From: Bank of Hillsboro, Arthur Kniffen

Proposal: 1442 (RIN 7100-AD 87) Regs H, Q, & Y Regulatory Capital Rules

Subject: Regs H & Y Regulatory Capital Proposals

Comments:

October 22, 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, SW
Mail Stop 2-3
Washington, DC 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:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

It is inconceivable to me that any regulator would truly believe that BASEL III is in the best interest of the U.S. financial system, or that it will be applied in the same spirit or letter of the law to the semi nationalized or nationalized banking systems of other nations. BASEL in all of its mutations does not level the playing field. Why should a 110 year old sixty million dollar bank in Hillsboro, Missouri or a 111 year old $523 million dollar bank in St. Louis, Missouri be subject to international banking standards? How does that Hillsboro or St. Louis safer. This will not make financial systems safer even on an international basis anymore than the previous BASEL II that assigned a risk weightings of zero ("0") to sovereign debt of Euro nations. In fact, the perception may come to be that the system is safe because of BASEL, but unfortunately it's the same mental trap that made everyone think that Bernie Madoff was a safe bet because of the Securitiies Exchange Commission rules and regulations assuring everyone that the government was protecting them.

In order to implement and maintain BASEL III capital calculations, we will forced to spend in time, personnel, and software a sizable amount of the capital BASEL wants us to preserve and build into a capital buffer. The Byzantine structure and minutia of this proposed system is staggering. As an attorney, I know that if I write a one page contract, that contract is more manageable and stronger than a 10 page contract, because in 10 pages there's always wiggle room, loopholes, and unintended consequences. BASEL III will ultimately prove to be easily manipulated in its complexity and full of unintended consequences, just like the IRS code.

Do the one to four family balloon home loans with 15 year or 30 year schedules that we keep in our portfolio really need to have layer upon layer of risked based capital differentiation? These are the best loans for our banks because from an asset liability perspective we are building a matched book; we are issuing 3year and 5 year Certificates of deposit and making 3 year and 5 year balloon loans to customers in our community. When our customers lose their job or their spouse dies or some other traumatic event occurs, we change their rate, we change their amortization, we put them on interest only, we let them skip payments until they get back on their feet. BASEL III and Dodd Frank spell the death knell for this sort of flexible and if you will, compassionate lending that's good for the customer, the bank, and the financial system. Despite all the legislative and regulatory disadvantages, community banks give their neighbors and communities the kind of banking they want and need, which they cannot get from a credit union, or an internet bank, or a mega bank.

I've managed bond portfolios since 1980, and I cannot think of anytime but today that I thought it was a good idea to count my unrealized bond profits or losses in regulatory capital Our little portfolio has a $6 million dollar unrealized net gain today, but Chairman Bernanke just has to hint that he will not "maintain his promise" about keeping rates down here, and that will be a $6 million dollar loss in the blink of one of his eyes, but we will still be collecting the same 4.5% interest stream.

Why should some international (European?) "accord" trump U.S. law and dictate U.S. policy? Why should BASEL trump our own Dodd Frank on trust preferred securities? It's bad precedent. Southern Commercial and Bank of Hillsboro never issued trust preferreds, but it was a source of capital we certainly considered using at some interest rate. It was a great way to increase capital without diluting existing common shareholders ownership. Why phase it out? Isn't it at risk just like common equity? It makes the system safer.

If BASEL III goes into effect as it stands, many community banks will fold up their tents, leaving the banking system and their communities the worse for it. BASEL demands a sub-S banks not make distributions to their shareholders because the bank build or maintain capital buffers, while at the same time the IRS demands taxes from the shareholder on earning they did not receive. Who wouldn't leave that party. Or the bank has plenty of capital but because of the buffer requirement it cannot pay dividends to shareholders who risk their capital every day or bonuses to staff who work long hours in the trenches serving their customers and ownership.

Owners and entrepreneurs are very community oriented, but they protect their families first. They will find opportunities elsewhere with less risk to their capital, less regulation of their capital, and better returns on their capital. One often hears that one doesn't mind treading water, but no one wants to drown. BASEL III and Dodd Frank (and its CFPB) are creating a deluge.

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.

Sincerely,

Arthur L. Kniffen
Bank of Hillsboro
[