Hawthorn
BANK™
MEMBER FDIC

October 18, 2012

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

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

Office of the Comptroller of the Currency
230 E Street, SW
Mail Stop 203
Washington D.C. 20219

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comments on the Basel III proposals that were recently approved by your agencies.

Hawthorn Bancshares, Inc. is a financial bank holding company headquartered in Lee's Summit, Missouri and is the parent of Hawthorn Bank of Jefferson City with 24 Missouri locations. We are a $1.2 billion community bank providing non-complex financial products typical of community banks.

We are a well-capitalized bank with a total risked based capital ratio of 16.90%, a tier 1 capital to risk weighted assets of 13.63% and a leverage ratio of 10.17%.

I am concerned, along with many of my fellow community bankers, that our ability to provide credit and services to our customers will be hampered by Basel III proposals that seem to have been fashioned in a one size fits all manner. We are proponents of strongly capitalized institutions, but the Basel III proposals make radical changes that I feel will tighten credit availability and threaten the weak economic recovery taking place in our region.

Let me point out just three things in Basel III that I feel will have an adverse effect on our bank. The first is the elimination of Trust Preferred as capital. When we issued our Trust Preferred Securities in 2004 and 2005, all of the regulators agreed that it would be treated as capital. Now with the 10 year phase out, we are changing the rules. If you want to phase out our Trust Preferred, then do it over the remaining life or over the final ten years to maturity. Some of our Trust Preferred have over 23 years to maturity. I don't understand the logic in phasing it out over the next ten years.

The second item is the proposed rules regarding changes in the risk rating of our loan portfolios. In particular, the ratings change in non-conforming mortgages may force us to stop making loans that historically have been good for our bank and our customers. In some instances, an unsecured loan is risk rated less than a secured second mortgage. From a safety and soundness standpoint, this makes no logical sense.

Finally, the requirement of recognizing unrealized security gains and losses for available-for-sale securities in Tier 1 Common Equity has the potential to cause unnecessary volatility in our bank's capital account. The proposed change encourages held-for-sale accounting and investment in very short duration assets. Both of these encouraged practices limit our ability to manage the investment portfolio in a manner appropriate for earnings, liquidity and the management of interest rate risk. How can we engage in meaningful strategic planning when we don't know what our capital account is going to be? We won't know if we have capital for growth or if we should shrink the bank to increase capital because interest rates have increased and reduced the market value of our securities' portfolio.

In conclusion, the proposal as currently written will negatively impact our company by complicating our business, lowering our earnings through increased unproductive compliance costs, lowering our Tier 1 capital and restricting our ability to provide credit to the communities we serve. The proposal is ill-timed at this point in the economic recovery as it retards business activity and threatens to prolong the housing slump. I much prefer current FDIC Board member Thomas Hoenig's recommendation to replace the Basel III rules with a simplified tangible equity to tangible assets leverage ratio as a method to reduce the risk present in the financial system. In the absence of this, we request that TRUPS be grandfathered, OCI be excluded from regulatory capital and all other proposals allow for grandfathering existing loans by applying the new capital requirements prospectively.

Thank you for your consideration.

Sincerely,

David T. Turner
Chairman, CEO, and President