

From: Gary Propheter [mailto:gpropheter@beobank.com]

Sent: Tuesday, September 18, 2012 6:51 PM

To: Comments

Cc: Kevin Christiansen; Linda Navarro; Jeff Bailey; Mark Lemmon; Becky Kindle

Subject: Comments on Basel III Capital Requirements

Concerns Re: Proposed Basel III Regulatory Capital Requirements

As proposed the Basel III Capital requirements will have a significant, negative impact on rural community banks like Bank of Eastern Oregon, primarily due to the inclusion of 'fair-value' accounting treatment for securities held to maturity.

Bank of Eastern Oregon has branches in seven rural eastern Oregon counties and operates loan production offices in three other rural counties. We are a primary public funds depository for municipal, county, and special districts in our markets and participate in the State of Oregon Department of the Treasury public funds collateralization pool to provide a guarantee for public deposits. The Treasurer only accepts qualified securities as a collateral pledge for public deposits, and the Bank purchases securities to be held-to-maturity for this purpose.

Accordingly, the Basel III fair-value treatment of securities (including it in 'Other Comprehensive Income' in bank capital calculations) creates conflict between the Bank's mission to serve public funds customers and our obligation to maintain adequate levels of capital to support business activities. Basel III, as proposed, will force Bank of Eastern Oregon to choose between maintaining banking services to its public entity customers or maintaining predictable capital levels.

Bank of Eastern Oregon has seen dramatic swings in its recent historical securities valuations. In October 2008 the portfolio had a **negative** mark-to-market valuation of \$720,000 on a portfolio in excess of \$30 Million. Today we have a **positive** mark-to-market of \$500,000 on an \$18 Million portfolio, with portfolio shrinkage generally being due to callable securities paid off early due the difference in issued and current rates. Note: the Bank's swing from a negative mark-to-market position to a positive one has been driven by market interest rates, not the Bank's management of its portfolio.

Despite Bank of Eastern Oregon actively working to maintain an adequate level of securities for pledging and liquidity purposes, today we are faced with the dilemma of buying low interest rate bearing securities to support public deposits, knowing these eligible securities will have a negative mark-to-market valuation

when interest rates rise, and according to the proposed Basel III definitions, a negative impact on our regulatory capital ratios.

Ask yourself these questions and see the incongruity of the current definitions in the Basel III Capital formulae:

- ? Should capital ratios be driven by interest rate swings caused by daily international market movements, or by a Bank's adherence to sound business practices?
- ? Should the fair-market value of a long-term security be recognized as a gain or a loss simply because there are changes in the short term interest rate environment?
- ? In today's rate environment, under the Basel III rules virtually any security purchased will have a negative future valuation with a negative impact on capital when rates eventually rise.
- ? Basel III creates conflict between three principal regulatory precepts: managing liquidity, managing capital, and managing interest rate risk, while imposing a new and significant barrier to providing banking services in our rural communities.

Including mark-to-market valuations in Other Comprehensive Income for assets being held to maturity is not in the best interest of our rural economies, public entities like cities, counties, schools, and special districts, and will have a long term negative impact on the viability of small community banks, particularly those in rural communities.

I strongly urge our regulatory and legislative bodies to either remove these provisions from Basel III altogether, or at a minimum, exempt smaller banks from these restrictions.

Gary Propheter
EVP & Chief Operations Officer
Bank of Eastern Oregon
PO Box 39
Heppner, OR 97836
gpropheter@beobank.com
541-676-0207