SECURITY BANK
Banking for Generations.

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October 17, 2012

Mr. Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Mr. Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
250 E. Street, SW
Washington, DC 20219

RE: Proposed Rulemaking in Minimum Regulatory Capital and the Standardized Approach for Risk-Weighted Assets under Basel III

Dear Sirs:

Please accept this letter as our comment on the proposed Basel III changes and the grave impact it will have on our bank, Security Bank, s.b. Security Bank is a 106 year old mutual savings bank in Springfield, Illinois. Our total assets for 2012 average $150,000,000. Primarily, we are a residential lender, as is the case with most savings and loans/savings banks. Our residential loans held in portfolio total approximately $63 million with a total servicing base of $157 million of which $94 million in loans are sold to FHLMC and FHLB-C MPF. We service over 98% of the loans we originate with only government loans (FHA/VA) loans being sold servicing-released. We originate fixed rate loans, balloon loans and ARM loans and tailor the product to the customer's needs and what makes the most sense for them to succeed. As a true community bank, we know our customers. We have never and will never put a customer into a loan product that is not right for them. Their success is our success. We expect to originate over $70 million in residential loans in 2012 with approximately 70% being sold on the secondary market, but serviced by our bank. We also only originate loans in our county and contiguous counties. As you can easily see, taking $70 million in lending out of such a small geographic region could be devastating to the housing market and the local economies.

For 106 years we have provided home loans to our customers. **For 106 years** we have averaged 2 foreclosures per year, most of which were the result of death or divorce. **For 106 years** we have been commended by our community, by our customers and yes, even by our field examiners, for originating quality loans and helping consumers live the American dream. We have always had excellent compliance and fair lending exams. We have always been rated as Satisfactory or Outstanding on our CRA exams. Putting it bluntly, we are darn good at residential lending.

But should Basel III pass as proposed, we believe the impact on providing residential loans will be gravely diminished for our bank. The proposed rulemakings penalize banks, such as ours, in many ways. I have been criticized by regulators for using the term “penalty”, but that is what it feels like. For the sins of others, those of us who KNOW how to make good loans are being treated as though we were a party to the housing devastation that has plagued our country for the past 4-5 years. Let me provide a detail summary of the risk weightings that will most greatly impact our bank:

I. Mortgage Risk Weighting Proposals

1) Junior liens risk weighting of 100-200% risk weight, including adding the current 1^{st} mortgage balance into the Junior lien risk weighting category should the bank hold both the 1^{st} and 2^{nd} mortgage.

   We have many junior liens on our books (Home Equity Lines or Second mortgages) that have low TLTV. We underwrite our junior liens to the same scrutiny that we do for 1^{st} mortgage liens, weighing customer’s ability to pay, willingness to pay and collateral valuations. In most cases, we do not go over a 90% TLTV based upon updated underwriting information. There is nothing inherently wrong with Junior liens, as long as they are underwritten properly.

   With many home owners now holding 1^{st} mortgage loans with rates under 5% for 15-30 years, they are NEVER going to want to refinance out of that rate to do home repairs, pay for medical emergencies or college tuition. Would you? Their most viable and affordable avenue will be a second mortgage to preserve the low interest and affordability of the first mortgage loan. If the rules pass as proposed, lenders will only want to provide 1^{st} mortgage liens, which when rates increase, will only hurt consumers who will lose their low interest rate from their first mortgage. The TLTV will be the same as if there had been a 1^{st} and 2^{nd} lien and the risk to the bank remains the same- yet the capital requirements are more stringent and the consumer is hurt.

   As lenders, we have always favored second liens on properties where we held the first mortgage, to provide the most collateral value and least potential risk to the bank should there need to be a foreclosure. If you hold just the second mortgage, to preserve your lien in the event of a foreclosure, you would be required to buy out the 1^{st} at greater expense or write off your entire loan. If you hold both the 1^{st} and 2^{nd} lien, your write down could be considerably less. Yet, we will now be penalized more for holding the 1^{st} and second versus just holding the 2^{nd} lien. This does not weigh risk properly to the bank and could potentially result in banks only providing seconds if they do NOT hold the 1st. Is that your intent?

2) Loans Sold in the Secondary Market now being considered in our capital requirements

We originate and sell more loans in the secondary market than we hold in portfolio for the following reasons:

a) Interest rate risk on long term fixed rate loans is not acceptable to the bank but this product benefits the consumer
b) Provide cash back to the bank to be able to help more consumers obtain home loans
If we kept all of our loans in portfolio, we would not have the return of funds to be able to continue QUALITY lending
c) We service 98% of the loans we originate. So, although we sell to FHLMC or the FHLBC, we still service and take care of OUR customers

In the 15 years I have been with Security Bank and sold loans on the secondary market, we have had to buy back two loans. We originate 200-400 loans per year, depending on the economy. Assuming the minimum of 200 over 15 years that is 3000 loans with 2 bought back resulting in a buy back percentage of .07%. Yet we will be required to hold capital on these loans reducing our ability to provide loans in our market. With this proposal, you will in essence be taking the GOOD/ QUALITY lenders out of the market.

3) Balloon loan risk weighting increased

Although balloon loans are a small percentage of our portfolio, there is a value both to the bank and consumers to have a balloon product:

a) Interest rate risk is minimized by balloon loans. For years, community banks have been encouraged by field examiners to provide balloon loans for portfolio loans to reduce interest rate risk. Now, after being told to do so, we will be penalized? This is inherently wrong!
b) For many consumers who do not plan on staying in their homes for extended periods of time, the balloon loan provides them a lower interest rate making the monthly payments more affordable. On average, homeowners stay in their homes 7 years. Many homeowners know they plan to move within that time frame and a balloon loan provides them the flexibility they are looking for. There are also many homes and consumers who do not qualify under the secondary market guidelines. In particular rural areas, many self employed borrowers, homeowners who run their business out of their home, loans with grant money for first time homebuyers with a soft second that are not salable on the secondary market, etc. These loans cannot be sold, but that does not make them a bad loan or a bad risk for the bank. Community banks are willing and able to help their customers with these loans, but again,

c) due to interest rate risk, cannot put them in long term fixed rate products. If we are now punished for making these loans, we will no longer offer the product and many potential homeowners will be left stranded with no opportunity to buy. Is this really your intention?

d) We have asked for but have NOT been provided the data to support that community banks making balloon loans led to the financial crisis or caused consumers to lose their homes. We believe that is because there is no data to support this claim.

In reality, banks have exams by their regulators for a reason. We truly believe in the value of bank exams. But isn't that process designed to find the perpetrators who have practiced unethical lending and taken advantage of consumers? Isn't that process in place to identify the inherent risk in that particular bank? That is the process that should determine the risks to capital, not broad blanket formulas that penalize the good lenders. We are THRILLED there will finally be a process to examine the mortgage brokers, the pay day lenders etc. who were the perpetrators of wrong doing. We have been asking for those entities to be regulated and examined for years and it is a welcome sight.

In summary, we oppose the mortgage lending risk weighting proposals in Basel III due to the negative impact it will have on community banks and on our customers and communities.

II. Accumulated Other Comprehensive Income (AOCI)

The proposal requires unrealized gains/losses on Available for Sale securities to flow through the income statement, causing potential radical swings in reported income and capital from one quarter to the next.

As a small community bank, we have a very conservative investment portfolio which holds mostly Agencies, Treasuries, Mortgage Backed securities and minimal municipals. During the crisis of the last 4 years, we took minimal losses on investments and are very proud of our record. However, based upon swings in the market place due to events of which we have no control and often which make no logical sense, on the last day of a quarter, there can be a huge swing in the unrealized gain or loss from even the day before. Pulling these numbers through the income statement can result in what we believe to be inaccurate valuations, in both directions. There will be times it will result in us showing more capital than we feel we should, and other times, much less capital How can you possibly place capital minimums on a bank based upon a potential for a 1 day swing in the markets? How will this differentiate between a portfolio that is available for sale vs. a trading portfolio? It would seem this proposal would be at odds with the Financial Accounting Standards Board #115. Are banks going to be placed in the position, once again, of having regulatory accounting that is in conflict with Generally Accepted Accounting Principles? Placing higher risk weighting on riskier investments is fine….but running it through the income statement is not logical.

III. Increased risk weights for past due loans

The proposal increases risk weights for loans that are 90 days past due. This appears to "double count" the risk because the ALLL calculation already adjusts for loans 90 days past due. Community banks are very aware of their loans on a one on one basis and allow for the proper calculations in the ALLL on a one on one loan basis. This calculation should be sufficient for capital calculations to identify risk in the loan portfolio.

IV. Disallowance for funds in excess of 1.25% in the ALLL for capital calculations

It would seem the continuance of this calculation flies in the face of what we have been asked for by regulators for years. We have continually been encouraged to build the ALLL to prepare for events such as we have been through and are going through with the economic crisis. Disallowing ALLL in excess of 1.25% to count toward the capital calculations only results in banks doing everything within the accounting standards to keep their ALLL **BELOW** the 1.25%. It would seem this proposal is counter intuitive to what regulatory agencies have been asking us to do. We are also required to be audited annually and each year are placed in the position of being criticized by auditors for placing too much in ALLL and violating FAS 5 and FAS 114 and then being criticized by regulators for not having enough. Never the twain shall meet and we as bankers are placed in a no-win situation. Regulatory and GAAP accounting need to come to an agreement on ALLL calculations and all funds in the ALLL account should count in the capital calculations. We should be commended for having more ALLL, not criticized.

V. Mortgage Servicing assets being reduced from 25% and 100% of capital to zero and 10% of capital.

As stated earlier, as a community bank we service the loans we originate. We know our customers. We sit by them in church, our kids play on the same teams. We see each other every day in our communities. Placing customers in loans that are not good for them, or ignoring them while servicing the loan will result in irreparable reputational risk. The servicers who did not know their customers were the perpetrators during this financial crisis, not the community banks who service **their** customers. There needs to be a distinct differentiation between loans originated and serviced by a bank versus mortgage servicers who did not originate the loans. The community bank model should be the **PREFERRED** model, not the model that is penalized for the ills of the large servicers.

Should this rule prevail, it will have the opposite effect for my bank as we will sell servicing to preserve capital. This is not in the best interest of the bank's risk profile and it is definitely not in the best interest of our customers.

VI. Credit Unions

Although we know you do not regulate the Credit Unions, there needs to be conformity in the capital rules between the banks and credit unions. The unlevel playing field presented at this point will be harmful to community banks, but especially harmful to a mutual bank such as mine. Like a credit union, we are owned by our depositors. However, we pay taxes and these proposals will place us in a stressed capital position with fewer options than most to generate additional capital. The playing field needs to be leveled with respect to capital calculations.

In summary, we understand banks need more capital. Had it not been for our extremely strong capital position, we could have been one of the non-survivors based upon commercial loan losses we had to take. It was our strong capital position (over 10% tier 1) and our conservative investment portfolio and our strong common sense residential lending that helped us make it through these tough years. We realize the value of banks holding strong Tier One capital. We believe strongly that a Tier One of 10% or greater for banks under $10 billion, 12% for banks in the $10-$25 billion range and 15% or greater for the mega banks is justified. None of us ever want to go through what we have been through the last 4-5 years. It has been painful.

But the proposal as laid out will result in banks, such as ours, who have served our community and served it well, leaving the market. You give us no choice and with that you will take away a very viable choice for consumers and for small town America. I truly believe Community Banks are the solution, we are not the problem.

Sincerely,

/s/

Robin Loftus
Executive Vice President/COO
Security Bank, s.b.

cc. IDFPR
Senator Richard Durbin
Senator Mark Kirk