

October 4, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve  
System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corp.  
550 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

Office of the Comptroller of the Currency  
250 E Street, S.W.  
Mail Stop 2-3  
Washington, D.C. 20219

Re: Basel III Capital Proposals

Ladies and Gentlemen:

I am writing to request that you reconsider 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.

Horizon Bank N.A. (Horizon) is a \$1.8 billion community bank located in Michigan City, Indiana. We are about to celebrate our 140<sup>th</sup> year in service to our local communities and the Basel III proposals will have a significant impact on the financial services we offer, as well as other community banks throughout the United States.

I am the Chief Financial Officer for Horizon and our Company is concerned about the impact of utilizing other comprehensive income/loss in the calculation of regulatory capital. The main component in most community banks other comprehensive income/loss is the unrealized gain/loss on investment securities. Accounting guidance requires a company to carry investments as available for sale if that investment has the potential to be used for liquidity purposes, even if there is the intent and ability to hold it to maturity. As liquidity is extremely important to a community bank most carry the majority of their investment portfolios as available for sale.

The concern is that the market value of investments held in available for sale will fluctuate significantly as interest rates move. For our Company, it is estimated that a 300 basis point increase in interest rates will generate a \$24 million unrealized loss in other

comprehensive income/loss. Currently we have a \$12 million unrealized gain, this a \$36 million impact to our regulatory capital in the proposal. This is significant volatility only due to a change in interest rates and could potentially cause a need for additional capital to meet the capital requirements.

Companies can eliminate the risk to capital by moving investments to held to maturity. This movement would not change the actual impact to the market value of investments, but only the accounting. However, moving investments to held to maturity reduces a community banks available liquidity. If an argument is made that held to maturity securities can still be used for liquidity, then including the unrealized gain/loss in the capital calculation is semantics and games will just be played with these accounting classification.

What we believe is not being considered by singling out the unrealized gain/loss on investment securities is the total market value of a community banks balance sheet. Unlike companies that use International Accounting Standards, for community banks, only the market value of available for sale securities is being considered. For our Company, in the same scenario of an increase in interest rates of 300 basis points where a \$24 million unrealized loss would be recognized in the calculation of regulatory capital, the market value of our entire balance sheet when liabilities are valued is a \$31 million unrealized gain. This indicates the strength of managing an entire balance sheet and not just one specific asset type. There is a significant danger to community banks asset liability management and interest rate risk if they are forced, due to this guidance, to manage the balance sheet based on the impact of one asset type to this regulatory capital calculation.

Managing an investment portfolio to reduce market value risk would require reducing the average duration of the investments. Currently this strategy would reduce current earnings but would produce more return as rates increase and maturing short term investments are purchased in a higher rate environment. However, in future years keeping the investment portfolios duration short to manage the volatility in market value reduces interest income, reducing real equity, and in a down interest rate environment creates significant interest rate risk.

Another concern relates to the reduction in allowance for loan losses. Our Company's current allowance for loan loss methodology reserves for known losses on non-performing assets, both with specific reserves allocated to individual credits and to the pool of substandard credits based on historical performance. This is a significant portion of our allowance. The new proposal requiring higher risk weighting to non-performing and substandard assets therefore allocating additional capital for these credits would cause our Company to double count reserves. The result of requiring higher risk weighting on these types of assets will create the need to change the allowance for loan loss methodology to consider the capital being allocated and reducing the allowance required for these credits.

The goal for Company's would be to not allocate capital twice and to maintain an allowance under the current 1.25% of risk weighted assets so that all the allowance can be utilized in the regulatory capital calculation. This goal potentially reduces the overall allowance and capital allocated to non-performing and substandard credits since most companies currently are limited by the 1.25% of their allowance to risk weighted assets putting a company in a lower overall capital and loan loss reserve for problem credits.

I respectfully request that you reconsider the proposed rules and modify them to allow community banks, like Horizon, to continue to serve local customers and keep the economy and local housing markets moving forward.

Yours truly,

Mark E. Secor  
Chief Financial Officer