From: Terry Stevens <tstevens@myalliancebank.com>
Sent: Monday, October 01, 2012 9:32 AM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

October 1, 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. As President of a small, rural Community bank, Alliance Bank of Francesville, Indiana, I have several concerns related to the Basel III proposals which I have outlined below.

- **Incorporating Accumulated Other Comprehensive Income in Regulatory Capital.**
    - The inclusion of AOCI in Community Bank Capital will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. For most Community Banks, AOCI is mostly comprised of unrealized securities gains and losses in investments held for sale. Today's historically low interest rates have generated unprecedented unrealized gains for most portfolios. While including this in capital now may actually make bank financials look better, the inevitable rise in rates will have dramatic negative impact moving forward. As an example, current calculations show that a 300 basis point increase in rates would generate a paper loss of $6,224,249. Such a loss would lower Alliance Bank's tier one ratio by 25%. Unlike the very large financial institutions, Alliance Bank does not have the expertise or ability to enter into qualifying hedges to mitigate the risks of capital volatility due to interest rate fluctuations.
- **Capital Conservation Buffers**
    - This provision will be extremely difficult for most Community banks to achieve given the current flattened yield curve and low interest rate environment. The only way for Community banks to raise capital is through the accumulation of retained earnings over time. The current environment is eroding profitability which further hampers the ability to grow capital. At the very minimum, we need to allow additional time to meet the additional capital requirements.
- **Risk Weighting**

- The proposed risk weighting framework is extremely complicated and will be a burden for community banks in terms of time and resources. As presently structured, the risk weighting may very well alter the business plan of community banks to exclude several currently viable and highly used types of credit. For instance, community banks who have traditionally remained conservative in Home Equity lending benefiting both the bank and consumers may move away from this product. Likely, community banks will either exit the residential loan market entirely, or only originate those loans that can be sold on the secondary market. Second lien loans will, at the very least, become more expensive for the consumer. I firmly believe that community banks should be allowed to stay with the current Basel 1 risk weight framework for residential mortgage for the sake of the bank and the consumer.

- **Subchapter S Community Banks**
  - Alliance Bank is a Subchapter S Corporation. Imposing distribution limits and prohibitions on us conflicts with the requirement that our shareholders pay income tax on all earned income. Subchapter S banks need to be exempt from the capital conservation buffers to ensure that our shareholders do not violate the provisions of the Internal Revenue Code. When taxable income is generated, a Subchapter S bank must be allowed to disburse funds for those shareholders to pay taxes and the capital conservation buffers need to be suspended during periods where the bank generates taxable income.

I sincerely question whether Basel III should be applicable to community banks. This program was designed for the largest, internationally active banks and not community banks. If you look at the cause of push for Basel III, and many other new regulations, you will find that community banks were not engaged in the highly leveraged activities that severely depleted the capital levels of large banks. Community banks operate on a relationship-based business model that is designed to serve our customers and our communities on a long-term basis. This model contributes to the success of community banks all over the U.S. through practical, common sense approaches to managing risk. We do not operate purely on transaction volume, paying little attention to the customer relationship as is the case with our countries larges institutions. The difference in banking models demonstrates a need to differentiate when regulating the different types of banks.

Thank you for your consideration of my comments and concerns. I do hope that you will acknowledge the basic differences that make community banks a strength of our nation's financial system and that you will consider those differences and keep community banks under the current Basel I framework.

Sincerely,

Terry Stevens

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[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.*