STAR
Financial Bank

October 16, 2012

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

Robert E. Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corp.
550 17th Street, NW
Washington, DC 20219

John G. Walsh
Officer of the Comptroller of the Currency
250 E Street, SW
Mail Stop 203
Washington, DC 20219

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").

STAR Financial Group ("STAR") is a $1.6 billion financial holding company operating in Northeast Indiana. We have been operating for seventy years in a safe and sound manner. STAR is a family-owned, privately held bank with 48 branches. Our capital ratios are: 9.84% Tier 1 Leverage, 12.11% Tier 1 RBC, and 13.36% Total Risk-Based Capital. We did not participate in the real estate lending practices that contributed to the real estate downturn beginning in 2008. We did not participate in TARP or SBLF. We are and have been profitable each of the past five years. We did not cause the crisis or contribute to it, but we are paying for it in terms of higher capital requirements, increased regulatory scrutiny, additional compliance costs and higher FDIC premiums.

In general, STAR is supportive of raising capital levels, particularly for systemically important banks in order to ensure that our industry can survive turbulent times. However, I do have concerns that the proposals as written create excess volatility in capital ratios that do not reflect the soundness of the institution, are contrary to the Collins Amendment of the Dodd-Frank Act and are exceedingly complex for community banks to implement.

STAR Financial Bank Building
Corporate Offices
127 West Berry Street, 2nd Floor
PO Box 10600
Fort Wayne, IN 46853-0600
Tel: (260) 428-7000
Fax: (260) 428-7050

Our greatest concern lies in the treatment of unrealized gains (losses) in the investment securities portfolio. As 80% of the bank's investment portfolio is U.S. government and GSE securities the majority of the unrealized gain (loss) is largely attributable to temporary impairments caused by the fluctuation of market interest rates rather than credit impairments. If it is the intent of the banking agencies to include a measure of interest rate risk in the capital, then this methodology is flawed. Like most institutions, STAR manages its interest rate risk through its entire balance sheet, not just its investment portfolio, with represents only 20% of its balance sheet.

The inclusion of unrealized gains (losses) in Common Equity Tier 1 comes at the worst possible time. The U.S. has had unprecedentedly low rates for an extended period of time. Most banks have investment portfolio durations of 3.5 – 4 years. Accordingly, an increase in market interest rates is likely to create a greater unrealized loss in the investment portfolio than historically. The impact of a 300 basis point rate change on STAR's investment portfolio and ultimately CET1 is illustrated in the following chart:

	Current Capital Guidelines	**Basel III NPR**
Total CET1	$159,258,000	$144,873,600
CET1 Ratio	9.84%	8.95%

While STAR still would still have strong capital, a $14 million reduction in capital is significant. If implemented as proposed, STAR would need to hold capital against potential securities price volatility, leaving less capital to support lending. In addition, we likely would change our investment strategies, pulling back from investing in longer duration MBS, agency debt, and municipals. The lack of demand for these financial products could result in higher interest rates on municipal debt and could cripple already weak GSEs.

The second concern that I have is the phasing out of Trust Preferred Securities in Tier 1 Capital. Despite the clear exemption within the Collins amendment for institutions under $15 billion in total assets, the proposal requires all institutions under $15 billion (not exempt by the Small Bank Holding Company Policy Statement) to deduct trust preferred instruments from Tier 1 capital based on the phase out schedule provided.

For STAR's parent company trust preferreds have served as an important source of capital. This capital has served as a source of strength to our institution. Given the strict definitions of qualifying capital imposed by Basel III proposals, there are limited opportunities to raise capital. Access to capital markets is severely constrained for a closely-held, financial institution such as STAR. Consequently, I encourage the banking agencies to remain consistent with the intent of the Collins amendment and allow for grandfathering of existing trust preferred instruments for institutions under $15 billion in total assets.

One of the most burdensome provisions in the proposal is the one related to the risk weighting of mortgages. The risk weighting is reliant upon data that does not currently exist in our systems. The new methodology is applied not only to new mortgages, but existing mortgages currently on our balance sheet which were underwritten, and priced, with existing capital standards in mind. STAR has approximately two thousand 1-4 family mortgages and Bank staff would be required to go through decades-old loan files to determine appraisal values and borrower characteristics to determine the appropriate risk weight. Our systems do not currently have the necessary fields to retain the required information. Our vendor would need time to modify its system. Our staff estimates the time required to review every file to take sixteen weeks at a minimum.

We can adjust our lending practices on a go forward basis but the administrative burden of the retroactive application of the rule is too onerous. Any final rule should grandfather all existing mortgage exposures by assigning them risk weights as required under the current general risk-based capital requirements (i.e. 50% risk weight). Given that the Basel III NPR is already substantially increasing required minimum capital, the need for retroactive application of the new standards is significantly narrowed.

I appreciate the opportunity to provide these comments on behalf of STAR and be part of a productive discourse on the implementation of Basel III. I acknowledge the challenges of conforming the Basel III rules developed among the G-20 countries to the U.S. banking market, where there is substantially more banking institutions with more diverse business strategies. At the root of my concern is the "one size fits all" approach of Basel III that has a negative impact on profitability and operating efficiency. In light of the negative outcomes that Basel III would have on the community banking industry, I respectfully request that you not implement this flawed regulation in its current form. I welcome the opportunity to discuss my comments or respond to the Banking Agencies questions as you finalize the rules.

Sincerely,

James C. Marcuccilli
President & CEO