Security Savings BANK

Part of your community, part of your life.

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October 10, 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, S.W.
Mail Stop 2-3
Washington, D.C. 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:

I appreciate the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

A strong financial institution with a strong level of capital has always been the goal of this bank, and we do not disagree that looking at an increased level of capital requirements for banks in our country should be addressed. The Basel III proposals, however, are problematic in the various ways they attempt to increase capital levels.

I am President/CEO of the $170 million savings bank located in Monmouth, Illinois. After three name changes and a charter change, our bank is celebrating its 130th anniversary this year. In 1882, the mutual charter of Monmouth Homestead and Loan Association was formed for the purpose of promoting thrift and home ownership. Through the years this mission was advanced and mutual institutions have been the gatekeepers to the safety and soundness of the home mortgage market. Mutual institutions have a significant in-house portfolio of home mortgages, and, therefore, have practiced prudent underwriting of the loans.

Security Savings Bank is located in a rural area with a very productive agriculture community. The area has not had growth in population or new businesses for the past three decades. Our community is stable, however, because of strong farming operations, a private, liberal arts college and hospital. Because it is a small community, the importance of community banking to this area is important for meeting the current and future needs of individuals, businesses and the Ag community.

We are concerned that elements of the Basel III proposal would create uncertainty in our business plan in the area of home financing and in our investment portfolio.

The proposal assigns risk weights to residential mortgages based on (1) whether the mortgage is a traditional category 1 mortgage or, as described in the proposal, a riskier category 2 mortgage; and (2) the loan-to-value ratio of the mortgage. This treatment is problematic for these reasons:

1. It is very likely that many small, community banks will gather the required data by pulling loan files. This would be, administratively, quite an undertaking for our bank with around 1,000 residential mortgage files; and our numbers are probably quite lower than many community banks in larger populated, growth areas.
2. The risk weights on second mortgages and Home Equity Lines of Credit (HELOC), which typically would fall within category 2, are punitive. Again, I would refer back to my statement on prudent underwriting by mutual institutions...regardless of whether it is a first or second mortgage or HELOC. Our bank strives to keep mortgage loans within the 80% LTV or less. The reason for second mortgages and HELOCs, mostly, is because the costs of the loan can be less and the borrower does not want to redo their first mortgage. We make second mortgages for special projects: a new kitchen, a remodeled bathroom, a room addition, etc. The second mortgage will, many times, increase the value of the home which would lower the LTV of the first mortgage.
3. If the LTV is above 80%, PMI coverage is considered and used to transfer the risk. PMI is not recognized in the Basel III proposal.
4. Given the substantial increase in capital that would be required for such existing category 2 mortgages, which may constitute a substantial amount of assets on an institution's balance sheet, the retroactive impact of the proposed treatment would be especially harsh.
5. The Basel III proposal does not take into account the future reform of the mortgage market, and there are many potential reforms proposed.

Given the above listed items, we think the mortgage treatment should be fundamentally rethought.

Another area of concern has to do with the requirement that gains and losses on available for sale securities must flow through to regulatory capital. Our investment portfolio is very conservative, comprised mainly of government securities. These securities have little, if any, risk of loss but are subject to interest rate risk. In an unprecedented period of low interest rates, we know that as interest rates begin to rise, the effect on our capital could be quick and dramatic. Because we would rather make loans than investments, we keep the investment portfolio in an available for sale, short term duration. By choosing to manage our liquidity in this fashion, we could be greatly penalized.

A final point we make is about the proposal to increase risk weights on delinquent loans. We have worked hard, over the years, to maintain an accurate and reliable ALLL. Through the discussions with examiners at each examination, we have established the ALLL to meet the needs of our delinquent loans. Basel III may also increase the amount of capital we hold based on the past due status, and so we are being required to set aside capital two times. The end result could be to increase a bank's aggressiveness to move delinquent loans that become 90 days past due off of the balance sheet and decrease the efforts to work with borrowers to correct delinquency issues.

These are three of the areas of Basel III that would have a negative impact on Security Savings Bank. We do not think that the Basel III proposal is a reasonable approach to increase the amount of capital that banks hold. Therefore, we respectfully ask that Basel III not be implemented for community banks.

Thank you for your consideration.

Sincerely,

Stanley D. Jenks
President/CEO