THE FIRST NATIONAL BANK

"Community Banking Since 1904"

October 16, 2012

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

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

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

RE: Proposed Rulemaking on Minimum Regulatory Capital
And the Standardized Approach for Risk-weighted assets
Basel III Federal Reserve Docket No.R-1430;
RIN No. 7100-AD87 and Docket No. R-1442; RIN No.
7100-AD87
Basel III FDIC RIN 3064-AD95, RIN 3064-AD96
Basel III OCC Docket ID OCC-2012-0008 and
Docket ID OCC-2012-0009

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals 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.

The Board of Directors of The First National Bank, Mattoon, Illinois, were extremely disappointed when the regulators approved imposing requirements contained in the NPRs on community banks. These proposed new Rules are <u>not</u> required

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under the Basel III capital agreement. Basel III was originally designed to prevent another financial crisis and to only apply to the largest, systemically important, and internationally active banks. Community banks did not engage in the reckless behavior that contributed to the financial crisis and subsequent economic downturn. Community banks have lower risk profiles because they operate under a relationship-based business model. Their less complex business model and lack of significant interrelationships are not reflected in the one-size-fits-all approach to the capital standards and asset risk-weighs in the NPRs. Individual community banks pose no systemic risk whatsoever. The NPRs are misguided and would significantly disadvantage community banks. Therefore, these requirements should not apply to community Banks.

The First National Bank Board of Directors strongly encourages you to exempt community banks from the proposed implementation of the NPRs and allow community banks to continue to operate under Basel I capital requirements. However, in the unfortunate event you choose to adopt these misguided Rules, several of the specific proposals identified below threaten the survival of community banks and must be eliminated.

I. <u>Incorporating AOCI as Part of Regulatory Capital</u>

Inclusion of accumulated other comprehensive income (AOCI) in capital for community banks 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. Additionally, demand for many implicitly and explicitly government guaranteed securities has risen due to a flight to safety and government intervention in the capital markets. This increased demand has caused credit spreads to tighten further increasing bond valuations. 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. At my bank, for instance, if interest rates increased by 300 basis points, my bank's bond portfolio would show a paper loss of $1,817,000. This would mean that my bank's tier one ratio would drop by 2.2%.*

*Refer to Before and After Risk Based Capital Analysis (6/30/12 before, 17.17%; 6/30/2012 after, 14.97%) included herewith.

Large financial institutions have the ability to mitigate the risks of capital volatility by entering into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Community banks do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry. Community banks should continue to exclude AOCI from capital measures as they are currently required to do today.

II. Capital Conservation Buffers

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. Community banks do not have ready access to capital that the larger banks have through the capital markets. The only way for community banks 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.

III. New Risk Weights

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 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. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages.

IV. Proposed Phase-out of Trust Preferred Securities

We object to the proposed ten year phase-out of the tier one treatment of instruments like trust preferred securities (TRUPS) because it is reliable source of capital for community banks that would be very difficult to replace. We believe it was the intent of the Collins amendment of the Dodd-Frank Act to permanently grandfather tier one treatment of TRUPS issued by bank holding companies between $500 million and $15 billion. Phasing out this important source of capital would be a particular burden for many privately-held banks and bank holding companies that are facing greatly reduced alternatives in raising capital. While we applaud the fact that TRUPS issued by bank holding companies under $500 million would not be impacted by the proposal, consistent with the Collins Amendment, we urge the banking regulators to continue the current tier one treatment of TRUPS issued by those bank holding companies with consolidated assets between $500 million and $15 billion in assets.

V. Mortgage Servicing Rights

Penalizing the existing mortgage servicing assets under the proposal is unreasonable for those banks that have large portfolios of mortgage servicing rights. Any mortgage servicing rights existing on community bank balance sheets should be allowed to continue to follow the current risk weight and deduction methodologies.

VI. Subchapter S Community Banks

Imposing distribution prohibitions on community banks with a Subchapter S corporate structure conflicts with the requirement that shareholders pay income taxes on earned income. Those banks with a Subchapter S capital structure would need to be exempt from the capital conservation buffers to ensure that their shareholders do not violate the provisions of the Internal Revenue Code. We recommend that the capital conservation buffers be suspended during those periods where the bank generates taxable income for the shareholder.

In conclusion, the Board of Directors of The First National Bank respectfully request that you exempt community banks from Basel III capital requirements. The First National Bank, Mattoon, Illinois, was chartered in 1904 and has provided community banking services to the communities it has served for 108 years. If you (the Regulators) have the desire to let 15 or 20 mega banks provide the banking services for the United States, imposing Basel III on community banks will accomplish that purpose.

Finally, as an example to support our discussion I offer the following: In our community, two (2) community banks sold out to mega banks approximately 20 years ago. Today, these same banks occupy one-half the space they did before the transfer; they have one-third the employees; and have a reduction in deposits of over ~~100%~~ 50% during the past 20 years. On the contrary, our Bank has grown over 200% during the same period of time. Community Banks provide consumer service—mega banks do not.

Thank you for your consideration.

Sincerely,

The Board of Directors
The First National Bank, Mattoon, Illinois

Preston G. Smith, President

Steven S. Schmitt

Lawrence G. Martin

Robert M. Ronchetti

The First National Bank
Risk Based Capital Analysis
June 30, 2012 With Basel III Adjustments/Mtgs 100%/Unrealized Loss AOCI

Call Report Line	Asset Item	Asset $ ($000 Omitted)	Risk Weight %	Adjusted Asset $ ($000 Omitted)
	Category #1			
4A-1	U.S. Treasury Securities	$0	0%	$0
	U.S. Government Agencies	$5,227	0%	$0
	Loans Secured by CD's & Savings	$368	0%	$0
4A-2	Currency & Coin	$367	0%	$0
	Interest Bearing Bank Balances	$1,699	0%	$0
	Federal Reserve Excess Balance (Thru MIB)	$423	0%	$0
	Federal Reserve Bank Stock	$180	0%	$0
	Federal Reserve Bank Balance	$15	0%	$0
	Total Category #1	**$8,279**	**0%**	**$0**
	Category #2			
5A-1	SBA/FHA Guaranteed Loans	$0	20%	$0
5A-3	Balance From Depository Institutions	$2,032	20%	$406
	U.S. Government Sponsored Securities HTM	$0	20%	$0
	U.S. Government Sponsored Securities AFS	$12,141	20%	$2,428
	General Obligations Securities	$4,880	20%	$976
	FHLB Stock	$402	20%	$80
	Fed Funds Sold	$0	20%	$0
	Short Gov't Fund	$0	20%	$0
	Cash Items	$13	20%	$3
	Total Category #2	**$19,468**	**20%**	**$3,894**
	Category #3			
6A	Municipal Bonds	$270	50%	$135
	Corporate Bonds	$0	50%	$0
	Total Category #3	**$270**	**50%**	**$135**
	Category #4			
7A	PLUG #	$32,538	100%	$32,538
	Off-Balance Equivalent (50% Letters of CR)	$370	100%	$370
	First Real Estate Mortgages (1-4 Family)	$7,109	100%	$7,109
	Unrealized Gain/Loss	($1,817)	100%	($1,817)
	Off-Balance Equiv MPF Credit Enhancement	$2,138	100%	$2,138
	Total Category #4	**$40,338**	**100%**	**$40,338**
	Other Items			
8A	Excluded On Balance Sheet Asset Values			
	Goodwill Net of Amortization	$153	100%	$153
	Total Other Items	$153	100%	$153
9A	* Total Schedule RC-R (Must Equal Total Assets Plus ALLL Including Reduction for OBS Credit Exposures)	**$66,000**	**N/A**	**$44,366**

RECAPITULATION

	Risk Weighted Assets ($000 Omitted)	Risk Weight	Adjusted Assets ($000 Omitted)
Category #1	$8,279	0%	$0
Category #2	$19,468	20%	$3,894
Category #3	$270	50%	$135
Category #4	$40,338	100%	$40,338
TOTAL RISK-WEIGHTED ASSETS Before Deductions for Excess Allowance	**$68,355**		**$44,366**
Tier 1 Risk Based Capital to 6/30/2012	$6,108		
Allowance for Loan Losses to 6.30/2012	$479		
Less: Excess Allowance (> 1.25% RWA)			
TOTAL RISK-BASED CAPITAL	**$6,587**		
Reduction to ALLL for OBS Credit Exposure	$0		
Adjusted Total Assets	$44,366		
QTD Average Assets	$67,758		
Total Risk-Weighted Assets	$44,366		

		WELL CAPITALIZED	
Total Risk-Based Capital to Risk-Weighted Assets	14.85%	≥	10.00%
Tier 1 Risk Based Capital to Risk-Weighted Assets	13.77%	≥	6.00%
Leverage Capital Ratio (Tier 1 to QTD Average Assets)	9.03%	≥	5.00%

I, Tracy J. Beem, Senior Vice President - CFO, hereby certifiy the above captial ratios accurately represent the capital position of The First National Bank, Mattoon, Illinois as of June 30, 2012, as calculated under regulatory standards for risk-based capital.

Tracy J. Beem

Tracy J. Beem, Senior Vice President - CFO

ADEQUATELY CAPITALIZED		UNDER CAPITALIZED	
≥	8.00%	<	8.00%
≥	4.00%	<	4.00%
≥	4.00%	<	4.00%

The First National Bank

Risk Based Capital Analysis

June 30, 2012 With Basel III Adjustments/Unrealized Loss AOCI

Call Report Line	Asset Item	Asset $ ($000 Omitted)	Risk Weight %	Adjusted Asset $ ($000 Omitted)
	Category #1			
4A-1	U.S. Treasury Securities	$0	0%	$0
	U.S. Government Agencies	$5,227	0%	$0
	Loans Secured by CD's & Savings	$368	0%	$0
4A-2	Currency & Coin	$367	0%	$0
	Interest Bearing Bank Balances	$1,699	0%	$0
	Federal Reserve Excess Balance (Thru MIB)	$423	0%	$0
	Federal Reserve Bank Stock	$180	0%	$0
	Federal Reserve Bank Balance	$15	0%	$0
	Total Category #1	**$8,279**	**0%**	**$0**
	Category #2			
5A-1	SBA/FHA Guaranteed Loans	$0	20%	$0
5A-3	Balance From Depository Institutions	$2,032	20%	$406
	U.S. Government Sponsored Securities HTM	$0	20%	$0
	U.S. Government Sponsored Securities AFS	$12,141	20%	$2,428
	General Obligations Securities	$4,880	20%	$976
	FHLB Stock	$402	20%	$80
	Fed Funds Sold	$0	20%	$0
	Short Gov't Fund	$0	20%	$0
	Cash Items	$13	20%	$3
	Total Category #2	**$19,468**	**20%**	**$3,894**
	Category #3			
6A	First Real Estate Mortgages (1-4 Family)	$7,109	50%	$3,555
	Municipal Bonds	$270	50%	$135
	Corporate Bonds	$0	50%	$0
	Total Category #3	**$7,379**	**50%**	**$3,690**
	Category #4			
7A	PLUG #	$32,538	100%	$32,538
	Off-Balance Equivalent (50% Letters of CR)	$370	100%	$370
	Unrealized Gain/Loss	($1,817)	100%	($1,817)
	Off-Balance Equiv MPF Credit Enhancement	$2,138	100%	$2,138
	Total Category #4	**$33,229**	**100%**	**$33,229**
	Other Items			
8A	Excluded On Balance Sheet Asset Values			
	Goodwill Net of Amortization	$153	100%	$153
	Total Other Items	$153	100%	$153
9A	* Total Schedule RC-R (Must Equal Total Assets Plus ALLL Including Reduction for OBS Credit Exposures)	**$66,000**	**N/A**	**$40,812**

RECAPITULATION

	Risk Weighted Assets ($000 Omitted)	Risk Weight	Adjusted Assets ($000 Omitted)
Category #1	$8,279	0%	$0
Category #2	$19,468	20%	$3,894
Category #3	$7,379	50%	$3,690
Category #4	$33,229	100%	$33,229
TOTAL RISK-WEIGHTED ASSETS Before Deductions for Excess Allowance	**$68,355**		**$40,812**
Tier 1 Risk Based Capital to 6/30/2012	$6,108		
Allowance for Loan Losses to 6.30/2012	$479		
Less: Excess Allowance (> 1.25% RWA)			
TOTAL RISK-BASED CAPITAL	**$6,587**		
Reduction to ALLL for OBS Credit Exposure	$0		
Adjusted Total Assets	$40,812		
QTD Average Assets	$67,758		
Total Risk-Weighted Assets	$40,812		

		WELL CAPITALIZED
Total Risk-Based Capital to Risk-Weighted Assets	16.14%	≥ 10.00%
Tier 1 Risk Based Capital to Risk-Weighted Assets	14.97%	≥ 6.00%
Leverage Capital Ratio (Tier 1 to QTD Average Assets)	9.03%	≥ 5.00%

I, Tracy J. Beem, Senior Vice President - CFO, hereby certifiy the above captial ratios accurately represent the capital position of The First National Bank, Mattoon, Illinois as of June 30, 2012, as calculated under regulatory standards for risk-based capital.

Tracy J. Beem

Tracy J. Beem, Senior Vice President - CFO

ADEQUATELY CAPITALIZED	**UNDER CAPITALIZED**
≥ 8.00%	< 8.00%
≥ 4.00%	< 4.00%
≥ 4.00%	< 4.00%

The First National Bank
Risk Based Capital Analysis
June 30, 2012

Call Report Line	Asset Item	Asset $ ($000 Omitted)	Risk Weight %	Adjusted Asset $ ($000 Omitted)
	Category #1			
4A-1	U.S. Treasury Securities	$0	0%	$0
	U.S. Government Agencies	$5,227	0%	$0
	Loans Secured by CD's & Savings	$368	0%	$0
4A-2	Currency & Coin	$367	0%	$0
	Interest Bearing Bank Balances	$1,699	0%	$0
	Federal Reserve Excess Balance (Thru MIB)	$423	0%	$0
	Federal Reserve Bank Stock	$180	0%	$0
	Federal Reserve Bank Balance	$15	0%	$0
	Total Category #1	**$8,279**	**0%**	**$0**
	Category #2			
5A-1	SBA/FHA Guaranteed Loans	$0	20%	$0
5A-3	Balance From Depository Institutions	$2,032	20%	$406
	U.S. Government Sponsored Securities HTM	$0	20%	$0
	U.S. Government Sponsored Securities AFS	$12,141	20%	$2,428
	General Obligations Securities	$4,880	20%	$976
	FHLB Stock	$402	20%	$80
	Fed Funds Sold	$0	20%	$0
	Short Gov't Fund	$0	20%	$0
	Cash Items	$13	20%	$3
	Total Category #2	**$19,468**	**20%**	**$3,894**
	Category #3			
6A	First Real Estate Mortgages (1-4 Family)	$7,109	50%	$3,555
	Municipal Bonds	$270	50%	$135
	Corporate Bonds	$0	50%	$0
	Total Category #3	**$7,379**	**50%**	**$3,690**
	Category #4			
7A	PLUG #	$32,538	100%	$32,538
	Off-Balance Equivalent (50% Letters of CR)	$370	100%	$370
	Off-Balance Equiv MPF Credit Enhancement	$2,138	100%	$2,138
	Total Category #4	**$35,046**	**100%**	**$35,046**
	Other Items			
8A	Excluded On Balance Sheet Asset Values			
	Unrealized Gain/Loss	$606	100%	$606
	Goodwill Net of Amortization	$153	100%	$153
	Total Other Items	$759	100%	$759
9A	* Total Schedule RC-R (Must Equal Total Assets Plus ALLL Including Reduction for OBS Credit Exposures)	**$68,423**	**N/A**	**$42,629**

RECAPITULATION

	Risk Weighted Assets ($000 Omitted)	Risk Weight	Adjusted Assets ($000 Omitted)
Category #1	$8,279	0%	$0
Category #2	$19,468	20%	$3,894
Category #3	$7,379	50%	$3,690
Category #4	$35,046	100%	$35,046
TOTAL RISK-WEIGHTED ASSETS Before Deductions for Excess Allowance	**$70,172**		**$42,629**
Tier 1 Risk Based Capital to 6/30/2012	$7,319		
Allowance for Loan Losses to 6.30/2012	$479		
Less: Excess Allowance (> 1.25% RWA)			
TOTAL RISK-BASED CAPITAL	**$7,798**		
Reduction to ALLL for OBS Credit Exposure	$0		
Adjusted Total Assets	$42,629		
QTD Average Assets	$67,758		
Total Risk-Weighted Assets	$42,629		

		WELL CAPITALIZED	
Total Risk-Based Capital to Risk-Weighted Assets	18.29%	≥	10.00%
Tier 1 Risk Based Capital to Risk-Weighted Assets	17.17%	≥	6.00%
Leverage Capital Ratio (Tier 1 to QTD Average Assets)	10.83%	≥	5.00%

I, Tracy J. Beem, Senior Vice President - CFO, hereby certifiy the above captial ratios accurately represent the capital position of The First National Bank, Mattoon, Illinois as of June 30, 2012, as calculated under regulatory standards for risk-based capital.

Tracy J. Beem, Senior Vice President - CFO

ADEQUATELY CAPITALIZED		UNDER CAPITALIZED	
≥	8.00%	<	8.00%
≥	4.00%	<	4.00%
≥	4.00%	<	4.00%