MNB
Moody National Bank
MEMBER F.D.I.C

09/11/12

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, D.C 20219

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

Via email

Re: Basel III Capital Proposals

Ladies and Gentleman:

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").

Moody National Bank was established in 1907 by the Moody family in Galveston, Texas. This year we will celebrate 105 years in existence. Our bank has been through many challenges like hurricanes, depressions, world wars and other obstacles that have defeated lesser institutions. The bank continues to reside in and support our local community and surrounding areas as a community bank. The people of Galveston have come to depend on and respect both the bank and the founding family as an important part of the local community. Moody National Bank has $890 million in assets and calls many of our local small businesses customers.

I am writing about the requirement of including unrealized gains and losses in capital calculations. The Basel III NPR proposes that unrealized gains and losses on the banking organization's Available-For-Sale (AFS) securities to "flow through" to common equity Tier I. Under current risk-based capital rules, unrealized gains and losses that exist in accumulated other comprehensive income on AFS debt securities are not included in regulatory capital.

Our bank's investment portfolio has approximately $316 million in AFS securities. This is approximately 95% of our total portfolio. The AFS designation allows the bank to maintain appropriate liquidity in the AFS designation while still earning an investment yield. How should our bank deal with this proposal, especially when interest rates rise again? Allowing unrealized gains and losses to flow through capital would negatively impact the ability of our bank to contribute to the economic recovery in the eventual rising rate environment. Rising interest rates would put downward pressure on bank's capital levels. This could reduce our growth of or decrease of our securities portfolio in order to maintain capital. Our investment portfolio is a part of our revenue income and allows us to continue to offer reasonable interest rates to our customers. With a reduced portfolio, we would have excess liquidity and be unable to serve the needs of our deposit customers. This would include large public fund customers like independent school districts, cities and counties. As a community bank this would be detrimental to our goal, which is to serve our community. Will we have to create an additional capital buffer as a cushion during value fluctuations? Is so, we are taking resources from customer needs and bank growth.

Gains and losses in the AFS portfolios happen primarily as a result of interest rate movements as opposed to changes in credit risk. Interest rates in debt securities can fluctuate (often daily), and the proposed rules will cause significant volatility in capital calculations. In generally accepted accounting principles, the gains and losses on securities are included in other comprehensive income. They are reported separately from owner's equity. They are not included in determining net income and do not enter into retained earnings. They are recognized in the period in which they occur and are combined with net income to determine comprehensive income. We are a community bank and, as such, should not be thrown into the "market-to-market" frenzy that has consumed other segments of the financial industry. I find it hard to see the logic behind this new proposal that departs so far from the accounting principles that allow us to have accurate and reliable financial statements.

The most likely result of this proposal will be an increase in employee time to monitor our AFS portfolio. This may also require us to purchase software to stay in compliance. Both would lead to less time and service to our customers to offer available credit.

The proposed rule should be revised so that unrealized gains and losses on AFS securities that reside in accumulated other comprehensive income do not flow through capital. This would allow unrealized losses due to credit impairment to be reflected in capital, but would exclude the interest rate impact. If the banking agencies are determined to require all unrealized gains and losses to flow through capital, our bank suggests that unrealized gains and losses that predominantly result from changes in interest rate risk should be carved out.

We appreciate your collective continued effort to maintain a safe and sound banking environment. As a long standing financial institution, we appreciate your consideration of our and many other community bank's views.

Sincerely,

Katherine Rodriguez, CPA
Chief Financial Officer
Moody National Bank