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

The Basel III proposal will put undue stress on capital of financial institutions like Farmers State Bank. On a daily basis, we manage the risk associated with changes in interest rates. In these times of extremely low interest rates, managing that risk has become more challenging because it is hard to get a decent return on your money at a rate that will cover your expenses. Net Interest Margins are being compressed by the current FED policy. This leads me to my point. We have seen increased liquidity in the past few years that we have in turn invested in securities to try to get a return on our investment. Our securities portfolio has nearly doubled in the past year. If rates were to move significantly in a short period of time, the value of our portfolio would change significantly. Under this proposal, that change would be reflected in capital and could take us from well capitalized to undercapitalized just like that. This makes no sense because nothing would have changed in the bank other than the value of the securities portfolio. Cash flows would remain the same. The investments would be held to maturity and the bank would receive the contracted interest amount. There would be no material change in the bank. When analyzing the Basel III proposal, I contacted our securities broker and asked him how he would feel if I told him I intended to dump our entire securities portfolio if I anticipated rates moving significantly. As he stated, that is not a good business practice, but I may be forced to do that if rates were to rise significantly just to protect my capital. I hope you can see that this isn't a good idea for community banks. What if every community bank decided they had to dump their securities portfolio to protect capital? What would that do

[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.*

to the securities market? That would be one of those unintended consequences. This is not a good idea.

As a lender in a small community I have to look at how I can best serve the needs of our community while mitigating risk for the bank. We currently offer residential real estate loans that balloon every five years. We do that because we hold all of our loans in-house. We do not make a lot of these type loans, but the ones we do make are either too small for the big banks to look at, or don't qualify to be sold on the secondary market. If we didn't make these loans, nobody would. We have to make them to serve our community! Through regulation, the FDIC has already made it very difficult for us to make these loans. We are a $100MM bank, but we have a full time Compliance Officer to make sure we are following all the regulations. There are other banks in our area that have decided NOT to make residential real estate loans because the regulations are too burdensome. We considered that, but we WANT to serve our community and that was not an option for us. If we have to increase the risk rating of these loans through Basel III, it is one more reason NOT to make these type loans. Is that what the regulators want us to do? I thought they wanted us to serve our community. I thought they wanted us to bank those people. Do they want us to move more people into the unbanked category? This risk rating system is not a good idea.

I understand what this regulation is trying to accomplish, but it is something that will be very harmful to community banks. This proposal must not be approved.

Sincerely,

Chad Johnston
President
Farmers State Bank
Maywood, NE