October 5, 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.

Our bank was formed in 2005 in West Bend, Wisconsin, serving Washington County. We have entered the Ozaukee County market in 2009. We have grown to $300 million in assets in 7 years. We are primarily a business bank, serving small to medium size businesses in each of our markets. We also serve many individuals of all means, especially through our mortgage division. We are dedicated to the communities we serve and we strive to be a leader in helping improve each of our communities.

We, like most other community banks in our country, want to make sure we are able to continue serving our communities in the way we have in the past. A strong economy is depended on job growth and job growth is dependent on availability of capital to fund the small businesses of our communities that produce most of the jobs. We want to ensure that the new rules do not reduce the ability of our community banks to provide this capital.

The following items are the areas of the proposal in which I have concerns:

1. Requirement that gains and losses on available for sale securities must flow through to regulatory capital.

   We are in an unprecedented period of low interest rates. Most banks have significant gains in their invest portfolios. This proposal would serve to increase regulatory capital in the short term. As interest rates begin to rise however this inflated capital would be quickly reversed and could move very dramatically in the other direction. While nothing will have changed in a bank's equity, their regulatory capital ratios could change drastically. This proposal will introduce a significant amount of cyclicality and volatility in the system, which is opposite of what I believe the goal should be.

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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.*

2. Increased risk weighting for residential mortgage loans.

   Our bank provides a significant number of mortgages to people living in the markets we serve. Our underwriting has been very strong as opposed to many of the non-bank mortgage lenders who were the real culprit in the housing crisis. The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that would be considered much riskier. This one section of the proposal will definitely reduce the number of loans that we are able to provide in our markets.

   In addition to the effect on our ability to lend, the changes from assigning "risk weightings to asset classes" to assigning "risk weighting to individual loans" will be an administrative nightmare. We will have to add "at least" one full time person, and probably more, just to assign and maintain risk weightings on the classes of loans that identifies in the proposal. You will not be able to just assign a risk weighting when you book the loan, you will have to continually re-evaluate the risk weighting based on changes in collateral values, past due status and other risk factors.

   We monitor our regulatory ratio's on a monthly basis and this will create additional problems for asset liability maintenance in order to calculate these numbers correctly.

3. Requirement to hold capital for credit enhancing representations and warranties of 1-4 family residential home loans which have been sold into the secondary market

   I am unclear as to what reps and warranties would cause our bank to set aside capital on a loan we have sold and for how long. Some of the reps and warranties in our correspondent contract as they relate to fraud, misrepresentation or later identified deficiencies in underwriting are considered to be life of loan reps and warranties. Other reps and warranties refer to early default and premium refund clauses do not subject the bank to the repurchase of the loan. In essence, the bank would be liable for approximately $5,000 on a $250,000 loan. The rule presently seems to state that the bank would have to maintain capital at 100% of the loan vs. the actual liability of $5,000. It seems to me that the capital we maintain should be commensurate with the amount of risk we are assuming.

   This rule as presently drafted threatens to drive every community bank in the country out of the mortgage lending business. I can't believe that is what is intended.

4. New rules regarding "High Volume Commercial Real Estate"

   This will reduce the underwriting and structuring of these transactions in banks. It will most likely reduce the number of development projects nationwide and may cause our bank to turn away from deals that we might have been able to do before. We would have to strive to make sure that every development project we do falls into the 100% category.

   Again, the administrative concern expressed previously, will necessitate increased staffing to accomplish this.

5. Proposal to increase risk weights on delinquent loans

   We already set aside reserves for loans that fall into a past due status of this severity. By also increasing the amount of capital we hold based on the past due status, we are being required to set aside capital two times. I feel the risk related to problem loans should continue to be managed through the loan loss reserve guidance and not by adding an additional capital requirement.

   The impact on banks to this rule will be to increase the aggressiveness in moving loans that become 90 days past due off the balance sheet. This will reduce the willingness to work as long as needed with a borrower to remediate the issues.

In conclusion, the proposal as it is currently written will greatly impact our bank in the following ways:

1. It will significantly increase the amount of capital we will need to hold above and beyond the increase which would occur as a result of the increased “capital ratios”. Each item I have detailed above will either increase our risk based assets or it will decrease the amount of capital we have. A “quick and dirty” estimate will reduce our risk based capital ratio from 12.6% to 11.1%. This is without going into every individual loan we have.

2. I have no way at this time to ascertain the full impact on our bank because of the amount of work that we will need to undertake to understand the rules, train our staff on how to apply the rules to our balance sheet, implement the coding of each individual loan in our portfolio with the new risk weights, re-program our core pressing software to handle the new coding requirements and then create the necessary reports to analyze the data. We will probably need to hire a consultant to help us work through the process.

The cumulative effect of each of these items reflected above will have a severe impact on most of the community banks in this country. I strongly urge you to consider this impact and to consider a possible exemption for most of our community banks from the bulk of these rules. Our nation’s community banks need to be able to continue serving our communities and helping to strengthen our local economies.

Thank you for your consideration.

Sincerely,

Joyce Zirtzlaff
Controller
Commerce State Bank

cc: Senator Herb Kohl
Senator Ron Johnson
Senator Glenn Grothman
Representative F. James Sensenbrenner JR
Representative Patricia Strachota