October 3, 2012

Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
"Basel III OCC Docket ID OCC-2012-0008, 0009, 0010"

Federal Reserve Board
regs.comments@federalreserve.gov
"Basel III Docket No. 1442"

Federal Deposit Insurance Corporation
comments@fdic.gov
"Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-AD97"

Dear Ladies and Gentlemen:

I am the President and Chief Operating Officer of Horizon Bank, N.A., which is a $1.7 billion bank headquartered in Michigan City, Indiana. We have branch offices throughout northwest Indiana and southwest Michigan and in Johnson County, Indiana, which is just south of Indianapolis. My primary responsibilities are centered on commercial and consumer lending. Since the proposed Basel III rules directly affect the risk weighting of these loans, my comments will be limited to the lending area.

For home equity (HE) lending, the "taint" rule seems a bit much. By offering a customer a second mortgage on his/her home, the bank runs the risk of changing its first mortgage from a category 1 to a category 2, thus increasing the risk weighting of the first mortgage anywhere from 35% to 100%. This will certainly discourage HE lending, and it will also discourage a bank from owning the mortgages that it originates. There are many cases where consumers fall out of the government's underwriting standards for first mortgages, yet many times the reasons for the fall out are easily mitigated and do not create an undue credit risk to the bank. These mortgages may still be classified as category 1, and the bank would be willing to book these mortgages into its own portfolio. Down the road, the customer may desire a HE loan for home improvement or maintenance and repair, but the bank may be reluctant to do so because the combined exposure of the first and second mortgages will taint that customer's first mortgage. Or, because of the increased risk weighting on the first mortgage, the bank will have to price the second mortgage higher in order to attain its desired return on equity. In either case, the consumer loses. Since a competitor bank doesn't have to worry about the first mortgage, it would be able to offer the HE loan at a much lower price, thus driving the consumer to another bank, which seems unnecessary. The first mortgage should not be tainted just because the bank makes a HE loan to its customer. Classifying the junior lien HE loan as a category 2 seems reasonable to me, but the first mortgage should remain a category 1 for risk weighting purposes.

This rule will have the negative effects of higher interest rates being charged on HE loans, fewer first mortgage loans being kept in a bank's portfolio, which would translate

into tighter credit and fewer mortgages being originated, and fewer mortgage products offered.

I'm confused by the rules covering high volatility commercial real estate (HVCRE) loans. My reading of the rules leads me to conclude that all construction loans will carry a 150% risk weighting. This would include owner-occupied construction projects, such as a new manufacturing plant or an expansion to an existing plant. The exemptions appear to be quite narrow with the exception of exempting all HVCRE loans that have to do with 1-4 family residential projects. Since the residential acquisition, development, and construction projects were affected the worst by the recession, I don't understand why these projects would be exempt from the rules, and yet much less risky loans such as owner-occupied construction, would be subject to the rules. As with HE lending, the higher risk weightings for HVCRE loans will result in much higher credit costs for not only developers and contractors, but for small business owners as well. It will also result in a tightening of this type of credit, which could very well have an adverse impact on local economies and possibly to the national economy as well.

Basel III rules appear to be a micro-managed approach to regulatory oversight. It's attempting to place various types of loans into risk buckets in an effort to control the types of lending that banks and other financial institutions provide to their communities. Community banks will be required to collect so much more granular information on its loans that increased overhead expenses will most certainly result. In all likelihood, community banks my size and smaller will have to hire third party consulting firms to collect the required data on existing loan portfolios, and then hire additional people to monitor the data going forward. In all likelihood, new systems and software will need to be purchased just to ensure compliance to the rules.

All of these factors, as well as others not discussed in this letter, will have the undesirable effects of increasing the cost of credit to consumers and small businesses alike, and most assuredly decreasing the availability of credit. It will ultimately have negative consequences to local, regional and national economies.

I ask that you reconsider your approach to regulating capital adequacy for community banks. I like the minimum capital requirements that you are proposing. However, I feel strongly that the additional cushions you propose should be a regulatory tool to be used to more closely supervise banks that have risk profiles that are much higher than would be deemed acceptable by the respective regulatory agencies. The cushions should not be required of all banks. They are too punitive for well-run banks that have acceptable risk profiles. The proposed rules give no reward or provide no incentive to banks that maintain their risk profiles within a reasonable range.

Sadly, the ever increasing regulatory burden will drive many community banks to sell because of the cost to comply with the regulations and the heavy consequences for non-compliance. Community banks are essential for the growth and well-being of small businesses. As the number of community banks shrink so will the number of small

businesses. When local banks sell to regional and national banks, communities suffer because the level of charitable giving and volunteerism is drastically reduced.

Basel III can be implemented in a much more simplified manner for community banks by setting reasonable and prudent minimum capital ratios, concentration limits for certain types of lending (much like the OCC did three years ago by setting a CRE limit of 300% of capital), and giving the regulatory agencies better tools to enforce higher capital limits on banks that have high risk profiles. A "one size fits all" approach to capital adequacy will most certainly increase the cost of credit and limit credit availability, which will in turn, have negative economic consequences for our nation.

Lastly, will Credit Unions be subject to Basel III? Federal Credit Unions already enjoy a competitive advantage when pricing loans because they do not have to pay federal income taxes. Many Credit Unions were recently granted expanded powers for commercial lending. If these institutions are not subject to Basel III capital requirements, they will enjoy an even greater competitive advantage over banks and thrifts. These expanded powers go way beyond the original intent of the legislation that created Credit Unions.

Respectfully,

Thomas H. Edwards
President and Chief Operating Officer