WOLF RIVER
COMMUNITY BANK

October 9, 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 Corporation,
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 Basel III proposals1 that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I am a community banker in a semi-rural village with 2,711 people in East Central Wisconsin. Our bank has approximately $121 million in assets. We serve the depository and credit needs of people living and working in our area and employ approximately 30 people from our community as well.

I am writing to express my opposition of the Basel III proposal application to community banks like the one I work at. I have a number of concerns that the proposed rules would have a negative impact on the ability to serve our customers and community in the same ways that we have traditionally.

I strongly believe that community banks should be allowed to continue using the current Basel I framework for computing their capital requirements. Basel III, (by definition) was designed to apply to the largest, internationally active, banks and not community banks. Community banks like the one I work at are based on relationships and we strive to serve our customers on a long-term basis. This approach contributes to the success of community banks like ours through practical, common sense approaches to managing risk. This differs significantly from the large banks that Basel III seems to be designed to apply to.

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[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements*; and *Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

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Also troubling is the proposed inclusion of accumulated other comprehensive income (AOCI) in capital for community banks that will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for most community banks represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities. Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. This decline will have a direct, immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce capital balances. Although we do not sell or trade such securities, the changes in valuation simply due to interest rate changes would impact our capital. This does not follow the true economic impact in that we sustain no loss and no ultimate impact to capital in the end when we hold the security to maturity. Community banks should continue to exclude AOCI from capital measures as they are currently required to do today.

Implementation of the capital conservation buffers for community banks will be difficult to achieve under the proposal and therefore should not be implemented. Many community banks will need to build additional capital balances to meet the minimum capital requirements with the buffers in place. The only way for community banks like ours to increase capital is through the accumulation of retained earnings over time. Due to the current ultra-low interest rate environment, community bank profitability has diminished further hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) in order for those banks that need the additional capital to retain and accumulate earnings accordingly.

Additionally, the proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks who offer these loan products to their customers and deprive our local customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. Many community banks will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE. Second liens will either become more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans.

The costs of capital, technology and operational costs will be a significant burden on community banks like the one I work at. These costs will ultimately negatively impact the ability of us to meet the needs of our small-town customers and far outweigh any benefits of the proposed capital required, again which was originally intended to apply to larger, more complex financial institutions.

Please consider my comments as you evaluate the applicability of Basel III to community financial institutions.

Sincerely,

Joseph W. Peikert
Executive Vice President