From: Morton Community Bank, Benjamin Craig

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

Subject: Regs H & Y Regulatory Capital Proposals

Comments:

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

Dear Ms. Johnson,

Thank you for the opportunity to share our comments regarding the proposed implementation of the BASEL III regulatory framework (Basel III Docket No. 1442.) Morton Community Bank, headquartered in Morton, IL, is a community bank serving rural and urban communities in Central Illinois. With over 30 branches and approximately $2.7B in assets, MCB known for its financial strength, conservative lending practices, and commitment to the communities it serves.

While MCB fully endorses the risk management principles of BASEL III, we sincerely hope that U.S. regulatory authorities will reconsider how these principles can be applied to community banking organizations. We acknowledge that the application of BASEL III may be necessary to manage the risk of large systemically important financial institutions; however, in our assessment, it may be counterproductive in meeting these same objectives at the community bank level.

#1 - The complexity of BASEL III may distract from the proven risk management practices that many community banks employ.

· Increased complexity: When applied to a community bank, BASEL III adds a great deal of complexity to a historically conservative business model. In our assessment, the additional levels of complexity and monitoring, including new capital ratios, new risk weightings and new liquidity measures, will reduce the effectiveness of our ability to manage true enterprise risk. Instead of talking about the real risks that we face, many community banks may find their attention diverted to understanding how the accounting of actions may affect these new more complex measurements and requirements.

#2 - BASEL III will create instability in community bank investor relations.

· Increased volatility in timing and level of capital needs: The inclusion of Accumulated Other Comprehensive Income in the definition of Common Equity Tier 1 will make MCB and other community banks highly susceptible to rising interest rates. Capital ratios that fluctuate as a result of interest rate changes will make it increasingly difficult for community banks to manage capital appropriately. In 2011, a year of relative financial stability in the U.S., the 10 Year Treasury fluctuated by 1.80%. These market changes, which were unreflective of true changes in national economic conditions, would have created significant challenges in capital management for community banks such as MCB. Neither we nor our investors desire unnecessary volatility in the expectations of our capital needs.

· New uncertainty in dividend practices: MCB enjoys a very engaged investor base, in part due to the organization's long history of stable earnings and dividends. Because BASEL III begins limiting dividends when the 2.5% Capital Conservation Buffer is breached, organizations such as MCB will be required to hold additional capital beyond what might otherwise be necessary, simply to ensure that this historic dividend practice will continue uninterrupted. This additional capital buffer, which would safely keep us from breaching the new Capital Conservation Buffer, will reduce shareholder return and potentially decrease investor interest in community financial institutions.

· Capital needs for residential lenders: While this is not the case for MCB, many community banks rely heavily on residential real estate as a source of portfolio lending. The new risk-weighting for this type of lending will create a significant burden on their ability to generate an acceptable return for their investors, and perhaps even mark the sunset of this conservative community-oriented business model.

#3 - BASEL III will result in monetary tightening as MCB and other banks shift the burden of the new regulation to commercial and personal borrowers.

· Increase in borrowing costs for homebuyers: Because Basel III includes AOCI in the definition of Common Equity Tier 1, MCB will be less likely to invest in medium and long-term securities such as GSE debt instruments. This shift in investment preference will increase the funding costs for GSE institutions and result in higher mortgage rates for U.S. homeowners. The proposed increase in risk-weightings for residential real estate and home equity loans will also result in higher mortgage rates for mortgages held in portfolio.

· Increase in borrowing costs for commercial borrowers: MCB and other community banks primarily create income by accepting appropriate levels of credit risk and interest rate risk. Because Basel III includes AOCI in the definition of Common Equity Tier 1, MCB will be less likely to generate income by investing excess cash in medium and long-term government securities. This loss of revenue, created by a reduction in the bank's acceptance of interest rate risk, will require the bank to shift the revenue burden to sources of credit risk. This natural transition will increase the cost of borrowing for local commercial borrowers, and to some extent dampen an already slow recovery.

· Increase in general borrowing costs due to higher overhead: Upon the implementation of BASEL III, many community banks will need to hire more people, not to manage our true enterprise risk, but to monitor how we measure against these new regulatory measurements. The increase in our overhead expense will likely flow through to our customers in the form of higher borrowing costs.

As you can see, we have significant concerns about the proposed implementation of BASEL III for community banks. We sincerely hope that U.S. regulatory authorities will seek a more appropriate method of applying BASEL III risk management principles to our community-based business model. Thank you for considering our comments.

Best Regards,

Benjamin Craig

Morton Community Bank