Bank of Advance
Where A Handshake Still Matters.

October 22, 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[1] 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.

The Bank of Advance was founded in 1902 and is headquartered in the rural Southeast Missouri town of Advance. Our asset size is currently just over $260 million with over $190 million of those assets composed of loans. We currently have 70+ employees within six branches located in the Missouri towns of Advance, Bell City and Dexter, as well as Bowen and Lerna, IL. In January 2013, we will be expanding into the Chaffee, MO community. We consider ourselves the epitome of a community bank, as we specialize in deposit and lending services for consumers, farmers, business, not for profits, municipalities, etc. As small town bankers, we have a deep sense of affection for our communities, as these are the very same places that most of our employees and shareholders live and raise their families. Our institution takes great pride in doing everything possible in helping the residents and businesses in our communities and neighboring communities thrive and prosper.

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements*; and *Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

First, I would like to make note that I do support stricter regulatory standards, including the Basel III proposals, for larger, more complex financial institutions. The systemic risk posed by these institutions must be mitigated in order to forego another financial meltdown. More importantly for community banks, these mega banks hold a clear competitive advantage by being "Too Big to Fail", and though more regulatory scrutiny does not counterbalance these advantages, it is a small step forward for banks like ours in our ongoing fight for a more fair and level playing field. With that said, I do not believe the Basel III proposals should apply to community banks such as ours. This reactionary proposal should be aimed at those that helped create the economic mess, not the stronger community banks that have weathered the storm. The overwhelming majority of community banks operate in a safe and sound manner with a simpler, more common sense approach to risk and capital management.

Basel III is a very complex set of rules. After only having time to scratch the surface, I have recognized the following items within the proposal that are of most concern to me. These concerns pertain not only to our bank, but to the community banking model.

First, I have a huge issue with the increase, and calculation methodology changes, in the risk weighting for residential mortgages. Approximately 39% of our $192 million loan portfolio consists of residential mortgages with over 80% of those being 5 year balloons with 20 years or less amortization periods. This is a substantial portion of our portfolio and it has been for many years. We are already mitigating risk with our choice in loan structure offerings. We have to manage the risk associated with these loans in order to remain profitable and in operation. These loans are underwritten and originated by us, and they are held on our books until the loan is paid off. The risk is also being managed by turning down applications that are not acceptable to our credit standards. The risk is managed by charging higher interest rates to loans of which we feel have a greater credit risk. The risk is managed by requiring down payments or specific equity positions. The risk is managed by knowing the borrower, and his/her financial situation. The risk is managing by managing past due loans daily. The risk is managed by having a loan rating system. The risk is managed by conducting regular loan reviews and having periodic regulatory exams. From an accounting standpoint, the risk is being managed by setting aside provisions for future loan loss based on a thorough and tedious analysis. Etc., etc., etc. A few of my many questions are: 1) Why should we be penalized for having products that were designed to mitigate risk? 2) Does the fact that we are underwriting and holding these loans in our portfolio not prove that we want to make profitable loans with a minimal amount of risk? We have been in operation for 110 years. 3) Should an unsecured loan have a risk weighting of 100%, while a 5 year balloon home mortgage loan at 90.1% loan to value and is being paid timely have a risk weighting of 200%? I just don't think these questions can be answered with any sort of logic.

If indeed, this proposal is to address the additional risk associated with balloons and other types of loans, then I would like to be made aware of that additional risk. Long term fixed rate mortgages, which are less risky according to Basel III, will only lengthen the duration and increase the long term rate sensitivity of our balance sheet. Thus our interest rate risk has increased. Not to mention that the market rate on these loans makes them highly unattractive for banks like ours. The profitability is minimal or non-existent when you consider the *risk* of loss. If the argument is that interest-only and second lien mortgage loans are more risky, my argument is that the requirements we set forth to obtain these loans are more stringent and they are priced higher. Again, the risk has been recognized and managed.

My final concern regarding this portion of the proposal is that we simply do not have the manpower or software to compile the data that will be required in order to accurately classify these loans into the different risk weight categories. This will require a substantial amount of time and resources to not only compile existing data, but to develop the systems to track this data going forward. We are already spending the overwhelming majority of our time putting systems in place to attempt to comply with a number of overly burdensome and unfair new regulatory requirements, most as a result of Dodd Frank. Our ability to serve our customers and communities will be even more restricted if this proposal is included.

Second, along the same lines as the above point, I do not agree with increased risk weighting on delinquent loans and "high volatility" commercial real estate loans. Again, these loans are part of a portfolio that has and is being managed for risk on an ongoing basis. There are far too many variables associated with each individual loan to assign them a risk weighting based solely on collateral value and type, loan structure, and timeliness of payment. Leave the risk management of individual and groups of assets to the bank and the safety and soundness examiners. Like mentioned above, the allowance for loan and lease loss is designed for this purpose, why duplicate?

Third, the inclusion of unrealized gains and losses into regulatory capital would be a mistake. These securities are held to maturity in almost all cases at our bank. Why mark to market? And if so, why not mark all assets to market? This inclusion would only increase the volatility of the balance sheet and further burden a CFO's job in managing it. A rising interest rate environment could put some community banks out of business. My guess is most would just set aside even more capital, if they have access to any, so that these fluctuations would not hamper the bank's daily operations. However, that capital that was set aside would have been used to conduct more business, thus more jobs, growth, taxes, etc. Another option would be to readjust the asset model to include fewer securities in order to stabilize the balance sheet. However, this would eliminate a profitable portion of the earning asset portfolio. Less revenue equals less employment, less return for shareholders, less expansion, etc. Another consequence of this change would be fewer investors for projects such as city sewer plants, school expansions, etc. I have no statistics, but I have to believe that community banks are often the first investors at the door to help finance projects such as these. I know that is the case with our bank. The costs of these projects could go up with a smaller list of potential and willing investors.

Fourth, the required capital conservation buffer should not be a requirement. Capital is the buffer itself. Anything above the already established capital guidelines should be up to the bank itself and the regulatory examiners for that institution. A one size fits all "2.5 % capital buffer" is an unfair and unjustified requirement for all community banks. Each bank is different. Each bank has different risks, and they should be managed as such.

Fifth, allowance for loan and lease losses inclusion in capital should not be capped at 1.25% of risk based assets. Why discourage an additional "capital buffer"? This allocation is the first line of defense against losses for the bank, yet we cannot recognize the full amount or even a percentage of the full amount allocated? If Basel III is truly about risk mitigation and capital requirements, why not encourage higher ALLL? Well run, conservative banks should be rewarded, not reprimanded.

In closing, I am strongly in favor of a strengthened financial system in our country, but the scope of this well-intended proposal is off base. The inadvertent consequences will inevitably harm our customers, employees, and many other facets of the communities we serve. Banks like ours have continued to be dedicated to our communities throughout the recession, as we are in this for the long haul. Consumers and small businesses outside of metropolitan areas would have minimal, and in most cases zero, options for credit and banking services if not for community banks. This is especially so for moderate and lower income families and individuals. We do not want this to change. If approved, typical community bank business like branch expansion, equipment and software investment, employee advancement and opportunity, and product development will be placed on hold in order to comply with Basel III. Tighter lending standards and even ceasing certain types of lending are other probabilities. When you look at this from a community perspective, this means less employment, less investment, less opportunity for growth and fewer ways for residents to prosper in places like Advance, MO or Bowen, IL. Our communities depend on us. If the proposals are left as is, the needs and betterment of smaller communities and rural America will once again be taking a back seat. I strongly urge you to reconsider the Basel III requirements as relating to community banks. Thank you for your consideration and I appreciate the opportunity to convey my opinion.

Respectfully,

Adam Rainey
Vice President
Bank of Advance