Pinnacle Bancorp, Inc

October 5, 2012

Robert E. Feldman, Executive Secretary
Attention: comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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

RE: FDIC RIN 3064-AD95 (Basel III NPR)
FDIC RIN 3064-AD96 (Standardized Approach NPR)

Dear Mr. Feldman:

I have the following major concerns with the subject NPR.

My first major concern is the inclusion of financial institutions (FI's) regardless of their size. I believe FI's under $50 billion in assets should be exempt from the new calculations. The regulations will require burdensome new recordkeeping requirements and subject the FI's to rapid fluctuations in their capital ratios. This rule will also subject FI's to additional competitive pressures from credit unions and non-bank banks.

I have been told that the FDIC projects that only 3 to 4% of community banks in Nebraska would not be well capitalized under these rules. If that is the case, then this shows that the new rules would not require a greater level of capital in community banks and thus, why make the banks subject to a burdensome new rule.

If FI's of all sizes are going to be subject to the rule I would recommend the following adjustments.

Exclude net unrealized gains/losses on available for sale debt securities from Tier 1

I believe the inclusion of net unrealized gains/losses on available for sale (AFS) debt securities potentially subjects FI's too extreme adjustments in their capital levels from one quarter to the next and makes capital planning extremely difficult. Our institution currently has and AFS gain of about $25 million and total risk based capital of $322 million (not including the gain). Our shock test shows that our gain of $25 million would change to a loss of $60 million if the yield curve suddenly shifted upwards by 300 basis points. That would represent a 20% drop in Tier 1 capital under the proposed rules.

The change in our market value would not be indicative of a capital problem but an indicator of a potential impact to future earnings, if rates do not decline during the life of the portfolio. The earnings impact should be analyzed as part of an examiners on-going risk analysis, not through an immediate capital ratio adjustment.

This proposal could lead banks to categorize more securities as Held to Maturity, weakening the liquidity position of many banks and making asset/liability management more difficult. Banks may also consider shortening the duration of their AFS portfolio's which, in a normal yield curve environment, would lower yields and accordingly, earnings, causing a negative impact on capital.

The only reasoning I can see for including the net unrealized gains/losses on available for sale debt securities in the calculation is to calculate a liquidation value for capital. However, since you are not adjusting the remainder of the balance sheet to market value, I don't know what you accomplish. I am not advocating marking the remainder of the balance sheet to market, however.

If the net loss is included, excluding U.S. Government and Agency securities from the calculation would lessen the potential negative impact of the rule.

Restricted Payments und the Capital Conservation Buffer

The restriction of the payment of dividends under the proposed rule unfairly penalizes S-Corp banks. While a C-Corp bank would be able to make payment for its income tax liabilities, and S-Corp would not be able to distribute a payment to shareholders to pay their tax liability related to bank earnings. At a minimum, S-Corp's should be able to pay a dividend representing the amount tax liability that would have been paid for tax liability if the bank were a C-Corp.

Restriction on Discretionary Bonus Payments

The definition of Executive Officer should not be any broader than the definition used pursuant to Regulation O. Including discretionary bonus payments among the restricted payments under this rule could subject community banks to extreme competitive issues in attracting and retaining quality management. It could also prevent incenting management to develop and implement a plan to restore the banks' capital position.

It seems like this provision was included to prevent the too-big-to-fail FI's from paying their historical bonuses that can represent 10 to 20 times their base salary. Remember that is not normal activity for community banks. If a restriction on discretionary bonus payments is maintained, consideration should be given to an exclusion of bonuses that represent less than 15% of the base salary. This would allow institutions to avoid raising executive officer's salaries to cover the normal level of bonus paid in order to remain competitive. It would also allow the institution to provide reasonable management incentives for above average performance.

FDIC RIN 3064-AD96 (Standardized Approach NPR)

1-4 Family Residential Mortgages

The first problem created by this new rule is the variability of the risk rating based on the loan to value. Most banks do not have this information in their database today. We process with Fiserv, like almost one-third of all commercial banks, and these are not fields in their software today.

Second, the exclusion from Category 1 of loans with balloon payments makes no sense to me. Community banks typically use balloon payments to limit interest rate risk exposure. As bankers, we are already borrowing short and lending long. Increasing the risk is not a good option. Neither, in my opinion, is picking an index so loans can be repriced every five years or annually. A community bank's cost of funds tends to vary in comparison to traditional index sources such as U.S. Treasury securities so there is risk in trying to pick an index that will be valid for 30 years. What if community banks had been repricing all loans to LIBOR when the rate was being artificially manipulated? Would that have been beneficial?

The higher risk rating associated with 1-4 family mortgages will be one more incentive to stop offering this type of credit. These rules combined with already over burdensome compliance regulations may well be the final straw that causes banks to stop offering real estate loans.

It will also be an incentive to make junior lien loans on an unsecured basis. You may not be aware but community banks, in most instances, underwrite these types of loans on the repayment basis of our borrower, not based on the collateral value of a junior lien. At Pinnacle, we generally consider a junior lien with an LTV greater than 80% as unsecured credit. With the proposed new rules, we might just as well make the loan on an unsecured basis and have less capital required. Even today, there are many times that the lien is only taken at the request of the borrower so they can deduct the interest for taxes.

Past Due Assets Risk Weights

While our bank has a limited amount of assets over 90 days past due or on nonaccrual, this rule is a disincentive to the conservative approach of putting a loan on nonaccrual if there is a slight change of loss. We believe that being aggressive in putting loans on nonaccrual is a good practice but the writers of these rules must not.

As a former bank examiner, I believe this rule will cause banks to extend loans and avoid placing loans on nonaccrual for the wrong reasons.

Off –Balance Sheet: Mortgage Banking

I do not see the reasoning behind eliminating the 120-day exclusion for loans sold in the secondary market. An early payment default on a prime residential mortgage underwritten according to very stringent criteria poses infinitesimal risk to our bank. We have originated and sold tens of thousands of single family loans and I am only aware of a handful of instances where we had to repurchase the loan, none of which were for payment default. An area where I see very limited risk for our institution, would require an underlying $15 million dollars of capital to support the service at current lending volumes. Why?

In summary, I recommend you exempt banks with assets under $50 billion from the rule. If it is implemented, retain the current treatment for unrealized gains and losses on available for sale debt and equity securities, adjust the rules on restricted payments to level the playing field for Sub-S banks related to tax liabilities and provide a threshold for discretionary bonus payments.

Additionally, changes to the 1-4 family residential mortgage rules, Past due asset risk weights rules should be considered and the 120-day exclusion for loans sold in the secondary market should remain in place.

Thank you for consideration of these comments and I would be happy to provide to any questions you may have.

Sincerely,

Mark A. Hesser

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