Security STATE BANK

MEMBER FDIC **IRON RIVER-BRULE-PORT WING** **EQUAL HOUSING LENDER**
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October 11, 2012

VIA ELECTRONIC DELIVERY
Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.,
Washington, DC 20429
comments@FDIC.gov
RIN 3064-AD95 and RIN 3064-AD96

RE: Regulatory Capital Rules: (1) Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Correction Act: RIN 3064-AD95; and (2) Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements: RIN 3064-AD96

Dear Mr. Feldman:

Security State Bank is an $84 million community bank in Iron River, Wisconsin. Of our $59 million loan portfolio, $10.2 million consists of 1-4 family residential home loans. In our rural area, our lending is the life blood providing the ability for our neighbors and community family to put roofs over their heads. Many of our customers and homes in our rural area of northwest Wisconsin simply do not qualify for FHA or secondary market financing. In order to serve these customers we offer loans with three to five-year maturities with amortizations ranging from 15 to 30 years.

In the past 3 years, we have experienced a total of net losses of just $24,000.00 on our residential loans; yet, the new proposed regulatory capital rules would classify these loans needing anywhere from 100% to 200% risk weighting for calculating risk based regulatory capital. It's disturbing that these percentages are arbitrarily used and not substantiated with any type of analysis. Under current rules these loans are 50% risk weighted. Under the proposed rules for example, if we make a 5-year balloon loan with a LTV of 81-90%, the capital risk weight skyrockets from the current rule of 50% to 150% under the proposals. This type of treatment will detrimentally impact just how many loans we can offer our customers and will reduce or eliminate a traditional credit product that our customers seek.

Also, the proposal classifies all junior liens, such as home-equity lines of credit (HELOCs), as Category 2 exposures with risk weights ranging from 100 to 200%. In addition, a bank that holds two or more mortgages on the same property would be required to treat *all* the mortgages on the property—even the first lien mortgage—as Category 2 exposures. Thus, if a bank that made the first lien also makes the junior lien, the junior lien may "taint" the first lien thereby causing the first lien to be placed in Category 2, and resulting in a higher risk weight for the first lien. By contrast, if one bank makes the first lien and a different

bank makes the junior lien, then the junior lien does not change the risk weight of the first lien. There is one exception to this general treatment; however, that exception is very narrow and thus, most junior lien mortgages will likely be deemed Category 2 mortgages.

Again, this is another area within the proposals for which the Agencies have provided no data to support their assertion that all HELOCs are risky and warrant such severe treatment. In reality, HELOCs are carefully underwritten—based not only on the value of the home, but upon the borrower's creditworthiness and with some of the strongest LTV ratios.

Under the proposed rules we will no longer be willing to serve our communities with home loans described above because no bank will take on loans with 100+ risk weighting. We will no longer be able to help the young family purchase their starter home or first very modest older home. These are individuals that work hard in our communities and build equity in their homes by improving them and then moving on to a nicer home. These customers provide a tax base for our schools, roads, and safety services. This all works because of our desire to help our communities we serve because it's what helps us to survive in a rural area. The proposed rules will very much shift our desire to make these types of loans and may end the era of the small community bank!

In addition to the risk based capital requirements, we also maintain reserves for loan losses under ASC Topic 450-20, Loss Contingencies (formerly FASB 5 General Reserve) and ASC Topic 310, Receivables (Formerly FASB 114 - Impaired Loans). These are additional funds that protect our capital and thus circumvent the need for higher risk weightings, especially of 1-4 family homes.

As proposed, all unrealized gains and losses on available for sale securities (AFS) must "flow through" to common equity tier 1 capital. Therefore, if there is a change in the value of an AFS security (which can occur daily in some circumstances), that change must immediately be accounted for in regulatory capital. It must be noted that unrealized gains and losses occur in AFS portfolios primarily as a result of movements in interest rates—and *not* as a result of credit risk.

If the rules are finalized as proposed, with the inclusion of unrealized losses of AFS securities in common equity tier 1 capital, rising interest rates would put downward pressure on banking organizations' capital levels. This will potentially cause my bank to reduce our growth or shrink our securities portfolios considerably in order to maintain capital ratios at the desired or required levels.

Additionally, as a community bank, we have been an investor in our local government entities to the extent of $3.4 million in Municipal Bonds. However, as proposed, the rules would discourage my bank from holding municipal securities, including holding U.S. Treasuries, because of the interest rate impact on such long-duration assets. This, in turn, could lead to a lower return on assets for my bank and less funding for the housing market and national and local governments, collectively.

I understand the want to implement rules is in response to a time of economic turmoil and subpar lending practices of some; however, let not haste make waste. And let us not forget what has made this nation great; the community bank being able to serve the neighbor next door. Therefore, let's not expand unjust regulatory burden on our community banks!

Thank you for the opportunity to comment on the Agencies' proposals.

Sincerely,

Wendy E Biggerstaff
Investment Officer