BELMONT BANK & TRUST

October 19, 2012

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

Office of the Comptroller of the Currency
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Delivered via email:
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Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
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[1] that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

I am the President & CEO of a *de novo* bank established in June 2006 on the northwest side of the City of Chicago, Illinois. We are a local community bank that delivers financial services solutions, provides access to experienced decision makers, and serves as a "partner in business". As an example of our commitment to the community, we have recently dedicated the basketball floor to the local high school, which has been extremely well received by the community. In addition to our commitment to the community, we focus our services on being a "partner" to the small business community. We believe that our accomplishments are tied to a successful *customer service* oriented culture. We pride ourselves on the close knowledge we have of our clients, the risks associated with doing business with them, and assisting them to be an integral part in our local economy.

Our bank is a full-service bank that emphasizes relationship banking that is highly individualized, efficient and responsive to local needs. We offer a full line of deposit and loan related products such as checking accounts, time deposits, a full array of loan services, and related services to individuals, small to medium-sized local businesses and professionals. In addition, we offer other specialized services, including mortgage lending, in order to meet the demands of our market. By delivering these products and services with user-friendly technology, coupled with a capable and experienced management team

[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.*

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leading a well-trained and motivated staff, our bank will continue to realize market share growth of deposit and loan products. Community banks such as our bank had little impact on the recent economic challenges confronting the U.S. economy, created primarily through the misuse of esoteric loan and investment products primarily conducted outside of the traditional banking system.

Since our bank opened in 2006, we have grown to over $200 million in assets. Like most other community banks in our country, we want to ensure that we are able to continue to provide the legendary experience that our customers and community have come to expect. The employees, directors and officers of our bank are focused on the success and growth of our community. Without our bank providing loans to our community and small businesses, the local economy will continue to suffer. I am extremely concerned about the effects Basel III will have on our ability to support the local economy, as well as the state of the community banking industry. Currently, within a three mile radius only a handful of banks could be considered true community banks.

The following represents the areas of the Basel III Capital Proposals for which I express concern:

I. Requirement that unrealized gains and losses on available-for-sale investment securities be included in the regulatory capital calculations.

I take pride in our bank maintaining a diversified balance sheet. As of September 30, 2012, our available-for-sale investment securities portfolio totals approximately $41 million, which represents over 20 percent of our bank's total assets. Of the $41 million in available-for-sale investment securities, more than 50% represent low risk securities such as U.S. government and agency debt obligations and U.S. GSE debt obligations. These securities have both the implicit or explicit full faith and credit of the United States, with risk weightings on these assets ranging from 0% to 20%.

Unrealized gains and losses primarily occur in available-for-sale investment debt securities portfolios as a result of movements in interest rates. As a result of the extended low interest rate environment that we currently find ourselves in, as of September 30, 2012 the market value of our bank's available-for-sale investment securities portfolio exceeds its amortized (i.e. book) value by approximately $1.4 million and has an overall modified duration of forty-nine months. As interest rates rise, the excess of market value can be reversed significantly. If we simulate a 300 basis point increase in interest rates, the market value of our available-for-sale investment securities portfolio will decrease more than $3.4 million, which creates a negative impact to our bank's regulatory capital under the Basel III capital proposals. As of September 30, 2012, our bank had Tier 1 Leverage Capital, Tier 1 Risk Based Capital, and Total Risk Based Capital ratios of 10.1%, 15.2%, and 16.4%, respectively. Based on a 300 basis point increase in interest rates, our regulatory capital ratios would decrease to 8.3%, 12.5%, and 13.7%, respectively. Although these ratios may still be deemed adequate under existing regulatory guidelines, as a *de novo* bank we believe we will be subject to further regulatory scrutiny, as well as create a negative impediment to our Bank's ability to lend, as the impact on capital will likely affect our bank's legal lending limit. Using the 300 basis point increase example above, the aforementioned impact to capital would lower our legal lending limit by approximately $900 thousand, or 15%, which is a significant amount. This effect could expose our bank to losing good customers to larger financial institutions, which would impact our bank's earnings, which subsequently would impact our ability to augment our capital (i.e. shareholders' equity) through retained earnings.

Although a consideration to address this recommendation could be to sell all of our bonds in our existing available-for-sale investment securities portfolio and classify new bond purchases as held-to-maturity, we believe this action would restrict our ability to manage our investment securities to mitigate interest rate risk on our Bank's balance sheet, as well as to utilize investment securities as a source of liquidity should the need arise. Furthermore, in order to reduce interest rate volatility our bank could shorten its duration on its available-for-sale investment securities, which would negatively impact yield and reduce earnings, which would further impact the bank's capital. Also, any future downgrades in the credit rating of the United States would further exacerbate this impact to bank capital.

Finally, in light of the proposed inclusion of unrealized gains and losses in banks' regulatory capital, I believe the limitation of the Allowance for Loan and Lease Losses (ALLL) to 1.25% of a bank's risk weighted assets as Tier 2 capital is counterintuitive to promoting enhanced capital requirements and a "capital conservation buffer" to survive downtowns in the economy. Banks should be encouraged to augment the ALLL, and limiting a bank's ability to include the full ALLL as capital serves to dissuade this practice.

II. Impact of increased risk weighting on 1-4 family residential mortgages.

We offer balloon products with fixed rates and amortized payments. We don't sell any mortgages in the secondary market. As such, our loans stay on our books, which encourage prudent risk management. In addition, the Bank uses this type of product as a tool to assist in the mitigation of interest rate risk, while still meeting the needs of the community. Under the proposal, all risk weightings would go to 100% due to the balloon features of these loans. These loans total over $31 million as of September 30, 2012. Under this proposal, our bank's Tier 1 Risk Based Capital, and Total Risk Based Capital ratios will decrease to 13.5% and 14.7%, respectively.

As indicated above, we believe the increased risk weighting requirements will restrict our bank's ability to lend as we will not be able to offer competitive rates to offset the impacts to capital associated with these proposed increased risk weighting requirements. This will restrict the availability of credit in our area.

In addition, as a community bank, we believe that the complexity associated with this provision will necessitate additional staffing to assign risk weightings to individual loans and monitor this at least on a quarterly basis based on changes to collateral values, past due status, as well as other risk factors as proposed, as well as the significant expense to augment our computer systems and/or outsource this service to a third party to ensure compliance with this provision.

III. Impact of proposed rule changes on High Volatility Commercial Real Estate (CRE) loans.

Our bank offers commercial mortgages to companies, investors and developers. These offerings include mortgages on owner-occupied properties, as well as mortgages on office buildings, apartment buildings, retail buildings, etc. CRE loans as of September 30, 2012 total approximately $68 million. The bank also has a portfolio of construction loans. Construction loans as of September 30, 2012 total almost $16 million. For example, the Bank has built over 75 units with a single developer. For example, the bank has financed construction that replaced vacant lots with vibrant developments that improve neighborhoods.

The changes as proposed would decrease the flexibility that the bank has to finance construction project to enhance communities, such as offering support to developers to finance the demolition of condemned and vacant structures and to replace them with a mixed unit development, in order to improve the neighborhood and add to the local community's existing tax base.

As a community bank, our bank offers CRE loans to its customers. In addition, as mentioned above related to the proposed changes to 1-4 family residential loans, we believe that the complexity associated with this provision will necessitate additional staffing to assign risk weightings to individual loans and monitor this at least on a quarterly basis based on changes to collateral values, past due status, as well as other risk factors as proposed, as well as the significant expense to augment our computer systems and/or outsource this service to a third party to ensure compliance with this provision.

IV. Impact of proposed rule changes on increasing risk weighting of past due loans.

As indicated above, we believe the increased risk weighting requirements will restrict our bank's ability to lend as we will not be able to offer competitive rates to offset the impacts to capital associated with these proposed increased risk weighting requirements. Furthermore, as it relates to the increase in risk weighting on past due loans, this will serve as a double impact to capital as an analysis of past due loans is a qualitative factor in our bank's quarterly analysis of the Adequacy of the ALLL. Thus, under this proposal we will be required to set aside capital twice. Our bank strives to maintain a balance in our bank's ALLL greater than that dictated through our Analysis of the ALLL. The increase in risk weighting may impact our bank's willingness to work with troubled borrowers to come up with the best solution in a difficult situation.

In addition, as a community bank, we believe that the complexity associated with this provision will also necessitate additional staffing for the same reasons as stated above.

V. Impact on deductions of Deferred Tax Assets to Capital

The exclusion from capital of certain Deferred Tax Assets (DTA) could impact our bank's capital ratios and the ability to lend. This proposal in its current format will increase the burden due to the complex calculations that would be required to determine allowable DTAs. Further, in its current form there is ambiguity in the proposed rules on determining what portion of DTAs can be realized through carry back to prior years; and the impact that exclusion of certain DTAs from capital will have on our bank.

In conclusion, the implementation of the Basel III Capital rules would have an extremely negative effect on capital, which ultimately will have a detrimental impact to our bank's goal to spur economic development and to support the needs of our customers and community.

Thank you for your consideration regarding this matter.

Sincerely,

William F. McCarty III
President & Chief Executive Officer

Cc: The Honorable Michael Quigley
The Honorable Richard Durbin
The Honorable Mark Kirk