AMERICAN NATIONAL BANK
OF TEXAS
www.anbtx.com

October 16, 2012

Via E-mail: regs.comments@occ.treas.gov
Office of the Comptroller of the Currency
250 E. Street, Southwest
Mail Stop 2-3
Washington, DC 20219

Via E-mail: regs.comments@federalreserve.gov
Jennifer J. Johnson, Secretary
Board of the Governors of the Federal Reserve System
20th Street and Constitution Avenue, Northwest
Washington, DC 20551

Via E-mail: comments@FDIC.gov
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, Northwest
Washington, DC 20429

Re: (i) Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, Docket ID OCC-2012-0008; Docket No. R-[XX]; RIN 3064-AD95 **(the Basel III NPR"),** and (ii) Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, Docket ID OCC-2012-0009; Docket No. [XX]; RIN3064-AD96 **(the "Standardized Approach NPR")** (the Basel III NPR and the Standardized Approach NPR bring collectively, the "**NPRs**")

Please accept this letter as my response to the Basel III NPR and the Standardized Approach NPR, each dated June 7, 2012 which together outline broad principles to be used by banking organizations in capital planning. My comments are intended to explain how these will affect our Bank and other privately held community banks in the United States.

The American National Bank is a privately owned community bank headquartered in Terrell, Texas. Our Bank was founded in 1875 and currently holds $2.1 billion in assets. We primarily serve communities East of Dallas and offer traditional community banking products and services to our customers.

Please consider the following issues:

1. ***Should Basel III apply to community banks?***

Community banks are very important to our economy. While we only hold 10% of our country's financial resources, we originate 40% of our nation's small business loans. Without community banks, not only will small businesses suffer, but we will have lost an important cog in our country's economic engine.

I would suggest that we better serve the smaller more rural markets than our larger brethren. I offer, as an example, Wills Point Texas. Wills Point is a community with a population of 2,500 located 50 miles east of Dallas. Wills Point has two community banks and no regional or national bank branches. If Wills Point loses its banks, it is unlikely that their larger replacements will shoulder the community development loads now carried by its community banks. Wills Point will not prosper as a community.

Community banks continued existence is dependent upon their ability to compete and to provide suitable returns to their shareholders. Basel III will make their survival more difficult while not providing any assistance to them in accomplishing their core mission. These banks did not cause the recent catastrophe and dictating new capital rules will not result in a more solvent banking system. It will only result in fewer community banks. I strongly recommend that all banks less than $10 billion be exempt from the new proposed capital rules.

2. ***What about Credit Unions?***

Evidently, Basel III capital rules will only apply to community banks. Community banks' most fierce competitors are many times credit unions. If these rules do not apply to credit unions it will increase their government sponsored competitive advantages over banks. These entities already enjoy a pricing advantage due to their tax free status. If we must hold more capital too, we will be even more shackled. We can compete, we simply ask for a level playing field.

3. ***What counts as Capital...?***

A. Trust Preferred Securities

The proposal calls for Trust Preferred Securities, Trups to be amortized from Tier 1 capital over a three year period for banks over $15 billion and ten years for banks under $15 billion. The instruments will still be considered Tier 1 capital for banks under $500 million. While this part is not the worst part of the proposed rules, it does offer some serious consequences for community banks.

There is some thought that small banks can adjust to the change in Trups treatment due to the long phase in time. This is likely true. I can best discuss the issue using our Bank as an example. The American National Bank of Texas is a $2.0 billion bank with $31 million in Trups. I have modeled a capital plan and it reflects that we can deal with the change in Trups and continue to be well capitalized.

The downside is that we will have less capital without Trups than if it still were considered Tier 1 capital. In our shop, we will have lost $31 million of capital over ten years. If you were to assume an 8% leverage ratio, we will have lost enough capital to support $387 million in assets. Given a 65% loan to asset ratio, we will lose the ability to generate $251 million in loans. This means that in our market there will be less available credit to small businesses.

The issue is also a little different for privately held companies compared to those that are publicly traded and somewhat impossible for Sub Chapter S Banks. These Banks do not have access to the public markets so they do not have the ability to raise additional common or preferred equity. That means that they will only have the common equity that they have now plus what can be generated through earnings. Capital is precious for a privately held bank so losing any is tough.

Trups is relatively inexpensive compared to other instruments. This is due to the cash payments being interest expense rather than dividends as payments on common or preferred stock are classified... Interest is tax deductable and dividends are not. That means that we pay Trups' interest with 65 cent dollars.

Bottom line; the loss of Trups will not kill us but it will affect our ability to grow and is more impactful on a privately held organization than a public company.

B. Unrealized Gains and Losses on AFS Securities

1. Capital Volatility

If the change in Trups is problematic for community banks, including changes in the market values of AFS securities is simply a really bad idea. If this change in current rules is adopted, it will have several significantly adverse affects on community banks.

Community banks will be subject to potentially devastating swings in capital due to changes in market rates that affect the market values of AFS securities. In our organization, our ALCO model suggests as much as a $71 million swing in market value given a three percent increase in interest rates. This would represent a drop of 35% of our capital. To deal with this possibility we would be required to hold even a greater capital buffer than suggested in the proposal, reclassify the security portfolio as "held to maturity" or structure the portfolio to only include short term investments that would be less susceptible to market price swings.

The result of the first strategy, reclassifying as held to maturity, would be to limit the Bank's ability to manage the portfolio by selling underperforming securities or utilizing security sales to meet short term liquidity needs. While these are infrequent they do occur from time to time and a well managed bank must be able to act quickly without fear of total mark to market of the remaining portfolio.

The second strategy, holding additional capital, would result in even lower returns on equity. The end result of the rule change will result in lower returns to owners any way and this will only add to the problem of capital attraction to the community bank sector. I have read one analysis that suggests that community banks will need an additional 10% to 15% capital as an additional buffer if the risk of mark to market on AFS securities exists.

Many banks will choose to adopt a more conservative investment strategy. For our bank with a $750 million portfolio centered in MBS's and CMO's, it would mean shifting from a current return of approximately 2.50% to something less than 1.0%. If we were to do so, our $2.0 billion bank would make $7.3 million less in a year. This would be a reduction of 37 bp in ROA.

In his recently published book, *Senseless Panic*, William Isaac; former Chairman of the FDIC, points to market rules as senselessly destroying over $500 billion in capital from the financial system during the recent downturn (page 4). If the rules are permanently changed as proposed, precious capital could needlessly disappear from the system again.

2. Impact on Debt Capital Markets

A potential side effect of the rules change could be less credit available or more costly credit to municipalities and home buyers. Banks are a major buyer of the debt of these entities either directly or as securitized assets. If banks are forced from these markets, due to capital management issues and the need to shrink balance sheets, the availability could decline and the price to these borrowers could increase.

C. Common Equity Reliance

The new rules highlight the desirability of common equity as capital and move to restrict basically all other forms of capital. With the exception of excluding TRUPS, I do not think that this is necessarily a bad idea.

4. ***Capital Adequacy***

A. Increasing the minimum level of capital required to be "Well Capitalized"

The rules propose increasing well capitalized Tier 1 from 6% to 8%, Tier 1 Risk Based from 6% to 8.5%, total risk based from 10% to 10.5%. The leverage ratio required to be well capitalized remains at 5%. These changes were expected and I think them to be reasonable.

B. Capital Conservation Buffer

The rules call for the adoption of a progressive limitation on stock repurchases and dividends as an organization's capital becomes more stressed. I believe this makes some sense. As an organization approaches minimum required capital levels due to losses, poor operating performance or growth, the company should restrict capital distributions until it obtains a more robust capital position. This rule allows for an objective measurement that is well known rather than the discretionary decision by some regulatory body.

The downside of the rule is that it eliminates any judgmental decisions due to unusual circumstances that could merit individual treatment. This could create competitive disadvantages for some organizations in the attraction of talent or capital. It would likely be more appropriate to adopt the buffer as a guideline and allow for some discretion in applying it to any banking organization.

If the capital conservation buffer is adopted, regulators must not be allowed to add another discretionary level of capital above the buffer. If that is allowed, there will be no improvement in the transparency and we will only experience an increase in capital.

5. ***Risk Weighting of Assets***

A. Increased Risk Weighting of Riskier Assets

The new rules call for increased risk weighing for those types of assets that have proven to be more problematic during the last downturn. This is likely warranted. All prudent bankers recognize the need to hold more capital as the risk in their balance sheets increases. The new rule quantifies the amount to be held and should allow an organization to better manage its capital.

B. Mortgage Loans

While the logic behind the risk weighting of mortgage loans based on loan to value sounds reasonable, the calculation and tracking is likely beyond the ability of most community banks. A better method for recognizing this risk is needed. This will be too complicated to track and accurately calculate.

Conclusion:

Significant regulatory reform always occurs after a major calamity. The financial meltdown of 2008-09 certainly has resulted in its share. All industry stakeholders hope that reforms are helpful and lead to a safer future where past mistakes are avoided.

Basel III's application to community banks does not meet this basic test. If it is enacted, as proposed, our system will not be safer. It will only have fewer community banks to offer much needed banking services to small communities and businesses. If this occurs, the end result will be a weaker system and we will have lost something extremely important to our society.

Sincerely,

Robert R. Messer
Executive Vice President /
Chief Financial Officer