CITIZENS NATIONAL BANK

Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue, N.W.,
Washington, D.C. 20551
Basel III Docket No. 1442

RE: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action;* and *Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements*

Dear Sir or Madam:

I am the SVP and Controller of Citizens National Bank, a $930,000M community bank located in Henderson, Texas. We are in the northeastern section of the state of Texas, having 18 branch locations which serve for the most part many rural residents. The communities range in population from as little as 600, up to approximately 150,000 residents.

The impact of Basel III will affect us overall and in many specific aspects as noted below.

<u>Overall</u>

The overall effect will have a negative bearing on our customers in that our capital will be so restricted and volatile as to market changes, that we will be unable to make loans to both consumer and commercial customers, or we will have to make loans at higher prices and increase loan-related charges, both <u>which are not beneficial to the customers.</u>

The costs to the banks will are also a concern in terms of personnel and time to devote to these continuing changes. The expense would include paying for higher compliance costs through employment of additional compliance personnel or contracting theses services outside the bank, education to understand the complexities of these proposed changes, and increased costs of revamping core systems to comply with these changes. <u>Again, the customer would lose.</u>

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Specific Concerns
To specifically address some of the changes in these proposals, please allow me to quantify some of the changes.

Accumulated Other Comprehensive Income (AOCI)
At the current time, our bank has a large unrealized gain in our Available for Sale (AFS) portfolio, of $13.5M, and for every $1.0M change, our Common Equity Tier 1(CET1) is affected by .3%. However, this calculation only reflects change in AOCI. The CET1 ratio will be much lower with the risk-weighted changes, as stated later in this letter.

With the historically low interest rate environment, there is much concern as to when rates move upward, and banks will be faced with potentially significant **unrealized** losses in their securities portfolios. This change will produce significant volatility into the capital calculations, and a formerly well-capitalized bank could face severe sanctions due solely to market rate movements.

Risk-Weighted Asset Changes
Additional risk-weighting on loans will constrain the capital and ability of community banks to make certain types of loans. For construction loans, this would affect home builders and consumers and would be a setback to an industry that has struggled and needs help recovering from the last economic crisis. The risk-weighting on balloon mortgages, interest-only loans, second lien loans and home equity loans would also be very devastating to consumers and banks. It would limit banks to making longer-term loans which would not be prudent for interest rate risk (remember the savings and loan crisis in the 1980's) or the banks would get out of the residential loan business altogether. This would not give the local rural consumer or contractor many alternatives for financing of the types of loans mentioned previously.

Trust Preferred Securities(TruPS)
We are a community bank which benefited from raising capital through TruPS in the early – mid 2000's. To change the rules as now proposed is very discouraging in that there could be future legislation passed which could be contradictory to previous legislation, or with no consideration of grandfathering current legislation.

Conclusion –
While I appreciate and recognize the importance of appropriate levels of capital as a key component of a safe and sound bank and banking system, I am concerned that these proposed regulations have serous and unintended consequences for community banks and their customers. All community bankers have a vested interest in a healthy banking system.

These proposed regulations have us applying the same rules as apply to the larger complex banks. There is such a vast difference between a small community bank and a large complex international financial institution that there should be differences in areas of the regulations that "do not fit" the framework of a community bank.

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Private equity firms are taking advantage as seen in the following quote taken from the October 19, 2012, *Banker Investment Daily* newsletter - " Large private equity firms are raising billions of dollars as they gear up to lend directly to mid-sized businesses in the U.S. The firms see an opportunity to step in between banks and businesses, given added regulation that falls on banks through Basel III and does not apply to them. Companies with EBITDA as low as $5mm will be targeted". **I don't think these private equity firms have an interest in the communities from which they will capture business.**

Community banks are focused on the communities in which they serve and are a major contributor to that community. As you can see from excerpts from our Mission Statement how important it is for us to continue to serve our customers and the importance and recognizing the value of our customers. , Several excerpts are as follows:

"The mission of Citizens National Bank is to maximize its long-term earnings in a growth mode, while being a responsible business that renders ***high quality service to customers*** through the efforts of fairly treated employees.

The Citizens National Bank through its ***excellent service to customers and its adherence to sound banking principles has since its beginning enjoyed a leading position in the growth of Henderson and Rusk County. During the last few years the Bank has extended its excellent service and adherence to sound banking principles to Marion, Henderson, Navarro, Harrison, Gregg and Smith counties***. There is every reason to believe that the future holds a tremendous challenge and an even greater opportunity for growth if our directors, officers and employees continue to conduct themselves in a manner that will maintain and enhance the bank's reputation for performance, safety, customer service and integrity.

The bank was established to make a profit ***while serving the financial needs of (1) our trade territory, (2) its businesses and, (3) its citizens. We are in the financial services industry, and no line of business is beyond our charter, as long as we are serving needs of businesses and families of our communities.***

The bank's most important asset is its customer base".

Thank you for your time.

Best Regards,

Becky Tanner

Becky Tanner
SVP & Controller