October 18, 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 the President and CEO of the Independent Community Bankers of South Dakota, I am deeply concerned regarding the impact Basel III rules will ultimately have on Community Banks. I am troubled that the rules will serve to limit available credit and increase lending costs in the rural and often already underserved areas of South Dakota. 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. South Dakota Community Banks, many of which are operated by 2nd and 3rd generation bankers, work to build long term mutually beneficial relationships. This model contributes to the success of community banks and small communities throughout South Dakota. Put simply, Community bankers use a common sense approach to managing risk and do not want or need to be lumped into rules not designed or originally envisioned for them.

The revised definition of capital to include accumulated other comprehensive income (AOCI) in capital for our community bank members will result in increased volatility and could rapidly deplete capital levels of Community banks. Capital would fall in a rising rate environment.

Large financial institutions have the ability to ease the risks of capital volatility by entering into hedge accounting relationships for financial accounting purposes with the use of interest rate swaps, options, and futures contracts. Community banks do not have the knowledge, personnel

[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.*

or expertise to engage in these transactions and manage the associated risks and costs. Our member Community banks should continue to exclude AOCI from capital measures as they are required under the current rules.

Implementation of the capital conservation buffers for community banks will be difficult to achieve under the proposal and therefore should not be implemented. Our Community bank members do not have ready access to capital that the larger banks have through the capital markets. The only way for many of our community bank members to increase capital is through the accumulation of retained earnings. The current near zero interest rate environment is leading to diminished community bank profitability. This further hampers our member banks' ability to grow capital. Community banks must be exempt from the capital conservation buffers.

The proposed risk weight framework under Basel III is far too complicated and will be an arduous regulatory encumbrance that will punish community banks and threaten the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will punish community banks and will deny community bank rural customers of many financing options for residential property. The rules force our member banks to originate only 15 or 30 year mortgages. These durations will make their balance sheets more sensitive to changes in long-term interest rates.

The rules will force our member banks to make substantial software advancements and incur other operational costs to track mortgage loan-to-value ratios. Second liens will either become more expensive for borrowers or vanish altogether. I have been told multiple times from our Community bank members that if these rules are imposed they will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE.

Many mortgages originated by our member Community banks are in rural underserved markets and are on properties that will not qualify for secondary markets. This will reduce credit in these markets, as our members are often the only banks to serve these rural markets. Community banks will simply be forced to eliminate residential lending activities.

In order to prevent damage to the current housing recovery, Community banks must be allowed to stay with the current Basel I risk weight framework for residential loans.

I appreciate your consideration of my comments and sincerely hope you take into careful consideration the many variances between community banks and systemically important banking institutions.

Sincerely,

Greg McCurry

Greg McCurry
President and CEO