From: Kris Ausborn <kausborn@iowatrustbank.com>
Sent: Wednesday, October 10, 2012 10:59 AM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

To Whom It May Concern:

I am opposed to the application of Basel III risk-based capital proposal to community banks. Basel III was advanced under the argument of placing stricter capital requirements on banks "to big to fail". The following points address why the adverse effect the application of the Basel III standards will have on community banks and why we should continued to be regulated under Basel I capital requirements:

- **Applicability of Basel III to Community Banks** Community banks did not engage in the highly leveraged activities that severely depleted capital levels of the largest banks and created panic in the financial markets. 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. The largest banks operate purely on transaction volume and pay little attention to the customer relationship. This difference in banking models demonstrates the need to place tougher capital standards exclusively on the largest banks to better manage the ability to absorb losses.
- **Incorporating AOCI as Part of Regulatory Capital** Community banks should continue to exclude AOCI from capital measures as they are currently required to do today. Inclusion of accumulated other comprehensive income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for our bank represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. This decline will have a direct, immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce capital balances. At our bank, for instance, if interest rates increased by 300 basis points, the bank's bond portfolio valuation could decrease 10%, and show a paper loss of $4,100,000. This would mean that the bank's tier one risk-based capital ratio would drop 3.5%. Large financial institutions have the ability to mitigate the risks of capital volatility by entering into qualifying hedge accounting relationships for financial accounting purposes. Community banks do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry.
- **New Risk Weights** The proposed risk weight framework under Basel III is too complicated and will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks who offer these loan products to their customers and deprive customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate long-term mortgages with durations that will make their balance sheets more sensitive to changes in interest rates. Many community banks will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE. Second liens will either become more expensive for borrowers or disappear as banks will choose not to allocate additional capital to these balance sheet exposures. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages.
- **Proposed Phase-out of Trust Preferred Securities** The proposed ten year phase-out of the tier one treatment of instruments like trust preferred securities (TRUPS) eliminates a reliable source of capital for community banks

that would be very difficult to replace. Phasing out this important source of capital would be a particular burden for many privately-held banks and bank holding companies that are facing greatly reduced alternatives in raising capital.

- **Subchapter S Community Banks** While not a Sub S bank, 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. We recommend that the capital conservation buffers be suspended during those periods where the bank generates taxable income for the shareholder.

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