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September 25, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Delivered via email: regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Delivered via email: comments@FDIC.gov

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Delivered via email: regs.comments@occ.treas.gov

Re: Basel III Capital Proposals

Thank you for the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

For background, our banking organization, Midwest Bank, N.A., traces its roots back three generations to 1952, when we purchased The Farmers National Bank of Pilger, in Pilger, NE. Pilger is a very small agricultural community located in Stanton County, Nebraska. Today, Midwest Bank has locations in eight separate Nebraska communities with total assets exceeding $540 million. Our financial position is sound with total equity capital of $54 million, resulting in a leverage ratio of 9.72%, a tier 1 capital ratio of 12.75%, and a total capital ratio of 14%. By every definition, Midwest Bank is a community bank, but from an even larger "macro" viewpoint Midwest Bank is a small business. In fact, and it is important to emphasize, Midwest Bank's success achieved over the past 6 decades is due in large part to the deep commitment we have in prudently serving the needs of the communities we are members of, financially and well beyond. The provisions contained within the Basel III Capital Proposal threaten our ability to continue to effectively serve our communities. Stated more bluntly by a Senior Official with the American Bankers Association "Basel III could destroy community banking as we know it".

Our organization supports the concept of increased capital requirements for financial institutions in our country. However, the Basel III "one size fits all" approach to capital adequacy overlooks the vast differences in operating models and risk profiles that exist between community banks and regional, super-regional or multi-national banks. Specifically, many of the provisions contained within Basel III will threaten the viability of many community banks that exist today. Following are comments on those specific provisions contained within the Basel III Capital Proposal for your consideration:

- **Regulatory Burden.**
  The scope and complexity of the proposed rules will require the collection, monitoring, and reporting of considerable new information to calculate the risk weights of assets for our institution. A considerable expansion to the Call Report also seems inevitable. The costs associated with new systems, software and technology, and human resources to meet these requirements appear to be significant;

- **Inclusion of Unrealized Gains and Losses on Available for Sale Securities in Accumulated Other Comprehensive Income.**
  This provision presents significant challenges and potential unintended consequences to community banks. In essence, this provision introduces "mark-to-market" accounting to capital adequacy measurement for only one segment, and on only one side, of the balance sheet. For example, we currently have $54 million in capital with the inclusion of $1.8 million in unrealized, after tax gains on available for sale securities. A 3% increase in interest rates would reverse that gain to a loss of $3.5 million, resulting in a $5.3 million total decline in capital as defined by the Basel III Proposal. This 10% impairment to capital is occurring on an investment portfolio with an average duration to first reset of 2.82 years. Meanwhile, there is no corresponding offset to this decline in capital that will result from the increase in economic value of equity occurring with our non-interest bearing DDA's and long-term, fixed-rate CD's. The volatility that this proposed measure will potentially have on capital will be both punitive and difficult to manage for community banks. Traditionally, community banks have maintained a very disciplined approach to the management of their investment securities portfolio, with priority placed on liquidity and asset quality. The consequences of this provision will impair a community bank's ability to prudently manage their investment portfolio, and appears completely unnecessary;

- **Increased Risk Weighting for Residential Real Estate Loans.**
  Residential real estate lending in rural communities, which are primarily served by community banks, has become an increasingly challenging need to meet given the secondary market underwriting requirements for comparable sales standards in appraisals, etc. Offering "in-house" residential real estate loans on a variable rate or balloon structure allows us to serve this financial need without assuming excessive credit or interest rate risk. The risk weight provisions on residential real estate loans will expose our bank to increased financial risk and administrative burden, and may potentially affect the delivery of this important product to rural communities and markets. Ultimately, the unintended consequences of this provision within Basel III may very well be the elimination of community bank home lending in small, rural

- **Increased Risk Weighting for Home Equity Lines of Credit (Jr. Liens on Residential Real Estate).** Home equity lending has proven to be a convenient, highly demanded, and fundamentally sound financing method for both our bank and our clients. Increasing the risk weight on these loan assets may also affect the delivery of this product as the return on risk adjusted assets will be insufficient given the additional administrative costs associated with this portfolio;

- **Increased Risk Weighting for High Volatility Commercial Real Estate Loans and Delinquent Loans.**
  Although conceptually sound, this is extremely burdensome to community banks, and theoretically redundant with satisfactory analysis of the adequacy of the allowance for loan and lease losses given the limitations placed on the allowance for loan and lease losses as Tier II Capital.

While we fully support enhanced capitalization in our country's banking system, the cumulative effect of the aforementioned issues of Basel III as a community bank capitalization standard will undoubtedly be severe and threaten the viability of many. We strongly urge you to consider this impact, and consider exempting community bank's from the Basel III Capital Proposal. Our nation's community banks, as well as the communities they serve, will be much better positioned with traditional capitalization standards and regulatory oversight appropriate for non-complex institutions containing no systemic risk exposure.

Thank you for your consideration,

Douglas G. Johnson
President & CEO of Midwest Bank