



# Peoples Exchange Bank

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October 10, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal  
Reserve System  
20<sup>th</sup> Street & Constitution Avenue, N.W.  
Washington, D.C. 20551

Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, N.W.  
Washington, D. C. 20429

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

RE: Basel III Capital Proposals

Ladies & Gentlemen:

Thank you for this opportunity to provide comment on the Basel III proposals that were recently approved by your respective agencies.

Peoples Exchange Bank is a \$63 million dollar community bank located in North Central Kansas. Our primary sources of business are primarily agricultural loans and home mortgage loans in the small communities (under 7,000 population) that we serve. Additionally, we have a wholly owned mortgage subsidiary in Manhattan, Kansas (population 50,000) originating residential real estate loans for sale on secondary market. Originally, my concern with the Basel III proposals was limited due to the size of our bank; however, the PEB charter is one of three charters within our \$600 million dollar holding company; this affiliation will further extend the impact of the Basel III proposals on our bank.

My first concern for our bank lies with the proposal concerning the treatment of the gains or losses on securities as regards the capital level of the bank. Given the current interest rate environment, it is almost a given that interest rates will rise at some point and that will create market losses in our security portfolio. Given the proposal those market losses would reduce our capital levels. While this bank is well capitalized, decreases in capital levels are never viewed favorably by regulators. Further, while PEB is a relatively small bank, we serve agricultural customers where the need for credit often leaves those customers near our legal lending limit especially at the peak credit needs in the growing season. Changes in our capital level due to market losses will create additional issues for us in meeting the credit needs of those customers.

Our bank does originate and sell residential real loans through the Mortgage Partnership Finance program of the Federal Home Loan Bank; however, we do retain the servicing rights on those loans. The ability to retain the servicing is a very positive factor in maintaining contact with our customers and

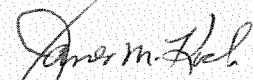
providing them other banking services while offsetting the interest rate risk in a long-term fixed rate mortgage. We are concerned that the Basel III may eliminate our ability to retain servicing rights.

Another concern deals with the increased weighting on delinquent loans. While our agricultural economy is currently very strong, I well remember the ag crisis of the 1980's. Workout situations often involve carrying loans in a past due status for some time. We expect to provide for these problems by having a well funded loan loss reserve. To increase the weighting for past due list has the double effect for banks of decreasing capital while at the same time we are holding large amounts in the loan loss reserve. It seems to us that managing the loan loss reserve is a more prudent and effective way to address this situation.

I am sure that I have only begun to touch the surface in outlining the ways in which Basel III will affect our bank. The proposal is so complex that complete understanding of all ramifications will require untold hours of research. Further, if the rules were to be implemented, it is highly likely that additional staff will be required to ensure compliance with the proposal. This will create greater hard ship given the current inability to have any significant earnings from the securities portfolio which in turn creates predatory loan pricing further hampering earnings. So, in this troubling condition, the last thing needed is the cost of additional staffing that will further hamper earnings. Earnings create additional capital which seemed to be an original intent of some of these proposals.

We acknowledge our duty to insure a safe and secure banking system. However, we are concerned that the Basel III proposals go far overboard in pursuit of that goal.

James M. Koch



President

Peoples Exchange Bank