ELDERTON
State Bank

The Right Direction

August 24, 2012

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 – RIN 3064-AD95 and RIN 3064-AD96

Mr. Feldman:

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.

Our institution is a community bank with $198 million in assets. Historically, our bank's performance has been strong, consistently out-performing our local and national peers. We've always maintained strong capital ratios. However, to achieve this success, we've had to become very efficient in the use of our resources. We operate with 41 full time equivalent employees; one of those employees is our compliance officer. We had loan growth of approximately 10% in 2011 and that demand has continued into 2012. We are a Farm Service Agency preferred lender.

We are very concerned that the proposed capital rules, if enacted as they are currently written, will have a negative impact on our performance, will result in fewer funds available for lending, will make it more difficult to offer the products our customers need and cause changes in our current mix of assets. Following are issues we have with the "Standardized Approach for Risk-Weighted Assets" (RIN 3064-AD96).

The proposed rules require that all unrealized gains and losses on available for sale securities (AFS) must "flow through" to common equity tier 1. Values of some of these securities can change daily resulting in frequent adjustments to the bank's capital. Our investment portfolio consists of: mortgage-backed securities, small business loan backed securities, municipal bonds and U.S. Agencies. The interest rate effect, in a rising rate environment, would move all of these securities into unrealized loss positions. Capital would be adversely impacted, even though, the intent would be to hold these bonds to maturity resulting in no loss of principal. We classify our investment portfolio "AFS" for liquidity purposes. Since interest rates are at historical lows, this proposal sets the stage for future capital declines in an eventual rising interest rate environment.

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This change in accounting could also result in a change in investment philosophy. In order to minimize the potential negative impact on capital, we may be forced to reduce our investment in long-term bonds, such as: mortgaged-back, small business and municipal securities. If this occurs industry-wide, housing markets, local and national governments, and small business lending will be adversely impacted. Another option would be to classify the investment portfolio as held-to-maturity. This would eliminate a liquidity source for the bank. A smaller cushion of liquid assets would most likely reduce the amount of funds we would be willing to lend.

The proposed rule makes substantial changes to the risk-weightings of 1 – 4 family residential mortgages. The new risk-weightings would be based on loan-to-value (LTV) ratios and certain product and underwriting features. To determine LTV ratios, bank personnel would need to access appraisal amounts, lien positions (if more than one loan is involved) and intervening liens if held by other entities. Currently, this information is not accessible through our electronic system. Each customer file would have to be physically accessed. Loan personnel would do this research, as they are familiar with the credit files. This would reduce loan department staff available to service customers. Unfortunately, customer wait time would probably increase. Once the information has been gathered, employees would need to input this information into the bank's main electronic system. Reports would have to be written that would provide bank personnel with updated LTV ratios for quarterly reporting. In addition, there would be loss of loan income due to the longer wait time in the new loan process. Longer wait time would provide opportunities for our competitors.

The types of mortgages we offer would also be affected. The focus would be on residential loans that would classify as category 1. This would make it harder for some customers to obtain residential loans.

The proposal to assign a 150% risk weight to loans that are 90 days or more past due would also have an adverse impact. We currently address troubled credits through the allowance for loan loss calculation. Commercial loans deemed to be impaired are individually evaluated for risk of loss. Monthly provisions are taken to maintain coverage for potential losses. Over the period of 1-1-2008 through 7-31-2012, the bank allocated $2.4 million of earnings to the loan loss provision. During that same period, total net charge-offs were $1.6 million. It is difficult to understand why loans past due 90 days or more would be risk-weighted at 150% when we have already reduced capital through the monthly loan loss provisions.

We also want to comment on proposed changes to minimum regulatory capital ratios as part of the "Regulatory Capital – Implementation of Basel III" rule (RIN 3064-AD95). For community banks, the increased minimum capital requirements will result in: decreased capital returns to shareholders, increased volatility of regulatory capital, increased administrative burdens and costs, and additional pressure on community banks to consolidate as a result of all of the above. Community banks have limited access to capital markets outside of their local regions. The higher capital requirements and resulting lower returns on investment will make it even more difficult to entice new shareholders.

For our bank, it would be very expensive to raise capital. We are privately held so there is no ready market for our stock. We would need to engage 3rd parties to do a stock valuation and write a prospectus. We would anticipate that those costs could amount to 10% or more of annual net income. Normally community banks increase capital through the retention of earnings. However, depending on the amount of capital needed, it could take many years to reach the required level.

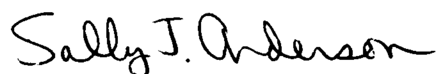
As a community bank, we did not engage in the risky practices that led to the financial crisis. We did not trade in complex financial products. However, the proposed capital rules will hold community banks to the same standards as international systemically significant institutions. The role of community banks is to provide resources for community development and job creation. We support local economies. These new capital rules, as written, will force us to retain a greater portion of earnings in capital rather than invest it in the local communities we serve. This will hamper local economic recovery.

The proposed rules need to be adjusted according to size, complexity and risk profile of the institution. A "one size fits all" approach could significantly curb community banks abilities to lend and provide liquidity to their local markets. This proposal mirrors the Basel III International Accord which targeted only the largest, internationally active banks. Applying this proposal to community banks, would negatively impact these banks, their customers and the local communities they serve.

Thank you for the opportunity to address these important issues.

Please contact the undersigned at 724-354-5010 or sallyanderson@eldertonbank.com if you have any questions or would like to discuss any of the issues addressed in this letter.

Respectfully submitted,



Sally J. Anderson
VP/CFO
Elderton State Bank