3

520 smp

HCSB

BRIAN POHLMEIER
PRESIDENT & CEO
EMAIL: BRIANP@HCSB.COM

October 15, 2012

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:

I would like to thank you for the opportunity to comment on the proposed Basel III guidance recently issued by the Federal Reserve Bank, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

It is with a bit of disbelief that I begin this letter and address the over reach by our Federal Government and Regulatory entities into the private sector. Strong capital requirements are well understood by Community Banks and the prior 5 years have delivered to us in impressive terms the need for well capitalized financial institutions. At issue with Basel III is an extremely complex form of capital requirements that will damage the Community Banks of this nation and the customers we serve. I cannot speak to the potential damage this may or may not cause the top 20 largest banks in this country, because the only thing a Community Bank and a Too Big to Fail Bank have in common is the name Bank.

As a bit of background – HCSB, a state banking association (HCSB) is a $400 million State Chartered – FED Member Bank located in the Panhandle of Texas with banking centers in Hart, Tulia, Kerrville, Fredericksburg and Boerne, Texas (LPO). All of our locations are in Non Metropolitan communities. We serve a diverse group of customers from Mortgage (Portfolio and Secondary Market), Agricultural, Commercial, Manufacturing, Home Builders and a wide variety of consumer based customers. Our bank was chartered in 1934 and have survived and thrived during this past 78 years.

The areas of damage to be created by Basel III are great and it would be difficult to enumerate all of them within a single letter. I will focus on three primary areas that will impact HCSB and its customers.

P.O. BOX 970 PLAINVIEW, TEXAS 79073 (806) 293-3635

Mortgage Lending:

HCSB provides home loans to a large number of bank customers in the various markets we serve through portfolio loans held on the banks books and secondary market loans sold upon origination. Many of the portfolio loans held by the bank are loans that do not fit the guidelines of the secondary market. In rural settings, getting conforming appraisals with little comparable sales history creates a situation that without the Community Bank, these home loans are not available for a great many potential home owners. Also with many self employed and minority customers with non established credit scores, the inability for them to qualify for secondary market loans, all but prohibits their ability to gain home ownership without the community bank. The change in risk classification for mortgage loans under Basel III will eliminate our desire to provide the portfolio type of mortgage product of which we have some $40 million on our books at this time. The portfolio mortgage loans have been a good source of credit in a low loan demand environment, with extremely low default rates, because we know who we are dealing with in that they are people we live and deal with daily. The elimination of this type of mortgage loan product, damages greatly the communities and ability of current home owners to sell their homes when jobs or age dictate changes in life.

Investment Portfolio Gains and Losses:

The Basel III proposal to FORCE unrecognized gains and losses in the bank's security portfolio through the earnings statement and thus the bank's capital account makes no sense for a Community Bank with the history of NOT operating a Trading Account. Normal market gains and losses in an investment portfolio are just part of the normal operations of the bank and are measured and analysised by the Interest Rate Risk models used by the bank. This Basel III proposal intends to separate one part of the balance sheet from the other in forcing gains and losses in one piece of the balance sheet (investment account), but ignoring the other counter balancing areas such as non maturity deposits, fixed liability instruments (CD's) or term FHLB advances with corresponding gains in a rising rate environment. In almost all cases the matching of assets and liabilities are offsetting in gains and loss values, but will not be such under the proposed Basel III guidelines. If there is a perceived risk in bank asset liability structure, then it should be addressed through Asset Liability and Interest Rate Risk Management, NOT by driving the gains and losses in one piece of the balance sheet through the income statement. This will create a huge fluctuation in the earnings of the Community Banks where the bank has the ability and intent to hold securities to maturity, where no such gains or losses will be recognized when the funds come back to the bank at PAR. The bank is already measuring these Security Portfolio gains and losses through its AFS account which is recognized on the balance sheet, just not run through the income statement. On a non publicly traded Community Bank it makes no sense in creating this type of turmoil in the financial statements of the bank.

As with any regulation, there are unintended consequences and one of these will be the virtual elimination of buyers for the longer term pieces of Municipal Bond Issues for the smaller Bank Qualified (BQ) communities. Community banks are the largest purchasers of the smaller community municipal bond issues of less than $10 million. Community banks will shorten their horizon to less than a 10 year bond maturity to eliminate the largest amount of the potential fluctuation in pricing. This will create a dearth of potential buyers for the longer end of the issues, thus throwing a great deal of interest rate risk back on the Communities in not being able to easily place the longer end of their funding needs for community based capital projects. Banks will take a much lower rate in the less than 10 year maturity bonds instead of placing bonds in the 15 to 20 year range in levels equal to capital accounts and non interest bearing deposits to create solid earnings for the bank over the long term.

Elimination of Trust Preferred Securities from Capital Calculation:

It is difficult to understand the rational of Basel III in eliminating a form of capital that has no risk to the Regulatory entities and provides a cushion to the FDIC Insurance fund? The difficult part of this equation is that when this form of capital was put on the bank's books, it conformed to the capital standards in place at that time by all of the Federal Regulators as being Qualified Tier 1 capital. Community Banks that are non publicly traded have had few options of outside sources of capital historically. The Trust Preferred Securities was one of the few avenues Community Banks had in accessing the capital markets for a form of capital. The elimination of this capital source is difficult enough for the smaller banks to have to deal with, but unilaterally deciding how long the capital is available that is currently on the books is entirely another. This is completely changing a contract between two different parties that was an acceptable form of regulatory capital at its inception. At a strict minimum these corporate contracts should be grandfathered to maturity of the securities, with the banks being able to retire these capital notes over that remaining term.

Sincerely,

Brian Pohlmeier
President / CEO