Jennifer J. Johnson
Board of Governors of the Federal
Reserve System
20th St and Constitution Ave., N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E. Street
Mail Sop 2-3
Washington, D.C. 20219

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Ladies and Gentlemen:

On behalf of the shareholders, Board of Directors, Officers and employees of The Home Trust & Savings Bank, a $210 million rural bank in Osage Iowa, I appreciate the opportunity to 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. 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 did not participate 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 our communities on a long-term basis. This model is the backbone to the success of community banks all over the United States through practical, common sense approaches to managing risk. The "too-big-fail" banks operate purely on transaction volume and pay little attention to customer relationship. This difference in how we conduct business demonstrates the need to place tougher capital standards exclusively on the largest banks to better manage the ability to absorb losses.

Capital Conservation Buffers/Subchapter S Community Banks

Implementation of the capital conservation buffers for community banks will be difficult to achieve under the proposal and therefore should not be implemented. 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, such as Home Trust & Savings Bank, 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.

New Risk Weights

The proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden that will penalize community banks and jeopardize mortgage lending. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks such as Home Trust & Savings Bank who offer these loan products to their customers and deprive our customers of financing options for residential property. Higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Banks may be forced will either exit the residential loan market entirely or only originate those loans that can be sold on the secondary market. We don't feel that is truly meeting the needs of our customers. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans. 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.

Incorporating AOCI as Part of Regulatory Capital

Including 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.

Interest rates have fallen to levels that are unsustainable long-term once an economic recovery starts. 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 my bank, for instance, if interest rates increased 300 basis points, my bank's bond portfolio would show a paper loss of $6,350 million. This would mean that my bank's tier one ratio would drop by 1.70%.

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 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.

In conclusion, our bank has no way to completely ascertain the full impact of this massive proposal because of the amount of work it will take to understand the rules and how they apply to our balance sheet. We will likely be required to hire ANOTHER team of consultants to implement the re-assessment of each individual loan in our portfolio with the new risk weights, costs for our data processor to re-program their software to handle the new coding requirements and then create reports to analyze data.

While I support the overall goal of strengthening the financial system by increasing the level and quality of capital that banks hold, these rules are designed much more for the large multi=billion dollar global financial institutions. We urge the agency to repeal this proposal so we may continue serving our communities and help strengthen our local economies.

Sincerely yours,

Jean A Brumm

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