CORNHUSKER
BANK

September 19, 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, D.C. 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 proposals recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I serve as the Financial Operations Officer for Cornhusker Bank in Lincoln, Nebraska. We are a family owned bank with approximately $400 million in assets, 120 employees, and have served the 260,000 residents of Lincoln and surrounding communities for 109 years. I would characterize our bank as a typical community business bank offering traditional banking services along with an insurance agency and consumer investment products. Our assets are comprised mainly of commercial and consumer real estate loans, including lines of credits, home equity loans, mortgages, and agricultural loans. We also have a portfolio of mortgage loans we have originated and retained the servicing rights.

While recognizing the need to evaluate capital requirements and structure, some regulatory reform, and consumer protections given the nature of the economy the past four years, I do find it extremely concerning for community banks, like ours, being painted with the same broad stroke of regulatory and capital reform while most will agree we did not contribute to the broad meltdown of the real estate market nor did we participate in highly risky and unfettered lending. The past four years our bank has grown assets, reduced credit risk, grown income, grown capital, and expanded services in our market. We find ourselves trying to digest the massive regulatory and compliance reforms and proposed capital changes while at the same time hearing how banks are neither lending nor serving their community's banking needs.

The proposed Basel III capital changes will affect us on several fronts and I would like to address some of the concerns I have with the proposed changes.

One of the proposed changes is the inclusion of a capital conservation buffer. This buffer along with the proposed increases in the minimum capital requirements now sets a new *de facto* capital minimum. As a single bank holding company formed as an S-Corp, we rely on the ability to dividend funds to the holding company for tax purposes. Given the new 2.5 percent buffer, we would be required to maintain these minimums in order to continue to dividend funds to our holding company without restrictions. This buffer would become our minimum capital ratio and we would have to maintain an additional buffer above this to ensure we don't fall below and face restrictions. This action immediately limits the amount of lending to serve our community and our ability to grow assets.

In the Basel III Notice of Proposed Rule the definition of Tier 2 capital includes the Allowance for Loan Loss but limits this to 1.25% of risk-weighted assets. While in the past this was typically a non-issue for us since we had less than 1.25% of our risk-weighted assets in our allowance due to small losses and a strong loan portfolio. As the economy weakened, we increased our allowance to allow for potential increased losses in our loan portfolio given the local economy. This is a fundamental logical practice any banker would perform during times of economic downturns. This allowance consists of "real funds" available to absorb losses, yet bankers are limited in the funds available for recognition in the calculation of several capital ratios. The decision for bank boards and management now consists of "do I put the funds into loan loss to absorb losses outside of our standard capital or do we keep the funds in capital and carry a lower allowance for loan loss so those dollars are not lost in the calculations?" This does not make any logical sense. This limitation should be removed with any proposed regulatory change.

The proposed Risk-Weighting Methodology revisions of our assets also greatly concern me. The proposed 1-4 Family Residential Mortgage Categories are too limited and would serve to penalize us for providing core banking service to our customers. As a community bank, we offer multiple products based on 3 and 5 year balloon payment loans in order to maintain and monitor our interest rate risk. I know many banks in even smaller communities don't have the option to offer 30 year fixed rate mortgages or sell those mortgages to mortgage packagers like Fannie or Freddie due to community size or appraisal requirements. Changing the risk weights on these loans from 50% up to even 200% is tremendously restrictive and serves no beneficial purpose to lenders or their customers.

In my research of the topic, I have not found any regulatory agency provided empirical support for these changes. Using our bank as an example, our annual five year loss average on 1-4 family non-revolving loans is .22% and our loss average on home equity loans is .27%. In comparison, our annual five year loss average on commercial and industrial loans is .83% and loans to individuals (such as unsecured loans or vehicle loans) is 1.45%, yet the proposed risk weight changes would require more capital to be held on home equity loans and 1-4 family mortgages than on unsecured or commercial and industrial loans. I can understand the need to evaluate risk weightings of certain assets given changes in types and quality of assets but I believe only looking at the recent loss history of mortgage real estate and justifying large changes is not sound. It makes little sense to be required to hold larger amounts of capital against consumer mortgages, which are our least risky assets, than car loans or unsecured loans. This applies to home equity loans as well. Prudently underwritten home equity loans with verifiable cash flow should not be unduly restricted and a longer time horizon should be analyzed for loss history not just a reaction to the market issues of the last four years.

The proposed Risk-Weighting changes also do not offer any type of grandfather provision. The rules are being changed in the "middle of the game" and we are being judged on decisions made years ago which might have been different given the same set of rules. Also, many of the proposed required information to be provided for calculations are not immediately available to us. We would be required to allocate dollars and significant manpower to go back and research all previously closed loans in order to obtain the information required. This is a large burden given the amount of time, energy, and resources we are already required to commit to compliance changes.

Also included in the proposed Risk-Weighting changes is the treatment of "High Volatility Commercial Real Estate." In the Lincoln, Nebraska market many commercial acquisition, development, and construction loans are done by community banks due to the size and nature of the projects. Many large national and international banks do not participate in this market due to the relatively small size of the loans and the required monitoring typically needed on construction projects. An example in our bank was a $7 million dollar hotel construction loan we put together with the help of two other community banks. This project was funded locally and would not have been done by a large national bank. Should the proposed limits be placed on these types of loans and/or the bank capital requirements be higher on these types of loans, projects such as these may be postponed or unfunded within the community because of the regulatory limits. This risk-weighting change also does not take into account any credit strength of the borrower, debt service ability, or of the underwriting process done to provide the loan.

Another of the proposed changes is related to the amount of any mortgage servicing asset included in common equity tier 1 (CET1). We began retaining mortgage servicing rights about 2 years ago after a significant "shake up" in our market concerning mortgage servicing. We have found customers truly appreciate having local servicing of their mortgages rather than being sold to companies outside the area. Customers gain the security in knowing they can talk to their local community bank about their mortgage and receive instance service. Limiting the amount of servicing rights that can be included in capital calculations is limiting local service and pushing smaller community banks to sell these assets to larger banks thus limiting customer service and the local impact of the community bank. Though our bank would not hit the threshold right now, we would have to make decisions on whether to continue to offer this service to customers in the future. This would impact our earnings, employment, and services we offer our customers. In effect, this is limiting the ability of community banks to service their customers and moving this service to large financial institutions which are not in the local market, sell the loan multiple times, and may not offer good customer services for a product extremely important to the consumer.

While I believe there are several other areas of concern with the Basel III NPR for community banks, I will limit my comments to the above. I believe it is imperative the regulatory agencies understand the impact and implications to the entire banking system, to include community banks, with these proposed changes. Banks of our size are overwhelmed with the regulatory burden forced upon us the past 4 years and these proposed changes only add to the commitment of resources in time, money, and employees now serving regulatory requirements instead of working with our local community and offering the customer service we have become known for. Community banks are an integral part of the fabric of communities the size of Lincoln, Nebraska and smaller. Our bank, along with thousands of others, serve our customers daily and the need to recognize these banks are not the same as "Wall Street" banks is as critical as ever. I continue to hear about the concern some banks are "too big to fail" and the need to break up the banking environment, yet on the other hand regulatory agency after agency and Congress pass laws and regulations making it harder and harder for the small community banks to remain.

Thank you for taking the time to read my concerns and if anyone wants to talk further about these or other concerns please don't hesitate to contact me.

Sincerely,

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Cc:
Senator Mike Johanns
Senator Ben Nelson
Congressman Jeff Fortenberry