LIBERTY TRUST & SAVINGS BANK

October 17, 2012

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

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 Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

Re: Basel III Capital Proposals

Ladies and Gentlemen:

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

I am vice president and cashier of Liberty Trust & Savings Bank, a $135 million bank located in Eastern Iowa. We have four locations located in rural farming communities in Cedar, Scott, and Muscatine Counties. Our current loan portfolio totals just over $55 million and it is comprised mainly of agricultural, 1-4 family, and commercial real estate loans, agricultural operating and machinery loans, and consumer loans. We also have loans for the purpose of 1-4 Family residential construction, home equity lines of credit, commercial operating, and loans to our local schools and municipalities. In simple terms, we serve our communities and our customers by providing them the financial tools needed to be successful.

First and foremost, I would like to emphasize that I am completely in favor of strengthening the quality of capital that the large, complex banks are required to maintain. With the increase in size and complexity comes a much greater risk to the bank and the banking system. Over the past 3+ years a growing problem has been the loss of the "large, complex" adjectives when discussing banking issues and regulating banks. With each new regulation, Liberty Trust & Savings Bank continues to be included with the large, complex banks when the only real common thread is the basic banking function.

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As I continue to study the Basel III proposal and each component included in calculating the Required Capital Ratio, my major concern continues to be the overall reporting burden that this will create. Under the current methodology, as of June 30, 2012, our Tier 1 risk-based capital ratio was 30.62% and our Total risk-based capital ratio was 31.88%. At this point, my assumption is that maintaining an adequate Required Capital Ratio is not a concern for Liberty Trust & Savings Bank but calculating a true and accurate Required Capital Ratio under the Basel III proposal becomes a major concern and burden.

My first major concern, and probably most burdensome, is in calculating and assigning the risk weights to residential mortgages. The amount of information and level of detail required to properly categorize our residential mortgages goes way above and beyond information readily available on our core processing system. Residential mortgages would have to be reviewed individually for them to be properly assigned their risk rating. An initial review that would require countless hours of human resources with an additional, ongoing commitment by staff to monitor and update values and loan status. Additional hours dedicated to regulation compliance, hours that could be used to serve our customers and our communities.

On a side note, virtually all of our residential mortgages are balloon payments with most being 5 year balloons. This would automatically move them to a "riskier" Category 2 mortgage with an exposure weight of 100-150% of the loan balance. A conservative estimate of at least 50% (probably closer to 75%) of the residential mortgages have a loan to value of 50% or less. According to initial Basel III guidelines, Liberty Trust & Savings Bank would then have over $5 million with a risk weight of 100% and the remaining 50% would be weighted at 100% or 150%. All residential mortgages risk weighted at 100-150% at a financial institution that has seen no ($0.00) charge-offs in the residential mortgage portfolio in the last 20 years!

Another major concern is the increased risk weights placed on loans past due greater than 90 days and non-accrual loans. Liberty Trust and Savings Bank is very fortunate that, through a generally conservative lending policy and careful underwriting, we typically maintain a fairly low delinquency rate. We also realize that this could change quickly based on economic conditions. This possible change in loan conditions is currently already allowed for in our calculation of the Allowance for Loan and Lease Losses. By proposing to also increase the capital we are required to hold on past due loans, we are basically being required to set aside capital twice. I feel the risk regarding past due loans and loan quality should continue to be managed through the loan loss reserve guidance and not by layering on an additional capital requirement.

Also of concern regarding the Basel III proposal is the inclusion of unrealized gains or losses from a bank's investment portfolio in regulatory capital. This provision would have a very undesirable and unnecessary affect of adding volatility to the bank's capital position. As of 6/30/12, Liberty Trust & Savings Bank's investment portfolio totaled over $68 million or roughly 50% of total assets. Net unrealized gains at that time were in excess of $2.2 million which then added an additional 2% to the Required Capital Ratio. Conversely, a 300 basis point rise in interest rates would translate into an unrealized loss on the investment portfolio of over $5 million and a roughly 6% drop in Required Capital Ratio. Basel III does not take into consideration a bank's overall sensitivity to interest rate movements and therefore cannot provide a true insight into a bank's level of interest rate risk. Existing rules for Other-Than-Temporarily-Impaired (OTTI) investments provides a mechanism through which potential credit losses can be reflected in a bank's capital. Most banks use the investment portfolio as a source of liquidity and to manage interest rate risk. A natural response to Basel III will be for banks to hold fewer securities or to migrate securities to held-to-maturity (HTM). This raises the following question: How can it be in the best interest of the financial system to ratify Basel III if it provides no improvement in measuring a bank's ability to sustain losses and at the same time would reduce liquidity system-wide?

In conclusion, I have no way to completely ascertain the full impact of this massive proposal because of the amount of research it will take to fully understand Basel III and how it will apply to our balance sheet. We will likely be required to seek outside assistance for the re-assessment of each individual loan in our portfolio to the new risk weights. It appears that re-programming of our core processing software to handle the new coding requirements may be necessary to create reports to analyze the data for the calculation of the Required Capital Ratio.

As stated above, while I support the overall goal of strengthening the financial system by increasing the level and quality of capital that banks hold, this proposal is designed for the large complex financial institutions participating in the global financial markets not the community banks like Liberty Trust & Savings Bank. I urge you to consider the impact that this proposal will have on community banks and to consider exempting community banks from the majority of these requirements.

Respectfully submitted,

Philip L. Keese
Vice President and Cashier
Liberty Trust and Savings Bank