Sb Settlers bank

August 31, 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, DC 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 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").

As a small community bank, we are deeply concerned about the affects that Basel III as proposed will have on our community. Our bank started five years ago with a business plan to provide small business lending in the Dane County area. We have been fortunate to not have experienced the past due loans and charge offs that many of our counterparts have experienced. We have been an active lender in small businesses while others have had to scale back and are proud of this ability.

When we look at the affects that Basel III will have on our bank, we are fortunate that because of our relative newness in banking, many of the factors will not apply to us currently. However, as we continue to grow we know that they will. These changes to capital requirements will put restrictions on our bank that will force us to make business decisions not because they make good economic sense, but because it keeps our capital levels higher. This quite frankly is bad business.

We understand the need for strengthening capital in institutions with greater risk in their portfolio. However, most small community banks do not carry these types of risk. And yet, stronger capital requirements and heavier risk weighting is going to make it more difficult and more costly for community banks to continue to lend.

Specific issues that I am concerned with are:

- Including unrealized gains and losses in tier one capital. Banks have investment portfolios in order to provide liquidity when needed. It also provides an alternative to lending when loan demand is sluggish and deposit demand is strong. Holding investments in available for sale accounts allows for the sale of a bond when needed although most banks rarely sell prior to maturity. Therefore, the unrealized gain or loss generally does not have a net effect on our capital (currently). When a bank holds these bonds and rates change, the unrealized gain or loss can fluctuate greatly. By requiring us to now adjust our capital by this could cause huge swings in our capital levels. This could force banks to shorten up portfolios or try to time the market, both of which are poor business decisions. The net effect of this requirement may also prevent banks from investing in bonds that are more susceptible to rate fluctuations such as 30 year fixed rate mortgage pools. As fewer banks purchase these bonds the market for this product will weaken causing negative impacts on a consumer's ability to borrow long term fixed rate mortgages.
- 1-4 family residential mortgage exposure. Most community banks do not carry long term mortgages on their books, they sell them off or they do in-house balloon notes. In my experience, in-house balloon notes were done when it was difficult qualifying the applicant for the secondary market but the applicant was a solid borrower and the bank was not concerned with the risk. Requiring higher capital levels for balloon notes could force banks to either not do the loan or book it as a 30 year mortgage which adds interest rate risk to the bank's portfolio. Again, higher capital levels are going to have a negative impact on a consumer's ability to borrow.
- Past due loans. Under existing rules, the risk-weight of a loan does not change when the loan becomes delinquent. Instead, banks adjust the grade of the loan and account for it through the allowance for loan losses. The proposal would change this approach significantly assigning loans over 90 days past due a risk-weight of 150% or more. This is forcing us to double count for capital purposes. Currently, we have the ability to work with customers through loan work out programs. This requirement, could force banks to proceed directly to foreclosure or loan sale.
- High volatility commercial real estate. This could have a huge impact on an already struggling business lending environment. And like the past due loans, banks already allocate for business risk by allocating more loan loss reserves on riskier ventures or riskier lines of business. The strict components for qualifying as a non-HVCRE loan will be burdensome and costly and will force many community banks to exit the CRE market. Those who remain in the market will find it difficult to track the components needed to qualify as a non-HVCRE thus forcing some of them to account at the higher capital levels and charging more for these loans.
- Home equity lending (HELOC). Historically, banks felt in a safer position doing a HELOC if they also had the primary position. Under the new risk-weighting, banks will likely exit the HELOC market or be required to charge more to account for the higher capital requirements. In our bank, we occasionally do HELOCs for our small business customers. Due to the increasing regulatory burden under Dodd-Frank along with these new proposed capital components, we will likely stop offering HELOC

The overall impact of the proposed Basel III capital and risk-weighting components will have a negative impact on our bank. The burden required to collect and report detailed loan data to qualify loans by category will be costly and time consuming. We will be required to obtain, maintain and report new information about underwriting features and LTV ratios of credit exposures, and sufficient information to satisfy due diligence requirements. In addition, we will be required to go back and gather this information and track it on all existing loans. With a large portfolio of Commercial Real Estate this will be very time consuming and costly for my bank as we try to qualify as many of these loans as we can for the non-HVCRE category. We will need to modify system specifications to be able to track this information. And the ongoing burden of gathering and maintaining this information will cause increased demand on staffing. An alternative to this proposal would be to strengthen the requirements for the allowance for loan loss reserves. This method not only looks at asset quality but also takes into effect economic factors that can cause additional risk to portfolios and would reduce the double counting of risk for capital purposes.

We ask that you strongly reconsider the depth of this proposal. Small community banks should be granted an exemption from this requirement. The cost and the burden of Basel III will have a negative impact on the small business and mortgage lending markets. It will continue to reduce the number of community banks that are capable of surviving in the market and ultimately will hurt the consumer.

While we understand the strategy that the regulators are taking to the past banking environment, the brute force of this requirement will cause harm to the banking industry as we strive to comply with this burden.

We thank you for your consideration in this manner.

Sincerely,

Heather L Longhenry
Chief Financial Officer