Security State Bank

STUART SANDER
PRESIDENT

10/18/2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, D.C. 20551
Delivered via email
regs.comments@federalreserve.gov

Office of the Comptroller of the Currency
250 E. Street, SW
Mail Stop 2-3
Washington, D.C. 20219
Delivered via email
regs.comments@occ.treas.gov

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, NW
Washington, D.C. 20429
Delivered via email
comments@fdic.gov

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Security State Bank is a $164,000,000 community bank in western Oklahoma with offices in Cheyenne and Hammon. Security State Bank takes its role as a community bank seriously, lending to members of our communities and county in all types of businesses located in our market. Security State Bank realizes the importance of capital. As of 9/30/12, Security State Bank had Tier 1 leverage capital of 9.25%; Tier 1 risk-based capital of 18.28% and Total risk-based capital of 19.54%.

We are in favor of strengthening the quality of loss absorption safeguards in the financial institution sector. While we support increased levels of capital, several areas of Basel III are troubling, and in our case virtually unworkable as we are a community bank with limited access to capital. In fact, our capital increases only through the retention of earnings, for the most part. Many areas of Basel III would require us to retain earnings to the point it would limit our ability to make loans and serve our communities in the best manner possible.

P.O. BOX 470 CHEYENNE, OKLAHOMA 73628 580-497-3354 FAX 580-497-3302

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A major area of concern is the inclusion of gains and losses on available-for-sale securities in the common equity Tier 1 computation. Currently, Security State Bank has a $82 million bond portfolio (U.S. Agencies, GSE-issued MBS products, and high-quality municipals) with approximately $3.5 million in unrealized gains and an average portfolio maturity of three years and 11 months. In the case of our bond portfolio the impact in a 300 basis point rise in interest rates would be significant. We would then have an approximate $5 million unrealized loss which would drop our Tier 1 leverage to an estimated 6.8%. This is despite the fact that our portfolio's maturity quite short. The result of this threat to our capital would result in the following:

- An avoidance of market swings by shortening the portfolio even more. This means lower yields and lower earnings. Lower earnings make it more difficult to raise capital since our primary means of raising capital is through retained earnings
- Lower earning assets could cause us to lower deposit rates in an attempt to maintain earnings. This would harm our deposit base as rates are already low enough.

The proposed rules regarding residential mortgages will make mortgage loans more difficult to obtain in many markets such as those served by community banks. Mortgage loans held on our books (generally adjustable-rate or balloon notes) are used as a tool to manage interest rate risk. We are not able to hold long-term(over ten years) fixed rate notes, especially in this interest rate environment due to the inherent risk of rising rates. Requiring higher risk-rating of adjustable and balloon notes requires more capital, increases the cost of the credit, and will serve to reduce the availability of credit. That's something that would significantly affect our communities. In fact, we've already had conversations in our loan committee meetings regarding compliance risk in home lending and the viability of continuing as a home lender. If Basel III passes as proposed we will again have conversations regarding the ability of Security State Bank remaining a home lender due to both compliance risk and now capital risk. That is a sad statement and I can't believe the intent of the proposal is to make home lending more difficult.

Also, the proposed rules increase risk weights on delinquent loans. This is a redundant means of increasing capital requirements. Delinquent loans are already considered in the ALLL. Community banks are already high regulated in this regard and criticized severely if not appropriately recognizing risk in the loan portfolio with an adequate ALLL. Thus, this part of the proposal is completely unnecessary.

The scope of the proposed rules will require the collection and reporting of new information in order to calculate the risk weights for our institution. We will need to acquire new software and install new systems in order to comply with the very complex calculations. As an alternative, we may need to outsource the project to a third party. Either way, the proposed rules will cause our institution to incur new costs and regulatory burden. This is wholly unnecessary as current regulations and examinations already ensure adequate calculations and reporting of community bank capital.

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Finally, Security State Bank believes the cumulative effect of the proposed rules will have a significant impact on us as well as the community banks across this country. While I support strong capital (in both quantity and quality), Basel III will do nothing to strengthen our capital position. In fact, it will likely serve to create uncertainty in our bank and in many community banks and will ultimately weaken the communities we serve.

I strongly urge you to consider the impact of the proposed rules and the harm that would befall our bank and other community banks as a result. At a minimum, please consider an exemption that would encompass community banks from these rules.

Respectfully,

Stuart Sander

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cc:
The Honorable Tom Coburn
The Honorable James Inhofe
The Honorable Frank Lucas

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