South Dakota BANKERS ASSOCIATION
P.O. Box 1081 ■ Pierre SD 57501-1081
PH: 605-224-1653 ■ FX: 605-224-7835

October 22, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket No. R-1430
RIN 3064-AD95

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Docket ID OCC-2012-0008

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064-AD95

Re: Basel III Capital Standards and Standardized Risk Weighting Approach

Dear Sir or Madam:

Thank you for the opportunity to comment on the Basel III proposals issued by your respective bank regulatory agency. On behalf of the 88 members of the South Dakota Bankers Association I wish to offer comments solely on the Basel III and the Standardized Approach proposals. South Dakota's banking marketplace is comprised primarily of traditional community banks, but is also home to the charters of Citibank NA, Wells Fargo Bank and TCF National Bank. Half of South Dakota's banking institutions are under $100 million in assets and fully one third have less than $50 million in assets.

Like much of America's breadbasket, South Dakota experienced a drought in 2012 the likes of which we have not seen since the mid 1970's. Some liken 2012 climate conditions to the dust bowl days of the 1930's . As I travelled the state visiting with bank CEOs over the past several months, I asked what keeps them up at night. I honestly expected that drought-related concerns with their bank's agricultural loan portfolio would be at or near the top of the list. That was not the case. Community bankers from institutions ranging in size from $14 million to $140 million to $1.9 billion all cited regulatory complexity and cost of compliance as their #1 worry. The new Basel III and Standardized Approach to Risk Weighting Assets proposals are major sources of concern.

By the time the official comment period closes, I trust that you will have received hundreds of comment letters from banks of varying size and charter. I am not a banker nor do not possess the technical expertise of many who work for larger state or national banking trade associations, so I will spend a limited amount of time touching on a few specific areas of concern. Rather I want to convey a general sense of the threats posed by an overly complex, one-size-fits-all regulatory approach, especially to community banks striving to do business in rural America.

I believe that the overriding goal of the Basel III capital standards was to assure consistency in capital standards for large, internationally active banks. South Dakota's traditional community banks do not fit the definition of large or internationally active. Frankly the community banking business model is little known in international circles. The fact that there are more differences than similarities between the business models of international or investment banks and those of this nation's traditional community and regional banking institutions begs the question why this nation's federal banking regulators chose to base a new and very complex capital model on the Basel III approach. State banking supervisors have stated that while they believe there is sufficient justification for higher levels of capital in our domestic banking system, they also contend that objective can be achieved without increasing the complexity of capital. They also contend that many of the issues you are attempting address through complex, highly proscriptive regulations can best managed through risk management and the supervisory process. I agree with their contentions.

South Dakota bankers appreciate the need for adequate levels of Tier 1 capital because they have experienced the ups and downs of economic cycles, especially those related to the production agriculture. Try as they might, bankers cannot always mitigate the 100% of the financial risks associated with the unpredictability of Mother Nature and commodity markets. Hence many banks carry capital at levels higher than regulatory required minimums. They have also at times engaged their prudential regulators over the need for counter-cyclical vs. pro-cyclical loan loss allowances, not always with success. Therefore many of South Dakota's banks have chosen to carry capital at levels above those required to be considered well-capitalized. Because capital is a precious commodity, especially for community banks without access to traditional capital markets, bankers have wisely chosen to build excess capital through retained earnings in order to support expanded lending during periods of economic recovery and growth. To have that precious capital eaten away by having to record unrealized losses on available for sale securities during times of rising interest rates makes no sense.

Neither do South Dakota bankers need multiple sets of mandatory capital ratios which are at best operationally cumbersome, and at their worst, may actually conflict with one another. For example, in order to be well capitalized, a bank must have a total risk-based capital ratio of 10 percent for purposes of prompt corrective action. But the minimum total risk based capital ratio including the capital conservation buffer is 10.5%. So a bank could be "well-capitalized" but still be restricted in terms of its ability to pay dividends or bonuses. This conundrum could be especially detrimental for banks organized as subchapter S corporations where new bank owners often use depend on those income streams to retire debt incurred to purchase their ownership interest in the bank. I doubt this is an outcome either anticipated or desired by federal banking regulators.

Bankers I have talked with have expressed many concerns about your standardized approach to risk weighting of assets. You will no doubt hear many of those concerns directly from bankers. I will limit my comments to one of the most troubling provisions in your proposal; increasing the risk weighting of certain residential real estate loans. Residential real estate loans currently carry a 50% risk weight. Under your proposal, a residential mortgage with a balloon payment will be assigned a risk weight of between 100 and 200% depending on its loan to value characteristics. Residential real estate loans made by community banks operating in rural America often carry a balloon payment feature for 2 fundamental reasons.

(1) Secondary market buyers of residential real estate mortgages will typically not purchase a mortgage associated with a home located in a rural area or in a small community because in many cases there are not enough sales of comparable homes to support an appraisal which meets USPAP standards.

(2) Absent the ability to sell a home mortgage into the secondary market, a community bank cannot bear the interest rate risk of a long-term, fixed rate loan. Hence a standard home loan for a community bank in a rural area is more likely to be a 30 year amortizing loan with a balloon payment at the end of 3 years.

Because history shows that the vast majority of these loans are solid performers, banks typically will extend the initial loan into a second 3 year balloon loan. It is likely that such a scenario would be repeated again and again until the loan is repaid. Assigning higher capital requirements to these types of high performing loans makes no sense. Finalization of this proposed risk weighting approach will have the effect of forcing more community banks to exit the residential real estate lending marketplace.

Even without this latest regulatory disincentive, community banks across the state of South Dakota are increasingly deciding that they cannot bear the regulatory compliance costs and risks associated with originating residential real estate loans. Community banks operating in smaller towns and cities do not make large numbers of home loans because houses simply do not change hands on a regular basis. That said, those banks want very much to meet the banking needs of their customers, including the occasional home loan. But because Congress and the bank regulatory community has chosen to impose stiff penalties on loan originators who might make even an innocent, inconsequential error on a mortgage application, the compliance-driven financial risks simply outweigh the income derived from originating home loans. Your newly proposed risk weighting scheme makes an already unbalanced cost / benefit equation even worse.

Rural America is home to a significant portion of the nation's small business community. Lack of available financing outlets for homes for workers will create a serious barrier to America's small business owners who might otherwise consider expanding their business and employment base. Bankers and business owners in larger towns and cities can attest to the importance of vibrant smaller towns in their trade areas. Complex, expensive bank regulations work against the best economic interests of banking institutions and the communities they serve, from the smallest to the largest. I strongly urge you to reconsider the many aspects of these regulatory proposals which will do more damage to traditional community banks and importantly, the customers and the communities they serve.

Best regards,

Curt A. Everson

Curt A. Everson
SDBA President