Astra Bank
Abilene Location

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October 19, 2012

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Basel III Docket No. 1442

The Honorable Thomas J. Curry, Chairman
Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
Basel III OCC Docket ID OCC-2012-0008, OCC-2012-0009 and OCC-2012-0010

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
comments@FDIC.gov
Basel III FDIC RIN 3064-AD95, RIN 3064-AD96 and RIN 3064-AD97

Re: Basel III Capital Proposals

Heads of Agencies:

Thank you for the opportunity to provide comment on the Basel III proposals[1]. Astra Bank is a small community bank with total assets of approximately $192 million. Our locations are in five rural communities from central Kansas to central Nebraska, with populations ranging from a few hundred people to a few thousand people. Since our chartering in 1911, we worked to provide a wide array of banking services to our customers and communities that enable them to fulfill their dreams.

While there are numerous aspects of the Basel III proposals that are concerning, this letter will be limited to the three adverse impacts of the proposals deemed by Astra Bank's management team to the be the most detrimental to the bank's operating strategy: the proposed requirement that unrealized gains and losses on available for sale (AFS) securities must flow through to the bank's regulatory capital, the proposed rules regarding risk-weighting on residential real estate mortgages, and the impact of the proposed scope and granularity of the proposals.

Proposed Requirement on Unrealized Gains and Losses from AFS Securities

Astra Bank is a bank that utilizes the AFS securities designation to provide the bank with an avenue to manage its liquidity and profitability needs. Astra Bank's

[1] The three NPRs are together titled *Regulatory Capital Rules* and individually subtitled *Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provision, and Prompt Corrective Action*, 77 FR 52792 (August 30, 2012); *Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements*, 77 FR 52888 (August 30, 2012); and *Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule,* 77 FR 52978 (August 30, 2012).

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portfolio, which makes up approximately one-third of its balance sheet, has provided the bank with a consistent source of liquidity and earnings that has been routinely cited in a positive manner by the bank's examiners. In addition to enhancing the safety and soundness of the bank, the AFS portfolio provides the bank with the necessary consistency in liquidity and earnings needed to serve small, rural communities. Consistent with the intent of AFS, Astra Bank is not in the routine practice of marketing its securities to enhance its profitability by realizing gains in its portfolio.

Given that Astra Bank adheres to the intent of the AFS designation for securities, the bank does not realize any tier 1 capital impacts of changes in interest rates. Under the present regulations, as the interest rate markets decline, the gain on its AFS portfolio solely represents the degree to which the bank will receive above current market cash flows from its portfolio. Conversely, when the interest rate markets rise, the loss on its AFS portfolio solely represents the degree to which the bank will receive below market cash flows from its portfolio.

However, the new proposals would require Astra Bank to recognize any changes in securities valuation through its common equity tier 1 (CET1) capital. While it is presently comforting to observe significant unrealized gains in our portfolio, Astra Bank is cognizant that the current interest rate markets are at 40-year lows. Therefore, it is reasonable to conclude that there is more risk to interest rates going up, thus providing an adverse impact to CET1 capital, than there is risk to interest rates going down. Should interest rates revert to a level that is more representative of the prior two, three, or even four decades, the bank would be required to inject capital equal to a year's earnings. This adverse impact to CET1 capital would likely preclude the bank from providing the banking services that are needed by its customers and communities.

Proposed Rules on Risk-Weighting Residential Real Estate Mortgages

Astra Bank is the leading provider of residential real estate mortgages in the markets it serves. While the bank has been a leading provider of secondary market mortgage financing to its customers and communities, the nature of the rural communities that we serve prevents the bank from providing all potential borrowers with access to the secondary market. To meet the needs of these customers, Astra Bank must portfolio these residential real estate loans.

Astra Bank ensures compliance with examination standards for interest rate risk by utilizing balloon features in these loans to provide the bank with an opportunity to re-price the loans to market rates in a rising rate environment. The proposals would place much more punitive risk-weightings on these loans that were underwritten to the same standards as secondary market loans and in full compliance with all applicable regulation. The Basel III proposals would increase the risk-weighting from the current 50% level to a minimum of 100% risk weighting, with a potential risk-weighting up to 200%. The implementation would leave Astra Bank with two

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choices – either exit the portion of the residential real estate market that cannot be served with secondary market loans, which would leave those consumers without a lender to meet their financial needs, or more than double the capital of the bank. Because Astra Bank is a small, community bank, it is very unlikely that the bank will be able to access sufficient capital to support its current business strategy. Therefore, it is reasonable to conclude that the implementation of this proposal will lead to Astra Bank exiting this type of lending, which would leave our communities without a lender to meet these needs.

Scope and Granularity of the Proposed Rules

The proposed rules have a very significant impact on a bank's operation, as the rules are very comprehensive in nature. Further, the rules provide a significant amount of new detail that will apply to current aspects of banking. The combination of these two aspects of the proposed rules is going to have significant adverse impact on Astra Bank.

To fully comply with the Basel III proposed rules, Astra Bank will incur additional expense. Based on our analysis of these rules, Astra Bank expects a 10% increase in staffing because of the enactment of Basel III. These personnel will be utilized for development, implementation and management of information gathering systems that collect information required by Basel III, for updating collateral valuations and for monitoring of loan classifications set forth in risk-weighting proposed changes. Not only will the bank incur the ongoing costs associated with the continued employment of these new employees, but the bank will incur a significant amount of training costs associated with properly onboarding and training these employees. The onboarding and training costs will likely double the initial year costs of these new employees.

Astra Bank will also incur additional costs with respect to the bank's data systems. The data requirements associated with Basel III exceed the current capabilities of the bank's systems. These systems will undoubtedly be upgraded to meet regulatory requirements of Basel III. However, these upgrades will not come without cost to banks like Astra Bank. As the current environment is not conducive to banks being able to pass along additional regulatory costs to its customer base, the bank is going to be forced to deal with the reality of a significantly higher cost structure.
For banks like Astra Bank, a higher cost structure is not simply something that makes the achievement of higher profits for the purposes of large bonuses and large dividends very difficult. Small, community banks, like Astra Bank, rely on the profit stream as a source of addition capital to support continued safe and sound operation of the bank. As there are not other sources of capital widely available to small, community banks, any change that has significant adverse potential impact to a bank's earnings leads to long-term jeopardy of the safety and soundness of small, community banks. In fact, this may be the cruelest irony of Basel III – a scenario in which a series of proposed rules designed to ensure that banks are more safe and sound by elevating the level of required capital ultimately ends up working to the detriment of these same banks by starving their primary source of capital.

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Sincerely,

Kyle A. Campbell, President & CEO