PINNACLE BANK

September 20, 2012

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 Corp.
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 proposals regarding Basel III Capital Ratios and the Standardized Approach for Risk-weighted Assets, which were recently approved by your respective agencies.

Pinnacle Bank is a state chartered, non-member financial institution that is located in Rogers, Arkansas. It commenced operations in August 2004, it has total assets of about $87 million, and it has a customer mix and loan portfolio that is primarily real estate based. The bank has one class of stock that is wholly owned by Pinnacle Bancshares, Inc., a one-bank holding company.

Our early estimates suggest that for the bank to remain in compliance with all the proposed capital requirements, it will need to retain more of its earnings, which correlates into less funds being available to support community needs and to compensate shareholders.

The proposal to apply unrealized gains and losses on "available for sale" (AFS) securities to Common Equity Tier 1 Capital is one of the proposed changes that would require greater earnings retention. These additional funds would be needed to bolster bank equity to compensate for the fluctuations that regularly occur in the market value of AFS securities. Currently, the bank's entire investment portfolio is designated AFS and these assets' values readily move with the financial markets. For example, between year-end 2011 and March 30, 2012, the bank experienced a 2 percent change in the dollar volume of unrealized gain/loss on AFS securities; however, between the first and second quarters of 2012 this change was 110 percent. These fluctuations would have moved the bank's Tier 1 Capital ratio by as much as 20 basis points. Mind you this has occurred in an ultra low and stable interest rate environment.

Our analysis shows that market value changes will be much more pronounced and detrimental to the bank's capital position when the economy begins to improve and interest rates start to rise. The situation will be compounded by the additional government guaranteed mortgage backed securities that the bank has purchased during this period of very weak loan demand and at a time where we've experienced historic low yields for investments, including Treasury securities.

This situation could obviously be mitigated by reclassifying some of the bank's holdings to "held-to-maturity" (HTM). However, such action would reduce available liquidity since HTM securities cannot be sold prior to maturity, and it would require the bank to amend its contingency funding plans and seek alternative sources. The bank could also purchase securities that had a shorter maturity, but this would limit current and future profitability. If the entire banking industry employed a strategy of buying shorter term investments it would result in less funding for housing, government agencies, local municipalities, and school districts.

We heard in one of the early regulatory presentations about these proposals that the basis for recognizing, for capital purposes, unrealized gains/losses on AFS securities was predicated on the Financial Accounting Standards Board's (FASB) plan to change fair-value accounting. However, after much comment from the banking community and consideration of the potential impact such would have on financial institutions, the FASB has voted to relax its position on this matter. Furthermore, the International Accounting Standards Board's ruling eliminates the AFS category in 2015, which will result in securities being measured at amortized cost, just like loans.

Based on this information and the potential consequences of this proposal, we would respectfully ask that the regulatory agencies follow the FASB's lead and forego the requirement that unrealized gains and losses on AFS securities flow through the bank's equity. Should you still find it necessary to implement this proposal, we would strongly suggest that you exclude, from accumulated other comprehensive income, price fluctuations that occur in securities that have little or no credit risk (e.g., debt obligations of the U.S. government, government agencies, and government sponsored enterprises).

The proposed rules revising certain methodologies for calculating risk-weighted assets will also have a detrimental impact on our bank. If these changes were implemented at June 30, 2012, our bank's risk-weighted assets would increase by $17.1 million or about 25% from that which was reported.

The risk weighting changes suggested for one-to-four family mortgage loans is of significant concern to us. Pinnacle Bank, like most all other community banks, has maintained prudent loan underwriting in providing single family residential property financing for local individuals. Furthermore, the single family residential loans that this bank has originated are not packaged and sold on the secondary market. Instead these loans have been kept "in-house" and are being serviced by Pinnacle Bank employees. To do this, we use loan products that have payment schedules (i.e., monthly principal and interest) that equate up to 30-year terms, but have maturities that range from two (2) to seven (7) years. The basis for this structure is to lessen the institution's interest rate risk. Neither we nor our regulators want the bank to be holding fixed rate, 30-year loans in a rising interest rate environment. This practice and deregulation are what destroyed the savings and loan industry. A variable rate loan product would obviously mitigate said interest rate risk; however, this type financing is unpopular when fixed rates for single family residential loans are currently so low, and will likely stay that way until the housing industry and overall economy improve. If this proposal is left unchanged, our bank will need to revisit its residential real estate lending programs, because the proposed risk rating for part of this portfolio will double and for the other part it will triple.

We believe that this proposed change will translate into less credit being available for single family residential property purchases. It will also lead to increased down payment requirements and lending costs. Furthermore, customers will find it more difficult to obtain mortgages that meet their needs and situations. Therefore we can foresee continued declines in the number of individuals buying residential property, which will prolong the economic slump in the housing market that the country is experiencing.

Although we take some exception to the risk ratings based on the loan-to-value percentage for the Group 1 loans, should you still find it necessary to implement this proposal, we would strongly suggest that you include in Group 1 loans, one-to-four residential mortgage loans, which are structured on traditional repayment terms (i.e., up to 30 years), but have balloon features (i.e., a maturity date of 2 to 7 years). In our opinion, this amendment would greatly lessen the negative impact the current proposal would have on our bank and many other community banks.

The increased risk weightings for delinquent loans and obligations that finance acquisition development and construction (ADC) activities will also negatively affect our bank's capital position. Risk in these assets has historically been addressed in loan loss reserves, and it seems reasonable that this should be continued.

Under the capital proposal, the risk weightings for delinquent loans will be at least 50 percent more than repossessed assets and other real estate owned. If implemented, this proposal will cause our bank to revisit the design and execution of work-out plans. It will also influence the longevity of such strategies, if they are employed. We therefore foresee this proposal limiting opportunities for troubled borrowers to remedy their situations, thus resulting in more foreclosures. Such occurrences would be detrimental to our bank and the community it serves.

If the bank cannot produce sufficient earnings to increase or maintain enough capital to comply with the proposed changes, additional funding will need to be obtained from external sources. Attracting such resources is challenging enough in this environment; however, the capital changes being proposed will make this even more difficult, as the requirements will result in decreased investment returns, which will cause investors to seek more lucrative financial opportunities outside the banking industry. We don't believe that the Basel III proposals were intended to place our institution or others at a competitive disadvantage when raising equity, but they very well could.

We again thank you for the opportunity to comment on the Basel III and the Standardized Approach for Risk-weighted Assets proposals. We respectfully ask that you give our comments, concerns, and suggestions due consideration.

Sincerely,

Wade Ruckle

Wade Ruckle
CEO
For the Pinnacle Bank Board of Directors