PIONEER BANK

of Wisconsin

September 18, 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:

This letter is provided in response to the request for comments on the proposed implementation of the Basel III regulations. I am the President of the Pioneer Bank of Wisconsin, Ladysmith and want to offer my comment from the perspective of an institution of less than $ 100,000,000.00 in assets. Our bank has a large investment portfolio and my comment will focus on the proposal to change the definition of regulatory capital by the introduction of Common Equity Tier 1 (CET1). The Basel III regulations as presently proposed will introduce volatility to the calculation of regulatory capital of our bank and that effect has a real potential to significantly dampen economic vitality in the communities we serve. It is my belief that the Basel III proposals are not necessary to aid in the recovery of our banking industry, and instead pose a threat to the community bank model.

One of the stated purposes of the Basel III proposal is to "enhance the resiliency of banking organizations, particularly during periods of financial distress." NPR, page 15. As an industry we are now completing the 4th year of recovery from the devastating events of the fall of 2008. From a statistical standpoint, we are doing well. The quarterly statistics from FDIC indicate that collectively banks under $100 million in assets have a leverage ratio of 11.24 % as of 3-31-2012. We are more profitable with our collective ROA at .76% up from -.50% in the fourth quarter of 2008. It is significant from my perspective that the community banking industry is demonstrating enhanced resiliency now before the regulations of Dodd Frank or Basel III have been fully implemented. The regulatory process in place over the last four year time period was adequate to effect the improvement to this point. The improvements came about due to the diligent efforts of community bankers and were monitored and in many cases demanded by the regulators from the Fed, FDIC, OCC, OTS and respective state counterparts. The efforts paid off and we as an industry are now on a path of improved performance.

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We are performing better in this time of financial distress even against the headwinds of the unprecedented low interest rate environment and sluggish loan demand.

I mention the interest rate environment for a reason. For the past four years our bank has worked hard to control those things that we can control and try to manage for the best result in those areas that cannot be controlled. That has worked. At our bank we have focused and improved our loan underwriting, closely managed operating costs and increased our analysis and understanding of interest rate risk. While we cannot control interest rate risk, we can understand and manage the risk to best position our portfolio to maintain profitability in various interest rate environments. We understand and develop strategies to maximize our shareholder value in various possible interest rate environments. We currently have tools to work out of an unrealized loss position over time. This is a disciplined approach and can be sustained under the current regulations.

The Basel III proposal will not increase strength and stability at our bank. Under the proposal, as it reads in its present form, all banks will face the new regulatory capital definition. The proposal specifically requires that unrealized gains and losses in available for sale securities held in the investment portfolio be included in the calculation of CET1. At our bank we hold all of our investments as available for sale. Based on the FDIC Statistics on Depository Institutions on an inquiry based on 6-30-2012 figures for all FDIC insured institutions, 91.92 % of all bank owned debt securities are held as available for sale. While our bank chooses to designate our securities as available for sale, our bank purchases investments with the intent to hold them to maturity. We choose to designate the securities as available for sale to allow flexibility and improve liquidity. I believe the proposal to include the unrealized gains and losses of available for sale securities is a game changing rule that introduces volatility and risk into the calculation of regulatory capital. It does not make banks more resilient. Banks will be forced to recognize loss based on a snapshot valuation of an investment security in that specific moment in time. That flies in the face of careful management practices where bankers can control the impact of fluid market valuation by exercising our ability and expectation to hold the investment to maturity when interest rate based market conditions produce a loss position. Unrealized gains and losses due to interest rate factors are different than unrealized gains and losses due to credit issues of the security. If a security faces a decline in value due to credit related issues that is other than temporary, that scenario is addressed under the existing regulations for Other Than Temporary Impairment analysis.

As I look ahead to the impact of that proposed change in regulatory capital on our bank, I see the proposal to be critically connected to the ability of banks to change the security designation from available for sale to held to maturity. So long as held to maturity is an option, banks can seemingly avoid the most severe impact to regulatory capital, volatile capital swings. The cost to designate investments as held to maturity is that banks lose critical balance sheet liquidity. The risk is that the accounting standards boards will not maintain the held to maturity designation. There is no certainty that the held to maturity designation will be available in the near future and beyond. It is my belief that the best way to eliminate the adverse and damaging impact of Basel III is to exempt community banks from the Basel III proposal. This one size fits all regulation really does not fit with the community banking model. An alternative option to consider is to exempt investments that have unrealized gains and losses solely due to interest rate changes from Available Other Comprehensive Income.

If Basel III is implemented as proposed and banks are forced to recognize unrealized gains and losses in the investment portfolio, for our bank the consequences are significant. After this unprecedented period of low interest rates a quick increase in interest rates will immediately impact the value of our investment portfolio. We have performed analysis of the immediate impact a 300 basis point increase in interest rates would have on the value of our bank. In that model we face a potential for paper loss in value of our debt securities of 48% under the proposed rules. That amounts to a drop in Tier 1 capital from 9.67% to 5.31%. Under the current rules, we can work out of the potential loss position over time. Not only does the impact of Basel III erode our capital cushion, it severely limits our ability to restructure our balance sheet. Our legal lending limit would be severely reduced by a 48% drop in regulatory capital. An unintended consequence of this regulation appears to me to be the reduction of legal lending capacity in community banks in certain interest rate cycles.

If the proposal moves forward and the safe harbor of held to maturity is removed, banks like ours would then need to manage their balance sheets to eliminate investments with market value volatility due to interest rate sensitivity. Please consider one possible unintended consequences of that scenario. Municipal bond market values have interest rate sensitivity. Our bank primarily holds general obligation municipal securities issued by municipalities located in Wisconsin, with some in Iowa and Minnesota. We also purchase United States Agencies and United States Agency mortgage backed securities. If banks like ours stop purchasing municipal securities, there will be an impact on the communities we serve. Local units of government depend on community banks to purchase their bonds. While we are not the only purchaser, we help provide a market that in turn keeps interest rates competitive. In some cases local communities depend on the local community banks to purchase the bonds that are used for utility and other infrastructure improvement when no one else will step forward. Further, in many rural areas, municipal districts are simply too small to attract the interest of larger banks. It is important to the small communities across the country that community banks continue to purchase municipal securities.

The Basel III proposed regulations were apparently designed for international financial institutions but applied to all banks of all sizes. The impact of the regulation disparately and unfairly impacts the smallest banks in our country. Instead of small banks focusing energy and resources in productive economic developing efforts for our communities in the midst of economic struggles, banks like ours are fighting the headwinds of an ill-fitting regulation. Unlike the large international banks, small community banks have only so many resources to devote. The community bank system in the United States is unique among the other countries in the world. It is not likely that the impact of Basel III to the United States community bank system was fully considered or even understood by the members of the Basel committee when these capital rules were proposed. Now is the time for our Federal regulators, who understand our community bank system, to take a close look at the likely consequences of this regulation to the thousands of community banks across our country. I urge you to reconsider the proposal. I urge you to exempt community banks from this proposed regulation.

Sincerely,

James E. Loe

James E. Loe
President/CEO