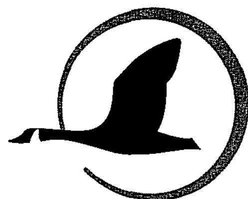


HORICON BANK

The Natural Choice

October 22, 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: Basel III Capital Proposals

Dear Mr. Feldman:

Thank you for the opportunity to provide comment on the Basel III proposals approved by the Federal Deposit Insurance Corporation (FDIC), together with the Board of Governors of the Federal Reserve System (FRB) and the Office of the Comptroller of the Currency (OCC), (collectively, the "Agencies").

Horicon Bank is a $515 million community bank located in Horicon, Wisconsin, with offices that serve Dodge, Washington, and Fond du Lac counties and the cities of Appleton and Oshkosh. The Bank, through its one-bank parent holding company, is a family- and employee-owned Sub Chapter S financial institution that emphasizes loans to small and medium sized businesses, and to individuals for residential mortgage loans.

As a community banker, I have concern over the broad approach taken by the Agencies to impose a "one-size-fits-all" regulatory capital scheme despite the fact that the industry believed the Basel III proposals were intended for the very large, complex international institutions. I believe this approach excessively tightens regulatory capital requirements on community banks which is unwarranted, and in my opinion, beyond Congressional intent and will likely cause a disruption in available credit in our marketplace. Therefore, I suggest that the Agencies should withdraw the proposed regulatory capital rules, conduct additional study and analysis, and only propose capital rules which take into consideration the impact other regulatory proposals and reforms will have on risk.

In a review of proposed capital rules, the Agencies should better recognize the differences between community banks and large, complex international institutions, and not force a community bank into the same capital calculation "peg-hole" as a sophisticated international institution. I urge the Agencies to take into consideration the specific concerns and recommended changes noted as follows.

Accumulated Other Comprehensive Income (AOCI)

As proposed, unrealized gains and losses on available for sale securities (AFS) must "flow through" to common equity tier 1 capital. In considering this provision, it is important to note 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. As such, when the economy begins to improve and interest rates start to rise, the inclusion of AFS security unrealized losses in common equity tier 1 capital will put downward pressure on banking organizations' capital levels. This could serve to undermine an economic recovery and potentially cause our bank to reduce our growth or shrink our securities portfolios in order to maintain capital ratios at the desired or required levels.

Additionally, as a community bank, we are an investor in our local government entities. However, the proposed rules would discourage us and other community banks from holding municipal securities due to the interest rate impact on such long-duration assets. While such action may reduce the cyclical and volatile effect of this proposal, it will also reduce our ability to manage our investment portfolio through different interest rate and economic cycles.

Therefore, I oppose this proposed treatment and suggest the Agencies should remove it from the proposals.

Treatment of Trust Preferred Securities (TruPS)

The Agencies' treatment of trust preferred securities (TruPS) under the proposals must not be finalized as proposed. Presumably out of concern for such a debt instrument being treated as "capital", Congress, as part of the Dodd-Frank Act (DFA), prohibited any new issuances of TruPS. However, under the Collins amendment in DFA, TruPS are grandfathered for institutions between $500 million and $15 billion. Nonetheless, the Agencies' proposals ignore the Collins amendment by requiring a complete phase-out of TruPS beginning in 2013.

Many Wisconsin community banks hold TruPS as capital on their books. The proposed complete phase-out of TruPS creates a significant problem for community banks that are privately held and have limited access to capital alternatives. Investors in community banks are motivated by the growth opportunities such an investment affords rather than a desire to fill capital holes caused by changes in regulation.

Horicon Bank benefited through a capital infusion made possible by a $9 million issue of TruPS through our bank holding company approximately eleven years ago. As a closely-held financial institution we have more limited sources of capital than larger institutions. Elimination of TruPS as a capital element could necessitate accelerated prepayments of these instruments through a return of capital from the bank.

Therefore, I oppose the Agencies' treatment of TruPS beyond that which Congress intended under DFA and urge the Agencies to preserve the full intent of the Collins amendment to DFA by permanently grandfathering outstanding TruPS for institutions between $500 million and $15 billion.

Capital Risk-Weights for Residential Mortgages and Related Matters

The Agencies' proposals place new significantly higher capital risk weights on in several categories of real property-secured loans despite having neither empirical evidence to substantiate

the need for such heightened capital levels, nor a mandate under law. Among these proposals are changes in residential mortgage loan exposure risk weights for which I have concerns.

The proposals assign risk weights to residential mortgage exposures based on whether the loan is a "traditional" mortgage (Category 1) or a "riskier" mortgage (Category 2) and the loan-to-value (LTV) ratio of the mortgage. The current risk weight for a real estate mortgage is generally 50%; however, depending upon the Category and LTV ratio of a particular residential mortgage, the capital risk could rise to 200%. These higher risk weights appear to be arbitrarily set as there is no empirical data presented by the Agencies to support this extraordinary increase in risk weights for certain types of mortgages.

I disagree with the Agencies' assumption that a residential mortgage has a higher degree of risk based exclusively upon the loan having a balloon payment, an adjustable rate, or an interest-only payment, to warrant the substantial increases in capital risk weights that are proposed. Our portfolio of balloon loans has experienced minimal losses with a current loss rate of under 0.45%, and was virtually non-existent in the years preceding our current economic slump. The Agencies' proposed capital treatment far outweighs the reality of risk that we have experienced for these types of loans.

In addition, the substantial increase in risk weights will discourage our bank from making these types of loans even though we have experienced minimal losses. As a community bank, we offer 3- and 5-year balloon mortgages with payments amortized up to 30 years. We provide such loan products in order to offer loans to good borrowers and to protect against interest-rate risk. A significant proportion of our balloon mortgages are to home purchasers who did not fit all the new secondary market requirements, many of whom were first time buyers. However, the new risk weights will discourage us from making such loans. 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 in our community, will reduce or eliminate a traditional credit product that customers seek, and will also reduce our ability to protect against interest rate risk.

Based on our current portfolio, I estimate the increase in total risk-weighted assets as proposed will reduce our capital ratio by approximately 1.10%, and will significantly reduce or eliminate our ability to offer such loans in our communities to customers that we know, but may not meet all of the secondary market requirements.

As such, the Agencies should not finalize the proposed rules with such severe and unwarranted risk weighted treatment of residential mortgage exposures.

No Grandfather Treatment for Existing Mortgage Loans

Finally, the proposed rules do not include any type of grandfather provision. Thus, all mortgage loans currently on the bank's books will be subject to the new capital requirements. This will require bank staff to examine old mortgage underwriting files to determine the appropriate category and LTV ratio for each mortgage. This is a significant and time consuming task and comes at a time when the industry is also implementing numerous other substantial regulatory revisions and reforms that require substantial efforts. We simply have limited resources necessary to gather all of the information required to properly determine the revised risk weights for existing mortgage loans.

Therefore, I suggest that if the proposed changes are implemented, the Agencies should grandfather all existing mortgage exposures by assigning them the current general capital risk-based weights.

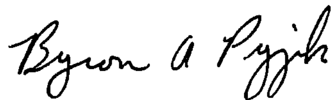
Conclusion

For the concerns outlined above, I believe the Agencies should withdraw the currently proposed regulatory capital rules, conduct additional study and analysis, and only propose capital rules which take into consideration the impact other regulatory proposals and reforms have on risk.

I urge the Agencies to recognize the many differences between community banks and large, complex international institutions, and to not force the same capital calculation requirements on community banks as they would on complex international institutions.

I appreciate the opportunity to comment on the Agencies' proposals.

Sincerely,



Byron A. Pyzik
Senior Vice President