Jennifer J. Johnson
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D. C. 20551

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 Comment

Ms Johnson and Mr. Feldman:

I am the Chief Financial Officer for Country Club Bank, a $1.1 billion community bank, headquartered in Kansas City, Missouri. Our bank offers loan, deposit, mortgage, wealth management and trust products and services to our commercial and retail customers. In addition, we have a capital markets division that sells fixed income securities to downstream community correspondent banks throughout the Midwest and across the country.

In reviewing the components of the Basel III proposal, it became apparent very quickly that the new capital requirements and the changes in risk weightings of various asset classes was a reaction to the most recent economic crisis and a broad brush attempt to create a one-size-fits-all solution to prevent another crisis.

Before I discuss a few of the issues and the related unintended consequences of implementing Basel III, especially at the community banking level, I want to discuss the basic differences between the Wall Street world of finance and community banks in general. The basic premise of community banking is rooted in our ability to offer something our Wall Street competitors cannot; a lifetime relationship. Our commitment is to work with each customer and help them to successfully manage the financial aspects of their lives and the life cycle of their businesses. We normally don't have the lowest loan rates, or the highest deposit rates and our service charges may be a bit higher than our national competitors, but because we offer something the Wall Street banks cannot we have a successful business model. And like us, there are thousands of successful community banks across the nation and they work every day with their clients to strengthen the backbone of main street America. Because we do not use formulas and templates to make our business decisions like the large national banks, we as a group faired much better than the Wall Street banks through the most recent economic downturn. Wall Street banks make decisions based upon their analysts' expectations for the upcoming quarter's earnings announcements. Community banks make their business decisions on what is best for the long-term viability of the bank and their customer base. Most community banks are privately owned, not publicly traded, and as such they only have to make sure that business decisions are in the best interest of shareholders over the long term, not the short run, so as a group, community banks are more conservative in their decision making and therefore, take fewer risks for immediate returns.

INCORPORATION OF AOCI AS PART OF REGULATORY CAPITAL

Inclusion of accumulated other comprehensive income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for most banks is represented by the unrealized gains and losses on investment securities held available-for-sale. If adopted as proposed, because these securities are held at fair value, any significant changes in interest rates will result in a change to regulatory capital.

Recent interest rates have fallen to levels that are not sustainable long-term and once an economic recovery occurs, most likely interest rates will rise and fair values of investment securities will fall causing the balance of AOCI to decline significantly. As proposed, this decline will have an immediate impact on common equity, tier I, and total capital, as the unrealized losses will reduce the capital balances. If you interest rate shock my bank, which has a current loan/deposit ratio just under 60%, to reflect an increase of 300 basis points, our bond portfolio would show a paper loss of approximately $17 million resulting in a 19% decrease of my bank's tier I capital ratio.

NEW RISK WEIGHTS

The proposed risk weight framework under Basel III is very complicated and community banks, in general, will find it to be an onerous regulatory burden. Increase risk weightings for residential balloon loans, interest only loans and second liens will penalize community banks who offer these products their customers. Many community banks that service agricultural areas will probably get out of the residential mortgage business, as balloon loans allow them to effectively manage their interest rate risk for their residential loan portfolios. Community banks cannot offer customers who have homes on acreages a traditional fixed rate 15 – 30 year home mortgage as they do not qualify to be sold to a GSE in the secondary market. A significant investment in system/software upgrades will be necessary to track loan-to-value ratios for residential first mortgage, second mortgage and HELOC loans and therefore, most community banks will probably just drop offering these products to the markets they serve.

DIVIDEND RESTRICTIONS ON SUB-S BANKS

The proposal does not distinguish between tax distributions paid to shareholders and dividends paid to shareholders. Sub-S banks do not pay income taxes directly, but pass tax distributions on to shareholders who pay income taxes based on their allocation of the company's earnings for which they receive a K-1 each year. If these tax payments are treated as dividends, then banks will be forced to become C Corporations so that shareholders are not put into a position where they could be required to pay income taxes on the company's earnings, but due to dividend restrictions, would not be allowed to receive tax distributions commensurate with the liability. Many community banks chose to become Sub-S banks because it allows the institutions to grow their capital accounts at a quicker rate than a C Corporation.

PHASE OUT OF TRUST PREFERRED SECURITIES

The original design of trust preferred securities was to provide banks, many of them community banks, with a reliable source of capital, up to 25% of their leverage capital, for an extended period of time. The appetite for correspondent banks to be in the bank stock lending arena comes and goes with the economic tide of the nation as a whole and with other capital market options not available to many of the privately held banks in the country, a stable and consistent method by which community banks were able to generate additional capital is necessary. If community banks are required to replace this capital source, it will be difficult as the outlook for bank earnings in the short run is not good when you consider that net interest margins will continue to shrink until the economy turns around. Outside investors will not be anxious to invest in community banks when returns are so scarce. It is simply not a good business model to provide an avenue for long term capital planning and then mid-stream eliminate that alternative after it has been implemented.

Members of the committees reviewing this proposed rule, I would like to thank you for the efforts you put forth in trying to develop and implement capital rules that are fair and appropriate for all banks and understand the enormity of the undertaking. All new laws, regulations and rules have unintended consequences and I don't believe the original intent of Basel III was to eliminate community banking across America, but I am quite certain that passage of Basel III, as proposed, will result in the elimination of hundreds of community banks across America. Corporate America banks, those with deposits over $50 billion, have no interest in those communities or the successful businesses within them. Corporate America banking is based on leverage, not relationships, and therefore without an adequate volume of transactions and balances, they will simply ignore that segment of America and small to mid size towns across the nation will simply disappear. Simply put, Basel III needs to be rejected and replaced with simple capital rules for community banks that are handling basic transactions for their customers.

Community banking was not the root of the latest financial crisis so don't make them pay for the Wall Street mistakes that occurred. Even after the financial crisis and all the talk of "too big to fail", the top 5 banks in America have more deposits today than before the start of the crisis. Address what needs to be addressed, fix what needs to be fixed, but leave the community banking system out of this issue.

I appreciate you taking the time to consider my comments and if you have any questions, please feel free to contact me at (816)-751-9342 or send me an email at the address below.

Sincerely,

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