First State Bank
& Trust Company

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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.

First State Bank and Trust Company is a $216 million community bank located in eastern Nebraska. We have been in business for over 55 years, focusing on the local community in which we live and work. We take great pride in being the only 100% locally-owned community bank and the role we have played in the growth of our community over the years.

As of the June call report, our bank has over 13 percent tier one risk-based capital, total risk-based capital of more than 14 percent, and loan loss reserves (capital conservation buffer) of 2 percent of total loans. Our intentions have always been and will continue to be, to maintain capital well above the minimum required levels even as loan demand recovers.

I support increasing the capital requirements for banks in our country to ensure that the entire industry can handle economic situations as they arise. However, I do have serious concerns about the proposals which have been approved and placed for comment. The current rules as proposed could create a detrimental impact on our ability to foster economic growth in our community.

[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.*

The following items are the main areas of the proposal in which I have concerns:

1) **Requirements that gains and losses on available for sale securities must flow through to regulatory capital**

Our country is in an unprecedented period of low rates. Our bank, like many others currently has significant gains in our portfolio ($663,000). The banks $25 million dollar bond portfolio is managed very conservatively and is made up primarily of government backed agencies. These investments have little risk, but are subject to interest rate risk. This proposal would serve to increase regulatory capital in the short term. However, as interest rates begin to rise, this "temporary" inflated capital would quickly reverse and could dramatically move in the opposite direction. If interest rates move up, nothing will have changed in the bank's equity capital components, however, our regulatory capital ratios could change dramatically based upon this proposal.

Shock testing our portfolio indicates that a 300 point increase in rates would decrease tier one capital to around 11.5 percent. Although this is considered adequate capital, this ratio is moving down and could potentially cause unnecessary regulatory scrutiny and reduced lending.

2) **Change in capital requirements on mortgage servicing assets**

We currently do not service the loans that we sell into the secondary market. However, in the future this may be an income producing opportunity for our bank. Basel III, as proposed, will potentially eliminate this revenue source for our bank and others.

3) **Increased risk weighting for residential mortgages**

The proposed increased risk weighting of residential mortgages are higher in many cases than many other loan types based upon our past experience. This section of the proposal will reduce the number of mortgage loans that we are able to provide, thus directly impacting our local home buyers and the community that we serve.

Besides reduced lending in the mortgage area, the paperwork nightmare associated with risk weighting individual loans will be a major administrative burden.

4) **Change in risk weighting for home equity and second lien loans**

Presently, the bank has approximately 4 million of junior lien mortgage loans. These loans are priced higher to accommodate the associated increased risk and have provided profit to our real estate lending business. The opportunity for our customers to have a second mortgage in certain situations has allowed our customers to receive the best pricing they could on their mortgage loans. This proposal will cause us to reevaluate this program.

5) **Increased risk weights on delinquent loans**

The proposal of increasing risk weightings on past due loans is redundant. Currently, past due loans are considered in the allowance for loan and lease losses. Community banks like ours are already highly regulated in this area. This proposal will impact our ability to work with a borrower that becomes past due in order to remediate issues.

6) **Requirement to hold capital for credit enhancing representations and warranties on 1-4 family residential homes loans sold into the secondary market.**

My biggest concern with this proposal is that it is ambiguous. I do not clearly understand what reps and warranties would cause us to set aside capital on the loans we have sold and for how long. In the time we have been in the secondary market business we have not had to repurchase a loan. This rule as drafted in its ambiguity, threatens to move all secondary market business to the big banks.

In conclusion, I believe that the cumulative effect of the items discussed above will have a significant impact on the daily operations of our bank and most community banks in this country. I strongly urge you to consider an exception for community banks.

Sincerely,

Charles P. Johannsen

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