Texas Heritage Bank

October 10, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Subject: **Docket No. R-1430: RIN No. 7100-AD87** Regulatory Capital Rules: Implementation of Basel III; **Docket No. R-1442; RIN No. 7100-AD87** Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets

Ladies and Gentlemen:

I am a shareholder, Director and serve as the Chief Executive Officer of Texas Heritage Bank, Boerne, Texas, a $100Million community bank with three locations in central Texas. The Bank is 81 years old this year. I am also a shareholder and Director of First State Bank in Abernathy, Texas, a $27Million 102 year old rural community bank on the south plains of Texas.

I am writing to provide comment on the above referenced proposed changes to the regulatory capital rules for the banking industry.

The economy of our great country has benefited since its founding by the entrepreneurial instincts of local people/investors that pooled their resources and took risks to establish community banks to serve local communities. This system of locally owned and managed community financial institutions is unique in the history of world and is foreign to European style of banking and finance. **The community bank system has served our country well.** It is local people who gather local deposits and make loans to farmers, ranchers, non-profit organizations and business people that they know and trust in the local community. It has served to encourage growth in agriculture, businesses, jobs, housing stock in rural markets and provided needed financial support for school districts and local colleges. Community bankers have always taken a long term approach to building their businesses and local economies. In short, this system of small, diverse and non-systemically risky financial institutions has been, over the long haul, the backbone of American agriculture and small business.

This wonderful system is greatly threatened by the proposed Basel III regulatory capital rules and the crush of federal regulation that has befallen our institutions in the last few years. Forcing these new rules on community banks epitomizes an unnecessary and costly regulatory burden with virtually no benefit to the safety and soundness of the banking industry as a whole. These rules were drafted for larger, more complex systemically risky financial institutions. **Community banks should be exempted from these proposed rules.**

The audit and compliance costs of the two institutions that I am engaged in have risen dramatically in the last few years. The cost of outside consultants to assist us in regulatory compliance has risen 350% (adjusted for growth) in the last ten years. These increased costs do not include the additional labor, systems and software costs we have incurred in boosting our compliance area. These new proposed rules will only serve to exacerbate the already unacceptable compliance costs. Our employees mourn the loss of time previously spent helping people with their banking needs because we now spend a majority of our time on regulatory paperwork, the dotting of i's and the crossing of t's to impress our regulators with ill-advised and unproductive regulatory piffle. No doubt, even more outside consultants, labor, systems and software will be needed to comply with these complex new capital rules. Since community banks are not able to use the capital markets to raise equity for growth, we rely heavily on organically generated and retained profits to augment capital. **Obviously, increased compliance costs are a threat to profit, the primary source of capital for most community banks.**

The inclusion of unrealized gains and losses in security portfolios in Tier 1 common equity capital is of grave concern to me. Why would we mark-to-market only a portion of the balance sheet of a bank? It makes no sense to arbitrarily decide that one particular asset category should be treated differently for capital purposes than any other balance sheet category. For community banks, securities purchases are for the long term and are typically held to maturity. We, like most community banks, do not actively trade our securities. Community banks are investors in issuances of local and state government and school district debt. The borrowing costs for these local government entities will likely rise under these proposed rules as banks become less likely to hold longer maturity bonds for fear of rate-driven capital volatility. And, given the current rate environment it is especially worrisome to consider that when rates rise -- *and they will rise* -- our capital would immediately be impacted at a time when our local economies need us the most to be ready and able to lend and support growth. **I am opposed to the proposal to include Accumulated Other Comprehensive Income as part of Tier 1 common equity capital.**

The proposed rules include complicated risk weighting guidelines for various assets. Implementing these complicated rules will require increased labor, systems and software costs. **But, I am mostly disturbed by the changes to risk weightings for mortgage and real estate loans, especially since we keep most nearly all mortgages "in-portfolio" as is common in the community banking model.** Regulatory guidelines already in effect and recently enacted have dampened our enthusiasm for supporting the financing of homes in our markets. These new rules such as escrow requirements, balloon note limitations, appraisal standards, and additional disclosures do nothing to reduce risk to the safety and soundness of the system since we make loans to our friends and neighbors in markets we understand intimately. Most community banks already have an extremely low default rate on in-portfolio mortgage loans. Community banks have been the best source for home financing in rural markets for well over a century. Big banks and mortgage companies have no interest in the small rural homestead located in central Texas. If community banks get out of that business there will be a significant decline in the value of homes in rural communities since there will be no reasonably priced lending source for those loans. **I am opposed to the proposed Risk-Weightings for mortgage loans.**

Five years ago we were thrilled to be able to tap into the Trust Preferred Securities (TruPS) market and raise $2Million at our holding company level that was 100% invested in the capital of our bank. This low cost source of capital provided support for needed growth in the bank that ultimately benefited our local markets with more loans. The Dodd-Frank carve-out for community banks on disallowing TruPS in Tier 1 capital was appropriate and necessary. It is unconscionable that you now propose to undo the will of Congress, our elected legislative branch, to disallow this low-cost source of capital for our bank. **I am opposed to the proposal to disallow TruPS as Tier 1 capital.**

As proposed, the new Basel III capital requirements will require us to change internal reporting systems, incur costly software enhancements, hire more outside consulting help, provide more training for our staff members, and require additional energy and focus from our Board and management. None of those things will do anything to benefit our customers and our local economy. These increased compliance costs will pull money out of capital and earnings rather than help us make more loans to assist getting our country bank in gear. These proposed *international* capital rules have no place in the community banking industry of the United States of America.

I urge you to exempt community banks from this harmful and unnecessary new regulatory burden.

Sincerely,
Steven Mack Digitally signed by Steven Mack
Steven S. Mack
Chief Executive Officer

Cc: Texas Heritage Bank Board of Directors; United States Senator John Cornyn; United States Senator Kay Bailey Hutchison; Congressman Lamar Smith (21st District/Texas); Congressman Randy Neugebauer (19th District/Texas); Congressman Mike Conaway (11th District/Texas)