1st National Bank of Waterloo

October 19, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Delivered via email: regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Delivered via email: comments@FDIC.gov

Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
250 E. Street, S.W.
Mail Stop 2-3
Washington D.C. 20219
Delivered via email: regs.comments@occ.treas.gove

Re: BASEL III Proposed Capital Guidelines

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the BASEL III proposed capital guidelines that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively the "banking agencies.").

I am President and CEO of First National Bank of Waterloo, a $370 million community bank in southern Illinois. Our bank was formed in 1912 and we have been very instrumental in the economic growth and development of the communities we serve. We are a typical community bank in that we care deeply about our customers and our employees. We provide home loans, agricultural loans, small business loans, and consumer loans which enable our communities to grow and prosper. I believe that the proposed BASEL III guidelines could have significant impact on the survival of such community banks as First National Bank of Waterloo and their ability to create and foster economic development within their local communities.

Concern One – Mark-to-Market of the investment portfolio. Under current capital guidelines Accumulated Other Comprehensive Income (AOCI) is excluded from capital calculations. Our bank currently has an investment portfolio totaling $165 million. We take a very conservative approach to managing our portfolio. However, in this extended low rate environment, we have had to realign the allocation mix within our portfolio. Today we have a positive $4.0 million in AOCI. Under today's calculations (this amount is excluded) our Tier I Capital to Average Assets (Leverage) Ratio is 9.03%. With the proposed new guidelines, our ratio would increase to 10.34%. However, when we stress-test the portfolio (rates up 300 basis points), the AOCI could decline to a negative $10.0 million. This would reduce the Leverage Ratio to 6.29%. Although this is still above the guidelines for being well capitalized (5.0%), I believe regulators would have concerns about the capital levels. Typically, our bank codes most of its investments (85%) as "Available For Sale" (AFS). This provides the bank flexibility in meeting liquidity needs or funding future loan demand. To avoid such impact to the bank's capital, we could elect to increase the percentage of "Held to Maturity (HTM)" investments. Typically, our bank holds most of its investments to maturity. This accounting change could have a significant impact to our bank's capital, when in reality nothing has changed. Such fluctuations in capital could affect bank's lending and growth opportunities.

Concern Two – Risk Weighting Residential (1-4 Family) Mortgage Loans and Home Equity Lines of Credit (HELOCs).

Our bank has a high percentage of residential mortgage loans. As of June 30, 2012, we had $46.5 million residential mortgage loans, or 33.0% of total loans. Such loans are either adjustable-rate mortgages (ARMs) or balloon term notes. As a community bank, we sell all of the 10-30 year fixed-rate mortgage loans into the secondary market. The bank's underwriting guidelines limit the Loan-to-Value (LTV) to 80% or less. Historically, this portfolio has had limited delinquencies and few charge-offs. Increasing the risk weighting of such quality loans does not make sense at a time when the housing market is struggling to recover.

Our bank also has a high percentage of Home Equity Lines of Credits (HELOCs). As of June 30, 2012 the bank had $14.8 million HELOCs, or 10.5% of total loans. Again such loans are underwritten to high standards and the LTVs are traditionally below 80%. The increase of risk weights to 200% will both increase the cost of credit to the consumer and have the effect of possibly restricting the availability of such consumer credit. Within our bank, HELOCs have replaced the traditional consumer loans. Again the quality of such loans has been very high as we had few delinquencies and charge-offs.

If there is perceived increased risk of such loans (residential mortgage and HELOCs), then let's allocate such risk to the Allowance for Loans and Lease Losses (ALLL).

As of June 30, 2012, the bank had a Tier I Capital to Risk Weighted Assets Ratio of 18.11%. Per our calculation, such change of the risk weights would reduce the ratio to 15.00%. This is still well above capitalized guidelines of 8.00%. However, if this change is coupled with the AOCI change, (and rates increase) the ratio could drop to 10.46%.

There are also questions about how often the bank has to determine the LTV of such loans. Will the bank have to acquire new appraisals on the existing portfolio loans? If so, this could substantially increase the bank's cost of doing business and one would have to evaluate the viability of such loans.

Concern Three – Risk Weighting for Mortgage Servicing Rights (MSRs). As of June 30, 2012, the bank has a secondary real estate residential mortgage portfolio of $170.8 million. Being a community bank, we maintain the servicing of such loans. The bank has MSRs on the balance sheet of $1.593 million, or 5.0% of Tier I Capital. Being below the 10% threshold, such amount would receive a 100% risk weight (eventually going to 250% in 2018) and this would have a further effect of reducing the current Tier I Capital to Risk Weighted Assets by 16 basis points. Again, if rates increase, AOCI and previously discusses risk weighting are applied, the bank's Tier I Capital to Risk Weighted Assets would decline from 18.11% to 10.38%. As the bank's secondary market real estate portfolio increases, this change could have an even greater impact.

Concern Four – Risk Weighting For Delinquent Loans. This change would have a minimal impact on our bank as of June 30, 3012. As of June 30, 2012, based on our understanding of the proposed change, this would only increase the bank's risk weighted assets by $906,000. This is not a significant change. My bigger concern is the possible impact in the future. I believe that such concerns would be better addressed through the bank's ALLL.

Other Concerns – An additional concern is how capital relates to the bank's legal lending limit. As capital fluctuates, so would a bank's legal lending. In a community bank, such as First National Bank of Waterloo, this could lower our legal lending limit and restrict our ability to service existing customer within our markets.

My final concern is that BASEL III is overall very complex and difficult to interpret. Most community banks do not have the staff or computer systems to adequately monitor the BASEL III requirements.

Thank you for the opportunity to respond. I certainly hope that the banking agencies would reevaluate the guidelines and consider the impact of such on the banking industry.

Sincerely,

Gary D. Hemmer

Gary D. Hemmer
President and CEO
First National Bank of Waterloo

Cc:
The Honorable Jerry F. Costello

The Honorable Mark Kirk

Jason Plummer
Plummer for Congress

Bill Enyart
Enyart for Congress

Wayne A. Abernathy
Executive Vice President
Financial Institutions Policy and Regulatory Affairs
American Bankers Association

Bert A. Otto
Deputy Comptroller Central District
Comptroller of the Currency

Lesslie A. Swip
Assistant Deputy Comptroller
Comptroller of the Currency

Linda Koch
President and CEO
Illinois Bankers Association