October 22, 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, NW
Washington, DC 20429

Re: FDIC RIN 3064-AD95, FDIC RIN 3064-AD96, and FDIC RIN 3064-AD97

Ladies and Gentlemen:

I am the CCO of Citizens Bank, Fort Scott, a $265MM community bank that primarily serves rural Kansas with 8 bank branch locations. I am writing you to express my concern about proposed regulations being considered under Basel III and in response to the notices of proposed rule making.

There are elements of this plan that will have severe negative consequences on the banking system, community banks and ultimately the communities we serve. I would like to outline my issues and concerns for your consideration:

1. We are concerned about the stipulation where available for sale securities must be marked to market and any change in value captured in the income statement and ultimately impacting capital. We have a $125MM portfolio of mostly mortgage backed securities that currently have a $6MM gain. We have the ability and willingness to hold these securities. A large portion of these securities derive their yield and performance from the underlying performance of the economy and therefore must be available for sale in order to manage our portfolio. Just as we are required to manage and require payoffs from loan customers, so must we have the ability to manage our security portfolio. This mark-to-market requirement on our security portfolio is done without consideration of the other components of

the balance sheet.. The security portfolio is used to provide liquidity and to provide balance in the bank's efforts to manage its interest rate risk. Any changes in value of the bank's security portfolio will be offset, virtually 100%, by changes in the value of its loans and deposits. Running a bank requiring treatment of this isolated piece of the balance sheet only would be like trying to drive a car with only one front wheel that turns.

2. When rates rise, the above mentioned-gain ($6MM) will move to a loss position and negatively impact earnings and capital even though no security was sold. This has the potential to create massive volatility in earnings and capital. Businesses strive to achieve stable earnings and capital structures and this legislation has the effect of putting banks in the position of having to raise capital and dilute shareholders when no financial transactions have taken place. Also, in a rising rate cycle the economy would typically be improving and loan demand would increase, further increasing the requirement for capital. If the bank is unsuccessful raising capital on either of these fronts, the communities in which we operate are the one's that are hurt.

3. We are concerned about the stipulation where individual residential mortgage loans receive risk weightings for Risk Based Capital treatment based on category of loan and loan-to-value. These risk weights are without the basis of loss experience. For the community bank, we have tried to keep certain low risk loan transactions in our portfolio, sell the balance of the loans in the secondary market and take an appropriate amount of real estate risk through the purchase of mortgage backed securities. Our real estate loans are the cornerstone of our bank and many community banks. We do not have long term funding sources and would be criticized if we made long term loans in large quantities. The only reasonable alternative is a balloon loan. If balloon loans are properly underwritten, I do not believe there is any empirical evidence to support the notion that these loans represent a higher degree of risk than any other conforming loan, yet, they receive a category 2 designation. Our bank's historical loss ratio on all single family real estate loans is extremely low, regardless of the fixed or variable nature of the loan; however, the proposals necessarily will raise capital requirements (and the availability of loans) for loans that the bank uses to address interest rate risk. In addition, the increased capital requirement will have the unintended consequence of encouraging increased risk assumption.

4. We are concerned about the proposal's treatment of Home Equity Loans. The proposal would classify junior liens as category 2 loans requiring higher risk weightings. Junior liens represent an effective way for home owners to tap into equity reserves, on a pre-arranged basis, if they need it for emergency purposes, longer term interest deductible purposes or to support business lending. Junior lien home equity loans have historically been a very safe and effective product for banks and the consumer, because the loans are typically underwritten as if they

are unsecured. It is noteworthy that unsecured lending (that would leave the consumer free to encumber the residence to another lender) receives more favorable treatment than the second mortgage product.

5. We are concerned about risk weighting delinquent loans higher. When loans become delinquent, accounting rules require that they be tested for impairment and any estimated losses charged against earnings (capital). While the proposals endeavor to provide capital for potential losses, they fail to consider the unintended consequences of the conflicts with accounting rules in existence now. Consider if this were in place in 2008. As customers developed problems and became delinquent, reserve requirements would have been 50% higher for those loans in addition to higher-than-normal loan loss reserves (due to the assumption of losses continuing at the same level). So at a time when the bank has addressed the problem loan, made all necessary capital adjustments for it, and made an increase to its loan loss reserves to cover a similar incident on a similar type loan, the proposals would require additional capital to cover the capital that was just allocated to support the perceived risk. In a recession, borrowers and their lenders need time to address the problems and these rules would reduce the ability of bank's to work with its borrowers because of the high cost of capital. The risk/reward between taking an actual loss on an asset, e.g., foreclosure, would simply be less than the capital charge due to the potential loss on the loan.

6. The proposal will require our bank to collect and report new and in many cases, very detailed information in order to calculate the risk weights of assets. We do not currently have that capacity and we do not believe it will be inexpensive to develop that capacity. The beneficial effect of such a change for community banks will have to be huge to justify such a change. Banks will be required to obtain, maintain and report new information about underwriting features and LTV ratios of credit exposures, and sufficient information to satisfy due diligence requirements. We do not have that capacity today. Additionally, in most cases, our existing loans are not grandfathered and therefore, the new information will need to be collected (in many cases obtained from the customer after the fact) on the bank's existing portfolio. While statisticians may need this information to determine whether a bank is serving its community, the reality is that community banks cannot exist without serving their communities. Raising the cost of doing business will only have the effect of raising costs to consumers in smaller markets where mega banks are unwilling to compete. If the consumers are unwilling or unable to pay the increased costs, there will be negative effects on the consumer, small business and job creation.

What does all this mean? Clearly, capital requirements will be higher. The problem for community banks is that capital seeks a return and capital will flow to where it can obtain a higher return. There does not appear to be anything contained in the proposals that would appear to provide any opportunity (or a desire to see) higher income, e.g., higher or same return. The only thing seen in the proposals are things that (1) increase, directly or indirectly, expenses associated with implementing the proposals, or (2) higher capital for the same activity. The proposals necessarily will require higher costs for consumers, or they will require community banks to cease to exist as they do today. Either income has to go up to support the higher capital ratios or capital will exit the banking industry, at least for community banks. None of this even deals with the consistency of earnings that investors want to see. Just as banks want to see consistent repayment sources for the loans they make, so to, do investors want reliable earnings, earnings that are not possible by marking-to-market an isolated part of the balance sheet. .

Our economy is feeling the effects of a significant deleveraging by banks over the past four years. The proposals represent a similar additional deleveraging by increasing capital to even higher levels. The intent of the proposals is primarily directed at the "too big to fail" institution. However, the fallout will tend to be in community banks and their communities where a disproportionate amount of the burden of compliance costs (and the ability to recoup those costs), and the lack of access to capital due to lower earnings will fall. As a bank that has had to deal with its share of loan problems, I can appreciate the desire to put a premium on risk-taking activities, but the focus of the proposals needs to be on managing risk, not discouraging it.

Thank you for your time and consideration.

Respectfully submitted,

Ellis Spencer
CCO
Citizens Bank, N.A.