CLEAR LAKE
BANK & TRUST CO.
A FULL SERVICE BANK MEMBER FDIC

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October 17, 2012

Jennifer 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
250 E Street S.W.
Mail Stop 2-3
Washington, D.C. 20219
Delivered via email: regs.comments@occ.treas.gov

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

CC: The Honorable Charles Grassley
United States Senate
Washington, D.C. 20510

The Honorable Tom Harkin
United States Senate
Washington, D.C. 205010

The Honorable Tom Latham
United States House of Representatives
Washington, D.C. 20515

RE: Basel III Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comments relative to the Basel III proposals recently approved by the Federal Reserve Board, the Office of the Comptroller of Currency, and the Federal Deposit Insurance Corporation.

Founded in 1934, Clear Lake Bank & Trust Company is a $260 million bank with offices in Clear Lake, Garner, and Mason City, Iowa. Throughout our 78 years in North Central Iowa, we have taken great pride in serving our friends and neighbors in true community banking fashion. Our 65 employees believe strongly in the mission of our community banking model, providing an array of financial services to many customers, including: consumers of all income levels and ages, small business, mid-size companies, larger corporations, farmers, school districts, city governments, and non-profit organizations.

After a thorough review of Basel III, we have serious concerns about how its changes will apply to our bank. Not only will it hinder our ability to continue serving customers across our broad spectrum of business, but will ultimately lead to an increase in the cost of our services. Detailed below are the primary Basel III propositions which will negatively impact our ability to provide financial products and services to our communities and to operate under a banking model that ensures maximization of profitability, efficient sources of liquidity, and proper interest rate risk management.

Unrealized Gains/Losses

A major area of concern is the impact that the inclusion of gains and losses on AFS securities in common equity tier 1 (CET1) will have on our bank's capital accounts and resulting ratios. Fluctuations in interest rates and overall valuation of AFS securities will cause great volatility of our capital levels and thus much less meaningful capital measurements for overall normal business cycles and changes in interest rates. To reduce the impact that unrealized gains and losses will have on our capital account, we will be forced to either (1) hold our bond portfolio as "held for sale" and eliminate its use as convenient and potentially lower cost source of liquidity or (2) purchase bonds with very short durations, resulting in lower yields on investments and the ability to use our bond portfolio to manage interest rate risk.

The impact of this change on municipalities should also be considered. From our standpoint, the demand for longer-term municipal bonds will likely decrease as banks scramble to purchase shorter duration bonds in an attempt to reduce capital volatility. Municipal entities may be forced to offer an even higher premium when selling longer duration bonds and the resulting impact may be an increase in taxes for consumers.

Mortgage Servicing Assets

Two years ago, Clear Lake Bank & Trust Company assessed the feasibility of entering the mortgage loan servicing business. After hearing that customers were growing increasingly frustrated with their home loan being sold and their payment instructions changing frequently, the decision was made to hire additional employees and make a significant investment in software to begin mortgage loan servicing. While we currently do not rely on the value of our mortgage servicing assets to supplement capital, we do feel that the service we provide our customer (i.e. the ability to work directly with their community bank where their mortgage loan was originated) carries substantial "goodwill" value. The significant reduction and limitation of mortgage servicing assets as capital reduces the profitability and value of offering this important service to bank customers. The result will likely be banks selling their mortgage servicing rights to potentially non-regulated entities and elimination of the significant preference of consumers to work with their community bank when making a mortgage payment, handling escrow issues, and overall questions concerning their mortgage loan. In addition, community banks which provide mortgage servicing to customers have both depth and breadth of knowledge of the community where mortgage properties are located and of individual mortgage customers. The result is a personal relationship between the customer and the banker, which encourages both parties to work toward a common benefit when faced with a problem loan situation. When a community bank sells its mortgage loan servicing rights, that relationship no longer exists. The result will likely be expedited foreclosures in lieu of cooperatively arranging an agreement between the two parties involved.

Residential Mortgage Exposure

One of the most significant impacts of Basel III on Clear Lake Bank & Trust Company will be the proposed risk weights to residential mortgages based on loan-to-value ratios. While we understand the mortgage crisis considerably impacted the banking industry and economy, most community banks did not contribute significantly to the crisis. Community banks have traditionally acted in a conservative and responsible manner in their mortgage lending activities.

Specifically, the proposed risk-weights will:

1. Encourage us to sell most or all future mortgage loans to the secondary market and significantly reduce or eliminate our own in-house residential mortgage loan portfolio.
2. Reduce or eliminate residential mortgage loans eligible for pledging to the FHLB for whole borrowing purposes.
3. Require that any residential mortgage loan retained by the bank (if the bank would even decide to hold an in house mortgage portfolio) be originated with a LTV of less than or equal to 80%. This new underwriting guideline will significantly reduce the availability of residential mortgage loans to low/moderate income families and first time home buyers who do not have the resources for a minimum 20% down payment. The result is a direct conflict with the purpose and expectations of the Community Reinvestment Act.
4. Increase mortgage pricing to support any loans that are retained in the bank's portfolio, thus affecting the cost to our customers.

Risk Weight for Delinquent Loans

The proposed increased risk weighting for loans past due 90 days or more will create an additional capital burden and is redundant. At this time, we are already required to fund an allowance for loan losses account and increase the balance in this account for loans that are assigned a higher internal risk rating code based on the borrower's ability to repay. Therefore, the new Basel III proposal will require us to sacrifice earnings to fund our allowance for loan losses account and at the same time increase capital levels to support the increased risk weight. We also feel this proposal encourages us to liquidate collateral and charge off any unrecovered principal balance once a loan becomes 90 days past due rather than work with the borrower to remediate any issues. Ultimately, the negative impact of this proposal affects both the bank and the customer.

Home Equity Lending

The Basel III proposal that potentially increases the risk weight for junior liens to 200% will have a significant impact on our bank's ability to provide these loans to our customers and will likely lead to increased loan pricing for consumers. Particularly troubling is the treatment of first lien mortgages when the same bank extends credit for a junior mortgage to the same customer. The conditions under which a first mortgage remains a Category 1 exposure is narrow and will more than likely classify both the first and junior mortgage as Category 2 exposures. Based on this proposal, we believe we will cease to offer or significantly limit any junior lien loans to customers that currently have a an existing mortgage loan with Clear Lake Bank & Trust Company, including home equity lines of credit.

High Volatility Commercial Real Estate

The HVCRE proposal will have a negative impact on our bank's existing loan portfolio. We would very likely adjust our lending decisions based on the effect a loan has on our capital position vs. the benefit of helping individuals and businesses with their financial goals. Additionally, we would be faced to choose between extending a good loan to a start-up or prospering business, while maintaining the (unnecessary) required capital position dictated by the new Basel III requirements. Without question, the new capital requirements would most certainly impact our ability to provide business loans. Unfortunately, this change could require us to forego renewing existing loans to our business customers. Lastly, as the ability to make loans is inhibited by the new capital requirements, our lending and support staff would be evaluated for efficiency. Most likely, we would see a reduction of staff.

Off Balance Sheet Exposure

The proposed Basel III risk weighting, of the unused portion of lines of credit with an original maturity of less than one year, will have a significant impact on the bank's capital position. The increase from 0% to 20% significantly questions our efforts to reduce the bank's overall risk by currently underwriting the majority of lines of credit for a time period less than one year. The majority of these lines are cancelable when negative circumstances arise so the need to increase their risk weight is questionable. This proposed change will likely lead to the reduction in the number of lines of credit issued as well as the decrease in the amount of lines of credit issued. We also anticipate the need to asses a percent-based fee on the unused portion of the line of credit, increasing the cost to business customers, particularly small businesses and farmers.

In summary, while we believe a strong capital position is extremely important for any financial institution, we believe the Basel III standards as proposed:

1. Punish community banks, including Clear lake Bank and Trust Company, which did not contribute to the banking crisis and is performing at peak levels.

2. Reduces products and services offered to customers due to increased risk weights, which will particularly affect low/moderate income families as well as first time home buyers.

3. Decreases the number of community banks that provide mortgage loan servicing for customers, thereby forcing customers to make payments to third-party processors outside of the customer's geographic area.

4. Imposes redundancy and decreases bank profits by requiring banks to both fund an allowance for loan loss reserve account and increase the risk weighting of delinquent loans.

5. Significantly limits the underwriting of loans secured by junior liens (home equity loans and home equity lines of credit).

6. Reduces the number of small business loans provided by banks due to the increased and unnecessary underwriting requirement for lower risk weight assignment.

7. Increases loan pricing and fees to consumers, small business, and farmers in order for banks to comply with new and significantly increased capital requirements.

We strongly urge you to take the above items into consideration prior to finalizing the implementation and application of Basel III to community banks. As we are sure you have ascertained, we feel Basel III will have a significant negative impact on community banks and our customers. Community banks provide a valuable alternative to the nation's largest financial institutions. We encourage you to take into account an unintended consequence to Basel III - a reduction in the number of community banks across the nation, especially in rural communities, considered "unworthy" of market presence by the nation's larger banks.

Thank you in advance for your consideration.

The Officers and Directors of Clear Lake Bank & Trust Company

Ray V. Hewitt, Chairman of the Board

Paul K. Stevenson, Sr. VP/Chief Credit Officer

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Paula K. Spilman, Personal Banking Officer