and planned to use them in our capital mix through their maturity in 2034. The Federal Regulators decision to eliminate Trust Preferred Securities from Tier 1 capital will have many unintended consequences for companies like ours. We forward locked in a rate on our Trust Preferred Securities so that our cost of capital would not exceed our historical averages and we are comfortable with the loss position at this time (we have a large off setting gain in our subsidiary bank's investment portfolio). While the forward SWAP rates are higher than current short rates, our goal was to protect against higher rates in the future. However, as Basel III has now been introduced, the suggested changes would start to erode our ability to use this as Tier 1 capital, and we will have to make other decisions that will not impact our overall capital in a positive way which will restrict our ability to grow our balance sheet over the next ten years. There seems to be a conflict with a monetary policy being as accommodative as possible and then this restrictive rule which will undermine and work against community banks making more loans to move this economy forward. Consideration should be given to looking at phasing out the Trust Preferred Securities over some period of time at the end of the instruments life, as opposed to some random date that imposes a phase out sooner than need be.

Basel III, as proposed, will continue to add unneeded complexity and will continue to add to the further consolidation of the community bank sector as bankers get more and more frustrated with compliance activities versus making good loans. I urge you to ask others to reconsider this final rule, who it applies to, and what long term implications it will leave in its wake. In so doing, you will help us to better serve our customers and strengthen our local economy.

Thank you for your support and attention to this matter.

Sincerely,

Stephen J. Goodenow, Chairman and CEO
Bank Midwest

Cc: Senator, Charles Grassley
Senator, Tom Harkin
Representative, Steve King