1st IOWA STATE BANK

MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION

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October 3, 2012

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 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. There are three main problems with this proposal as it relates to this community bank. These issues are addressed below:

1. Incorporating accumulated other comprehensive income (AOCI) as part of regulatory capital for community banks results in increased volatility due to economic conditions. Due to historically low interest rates, most investment portfolios have experienced unprecedented unrealized gains; which will be depleted when rates begin to move upward. So for example, the condition of a community bank remains relatively unchanged but if in six months market interest rates have increased; according to the new proposal, the bank is required to obtain additional capital due to changes in broad economic conditions. At my bank, for instance, if interest rates increased by 300 basis points, my bank's bond portfolio would show a *paper* loss of $5,055,000. This would mean that my bank's tier one ratio would drop by 3.02%.
2. The proposed risk weight framework under Basel III is extremely complicated and an onerous regulatory burden on community banks. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks and deprive customers of many financing options for residential property. Community banks mitigate interest rate risk in their asset-liability management through balloon loans; Basel III threatens this sound management practice. The duration of 15 or 30 year mortgages creates balance sheets sensitive to changes in long-term interest rates.

3. Imposing distribution prohibitions on community banks with a Subchapter S corporate structure conflicts with the requirement that shareholders pay income taxes on earned income. Those banks with a Subchapter S capital structure would need to be exempt from the capital conservation buffers to ensure that their shareholders do not violate the provisions of the Internal Revenue Code.

Community banks operate on a relationship based business model that is specifically designed to serve customers in their respective communities on a long-term basis. There is a significant difference in banking models between community banks and "big" banks. If you fail to exempt community banks from this proposal you fail to acknowledge their importance to their customers and their communities!

Respectfully,

Melissa Ballard

Melissa Ballard
Compliance Officer (and a community bank customer)