JCB

October 16, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20551

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.

Applicability of Basel III to Community Banks
Jackson County Bank is a $400 million privately-owned community bank located in Seymour, Indiana that has been in business for over 112 years. Jackson County Bank's board of directors and management team firmly believes that community banks should be allowed to continue using the current Basel I framework for computing their capital requirements. Basel III was designed to apply to the largest, internationally active, banks and not community banks. Community banks, like Jackson County Bank, 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 like Jackson County Bank operate on a relationship-based business model that is specifically designed to serve customers in their respective communities on a long-term basis. This model contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. 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.

The burden of conformance with the proposed BASEL III capital standards by community banks generally and Jackson County Bank specifically will be high in terms of man hours as well as systems investment. Even with systems modifications, to the extent they can be made, so much of the loan parameter risk weighting involves loan level data that may not be able to be captured through systems, leaving even more manual processes to properly and adequately determine risk weighting for residential and commercial real estate loans.

[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.*

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Incorporating AOCI as Part of Regulatory Capital
We believe that 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 most community banks 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. Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities. Additionally, demand for many implicitly and explicitly government guaranteed securities has risen due to a flight to safety and government intervention in the capital markets. This increased demand has caused credit spreads to tighten further increasing bond valuations. 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.

Jackson County Bank has an investment portfolio of approximately $75 million, all of which is classified as AFS and comprised of government agencies (including mortgage-backed securities), municipals and corporate bonds. If interest rates increased by 300 basis points, Jackson County Bank's investment portfolio would show a paper loss of approximately $3.7 million, which is approximately a $5.4 million change from our current September 30, 2012 position. This change would result in an approximate 13.1% loss in capital dollars. Further, Jackson County Bank's tier one ratio would drop by approximately 1.70%. Such a drop would result in the potential need to shrink the bank by contracting lending resulting in fewer loans available to individuals, businesses and not-for-profit organizations; this in turns leads to less earnings for the bank.

Jackson County Bank's security portfolio, like many community banks is a place to park short and long term funds to manage liquidity, interest rate risk and earnings. We are not traders of our securities but rather long term holders of them. The implications of including AOCI in the capital computations would likely result in a very major adjustment to the types and longevity of securities we purchase, such as tax exempt municipal investments, some of which is within our own market area and nearby states and municipalities.

Large financial institutions have the ability to mitigate the risks of capital volatility by entering into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Community banks, including Jackson County Bank, do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry. Community banks should continue to exclude AOCI from capital measures as they are currently required to do today.

Capital Conservation Buffers
Implementation of the capital conservation buffers for community banks could be difficult to achieve under the proposal and therefore should not be implemented in our view. Although on a static basis currently, Jackson County Bank meets the ultimate BASEL III capital limitations, based upon our preliminary assessment; we expect that

many community banks will need to build additional capital balances initially, to meet the minimum capital requirements with the buffers in place.

Community banks do not have ready access to capital that the larger banks have through the capital markets. The only way for community banks to increase capital is through the accumulation of retained earnings over time. Due to the current ultra low interest rate environment, community bank profitability has diminished further hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) in order for those banks that need the additional capital to retain and accumulate earnings accordingly.

New Risk Weights

The proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden for Jackson County Bank and we believe 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 that 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 Jackson County Bank specifically and community banks generally, for mitigating interest rate risk in their asset-liability management. Jackson County Bank extends balloon residential mortgage loans particularly when they are non-conforming with the now more stringent secondary market guidelines. Since we know our customers and their, at times, unusual circumstances, we will extend balloon loans and variable rate loans to help them during a transition achieve their desired objectives. With the required allocation of capital under BASEL III, it is highly conceivable that we would discontinue this type of lending, to the detriment of our customers and the bank.

We see the alternative for us and community banks generally to be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. We expect this could lead to an unintended consequence of community banks either exiting 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 altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans. Jackson County Bank has attempted to derive specific loan-to-value ratios in order to determine the proper risk weight categories for mortgages under the proposed BASEL III proposed guidelines. Jackson County Bank has spent a considerable amount of time and has found that its systems do not readily capture the information, especially in those cases where a first mortgage and junior-lien mortgage on the same residential property and there is no intervening lien. The combined exposure as a single-lien is not captured. With that being said, Jackson County Bank does not believe there would be a significant change in the ultimate risk weights regarding 1-4 family residential mortgage loans should the proposed guidelines be adopted, so it does not seem such benefit would outweigh the implementation costs, which would include not only software upgrades, but also the additional cost of internal staff time to comply with such new regulation.

It is also our view that increasing the risk weights on loans 90 days or more past due or on nonaccrual status duplicates the real purpose of the allowance for loan and lease loss analysis and would further deplete capital.

Mortgage Servicing Rights
Jackson County Bank, for its size, is a rather prolific underwriter, seller and servicer of conforming residential mortgage loans. Our servicing portfolio currently accounts for 2,005 loans, totaling approximately $160 million; the portfolio currently generates approximately $400 thousand in mortgage servicing rights. This is an important business for our bank and customers as they generate consistent revenue streams for the bank; our customers value their ability to contact us directly to work through any number of issues concerning their mortgage loans compared with having to call an 800 number when the loan servicing is sold to a third part. Penalizing the existing mortgage servicing assets under the proposal is unreasonable for those banks that have large portfolios of mortgage servicing rights. Any mortgage servicing rights existing on community bank balance sheets should be allowed to continue to follow the current risk weight and deduction methodologies.

Subchapter S Community Banks
While Jackson County Bank is currently a C Corporation, it is within the realm of possibility that we may seek to change our status to an S Corp. in the future for strategic purposes that would suit our shareholders and benefit the performance of our 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.

In conclusion, on behalf of Jackson County Bank's board of directors and management, we appreciate the opportunity to express our views on the potential implications of BASEL III capital standards on our bank specifically and community banks generally. Our strong preference is to have "community banks" entirely exempted from its provisions and continue to rely upon BASEL I as the proven and practical basis for assuring appropriate capitalization for community banks. In the event this is not deemed possible, then we respectfully ask that you considerably moderate the above referenced aspects of BASEL III by taking into account the burdens noted above on our bank and community banks and the potential consequences upon our customers that could lead to unintended consequences of less credit availability, less choice of product types for residential housing and development, all in a time when our nation's recovery rests heavily on community banks' willingness and ability to lend; at a time, when the generation and retention of bank earnings to support capital and our ability to grow and prosper is of significant importance.

Sincerely,

David M. Geis
President / CEO

Marvin S. Veatch
SVP / CFO