ThePeoplesBank

October 16, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20^{th} Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E. Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

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

RE: Basel III Capital Proposals

Ladies and Gentlemen:

We appreciate this opportunity to respond to the Basel III NPR and the Standardized Approach NPR, each dated June 7, 2012, which together outline broad principles to be used by banking organizations in capital planning.

Background:
The Peoples Bank in Eatonton, Georgia is a community bank established in 1943, currently with $136 million in assets, serving Putnam County from three full service banking offices. Our customer base and geography includes two Georgia lake communities, Lake Oconee and Lake Sinclair, and we are approximately 40 miles to the southeast of the outlying regions of the Atlanta, Georgia MSA. We have a small one-bank holding company, Peoples Bankshares, Inc. Our company elected Subchapter S status for income tax purposes in 2007. Our shareholders are generally local individuals and families, most of whom are also long-term customers of the Bank. Our loan portfolio has a large proportion of loans secured by residential properties in our lake communities, both permanent and second single-family homes, and land lots held by individual families for future construction of their dream homes when times get better.

Upon the release of the above-referenced NPRs in June, our Bank management performed an extensive internal study of the proposals to determine potential Basel III impacts to our capital levels on a fully phased-in basis. We prepared pro-forma modeling based on our financial statements of June 30, 2012, networked with our Georgia bank peers and trade association, and reviewed our findings at our most recent ALCO Committee meeting to gain Board and management support for the submission of this comment letter.

Impact Analysis on Our Bank's Capital Ratios:

At June 30, 2012, under current well-capitalized definitions, our Bank's Tier 1 Leverage Ratio was 8.02% and our Total Risk-Based Capital Ratio was 14.65%. Our Board of Directors has always been watchful of capital resources and we tend to manage our balance sheet to maintain Tier 1 Capital near or above 8.00%. We have a long and established track record of doing so.

Based on our 6/30/2012 pro-forma modeling and internal record-gathering, we estimate that the fully phased-in Basel III requirements would cause our Total Risk-Based Capital Ratio to decline from 14.65% to 10.87%, and our Total Risk-Weighted Assets would increase by a staggering 44%, from $80.6 million now to $115.9 million under Basel rules. The full phase in of Basel III proposals, including the new Capital Conservation Buffer, would require our small community bank to carry $2.9 million in additional capital to comply, even though the risk attributes on our balance sheet have not changed at all. Although we applaud the intent of the Basel III proposals to assure adequate capital to mitigate risk in the banking system, we fail to see how this accomplishes the intent to better control risk at community banks across the country.

The pro-forma impact on our 6/30/2012 Tier 1 Capital ratio was actually somewhat positive, but only because of our current unrealized gain position in our Available-For-Sale (AFS) bond portfolio, which Basel III has slated for inclusion in Tier 1 common equity capital calculations. We further tested the "what if" potential of a 300 basis point upward rate shock in interest rates on our AFS bond portfolio, which has grown in relative size on our balance sheet through this extended recessionary period of low loan demand. In spite of our conservative bond portfolio mix, such a scenario would cause an added shortfall of $1.7 million to comply with fully phased-in Basel III rules, increasing the total potential shortfall for our Bank to over $5.0 million. This is a shocking outcome for a Bank with only $11.8 million in Total Risk-Based Capital at 6/30/2012. Our Total Risk-Based Capital ratio could be pulled down to roughly 9.0% if this "what if" scenario on our AFS bond portfolio is included.

Key Elements of Concern to Our Bank:

1) HIGHER RISK-WEIGHTINGS ON 1-4 FAMILY RESIDENTIAL LOANS – CATEGORY 1 DEFINITION:
The largest damaging Basel component to us by far is the new risk emphasis on 1-4 family residential real estate lending. As of June 30, 2012, at the Peoples Bank, we had 40.4% of our loan portfolio secured by such collateral as reflected in our FFIEC Call Report Schedule RC-C- line item 1.c. The Basel Definition of "Category 1" treatment for first lien 1-4 family residential real estate loans clearly specifies that a balloon payment arrangement does not qualify for Category 1 status for risk-weighting purposes, but that is how almost all Georgia community banks, including ours, structure the mortgages that they keep on the books. Community banks do not generally book any "classic" 15- or 20- or 30-year mortgages. We use those amortization schedules, but with a 5-year or 3-year or even 2-year balloon. This balloon payment practice

reflects our efforts to manage long-term interest rate risk, and to re-appraise and possibly re-price the credit at appropriate intervals. Community banks have limited access to long-term noncore funding that larger financial institutions enjoy, and our regulatory authorities strongly discourage reliance on noncore funding sources to any material degree. Small community banks are expected to be self-funding through local deposits. Community banks also have a tendency to take real estate on many credits as extra collateral in an abundance of caution, so a large percentage of loans are thrown into this 1-4 residential bucket on our quarterly FFIEC Call Reports. Because of the balloon feature we use, our entire first lien residential portfolio will be classified as "Category 2" along with our second liens and home equity lines.

2) HIGHER RISK-WEIGHTINGS ON 1-4 FAMILY RESIDENTIAL LOANS – TIERED LTV TABLES:
Our Bank's severe increase in Total Risk-Weighted Assets will be caused primarily by the proposed Loan-to Value (LTV) tables on residential loans. Both Category 1 and Category 2 loans under Basel III proposals are subjected to a tiered set of risk-weights based on the underlying LTV ratios. Category loans are subjected to an LTV table varying from 35% to 100% risk-weighting. The Category 2 loan bucket (including all non-Category 1 first liens, second liens, and home equity lines of credit) turns into a large bucket for community banks due to the balloon payment issue discussed above. Category 2 loans are subjected to graduated risk-weightings that can go up to 200% of the loan amount based on an LTV table that runs from below 60% of value up to past 90% of value – the higher the LTV, the higher the risk-weighting assigned.

In today's environment, appraised real estate values are severely depressed. Foreclosure activity, FDIC-assisted closures of banks, FDIC clearing practices on assets requiring liquidation, and the operation of loss share programs in our immediate markets have devastated real estate values. We expect this to continue until the cycle clears. Economic conditions will cause our LTV tier totals to be at or near the top of the Basel tables, causing punitive increases to our risk-weighted assets.

3) INCLUSION OF NET UNREALIZED GAINS (LOSSES) ON AFS SECURITIES PORTFOLIO IN TIER 1 COMMON EQUITY:
We do not understand why the inclusion of net unrealized gains (losses) on AFS securities is now being considered for direct inclusion in capital ratio calculations. We distinctly remember the decisions that our Bank made upon the initial imposition of FASB 115 in 1993, when we classified the majority of our bond portfolio as Available-For-Sale instead of Held-To-Maturity to retain flexibility in managing balance sheet liquidity and hedging interest rate risk. We avoided setting up a trading account to remain within the safe confines of our expertise. We also remember the subsequent confusion caused among regulators as they sought to determine appropriate treatment for capital calculation purposes.

Please refer to FDIC PR-85-94 (12-20-94) "FDIC ADOPTS CAPITAL RULE FOR UNREALIZED GAINS AND LOSSES ON SECURITIES FOR IMMEDIATE RELEASE," in which then-FDIC Chairman Ricki R. Tigert said: "We believe bank regulatory capital levels would be unnecessarily volatile, without appreciable benefits to the safety and soundness of the banking system, if institutions were required to include all unrealized securities losses in their regulatory capital calculations." We would ike to know what has changed.

4) PRACTICAL REPORTING AND TRACKING BURDEN:
We have spent untold staff hours trying to absorb and measure impacts from the Basel III proposals for our comment letter. When combined with the volume and complexity of an ever-increasing level of regulatory burden in recent years, small community banks like ours are overwhelmed to keep up and comply. If these Basel rules are imposed unchanged, we will incur material ongoing overhead costs to measure the complex risk-weighting systems required, hire external software and modeling support, work with our data processing vendors to assure proper coding systems on various loans, and train our financial staff to understand and comply with Basel III to file accurate Call Reports. We do not understand how these complex rules help to mitigate risks in our Bank.

We were encouraged to read a recent speech delivered to The American Banker Regulatory Symposium; Washington, D.C. on September 14, 2012 by Mr. Thomas M. Hoenig, Director, Federal Deposit Insurance Corporation "Back to Basics: A Better Alternative to Basel Capital Rules." Mr. Hoenig's sound logic in urging that we scrap Basel III and start over to find a simple measurement system gives us hope.

Recommendations:

1) We fail to comprehend the rationale for applying the Basel III standards to community banks. We urge you to consider eliminating the application of proposed Basel III rules to banks with under $10 Billion in Total Assets, leaving smaller financial institutions under existing regulations. If our top priority recommendation is not granted, then we urge you to reconsider the most damaging elements in the Basel proposals that will severely impact community banks as shown below.

2) Eliminate, or at least lessen, the punitive new risk assignments on 1-4 family residential lending in all ways possible. We already assess and provide for this risk in our Allowance for Loan & Lease Losses ("ALLL") valuations.
    a) Amend "Category 1" definition to permit balloon payments that almost all community banks use.
    b) Scale back LTV risk-weighting tables for Category 1 loans so that no loan has a risk weight of over 50%.
    c) Scale back LTV risk-weighting tables for Category 2 loans so that no loan has a risk weight of over 100%.

3) Eliminate the Basel III proposal to include Net Unrealized Gains (Losses) on AFS Debt Securities in common equity and all capital calculations. Upward interest rate spirals will be devastating and will serve no purpose.

4) Eliminate the limitation of ALLL balances from its current 1.25% cap of Total Risk-Weighted Assets. Permit the entire ALLL to be counted in total capital. There are so many added risk metrics in Basel III proposals that will demand more capital. Continuing to exclude our extra safety net reserves above 1.25%, which we have already expensed and set aside in the ALLL, is unfairly "doubling up" on capital demands.

5) Eliminate the new definition for "High Volatility Commercial Real Estate" and roll back the new 150% risk-weightings to 100%. We already assess and provide for this risk in our ALLL valuations, and loan concentration category limitations are now prevalent in community bank loan policies based on lessons learned in the "Great Recession."

6) Eliminate the new 150% risk-weighting on most Nonaccrual and 90+ Days Past Due Loans and roll back to 100% risk weights. We already assess and provide for the heightened risk on nonperforming loans in our ALLL valuations.

7) Eliminate the complex new Capital Conservation Buffer. Continue to use existing regulatory powers, a well-applied examination process, and formal enforcement orders to require or control behaviors on cash dividends, capital actions, compensation practices, etc.

8) Exempt Subchapter S banks from the Capital Conservation Buffer provisions that could preclude otherwise well-capitalized S Corp banks from making tax distributions to shareholders.

9) Impose a master cap on risk-weighting of assets so that Total Risk-Weighted Assets can never be more than a financial institution's Total Assets at any measurement date. We can envision this happening to our Bank due to the large relative size of our residential loan portfolio.

Although these elements do not specifically impact our Bank, we would also urge the following:

10) Permit grandfathered inclusion of existing Trust Preferred Securities ("TruPS") as a part of capital under current limits for smaller bank holding companies under $10 Billion in size. Small banking companies have limited market access to raise more capital, and limited prospects from local investors in the current environment.

11) Seek to eliminate the deduction from common equity of the portions of Deferred Tax Assets ("DTAs") relating to operating losses and tax credit carryforwards. The future probability of realizing these DTAs is already properly accounted for through GAAP treatment.

<u>Conclusion:</u>

Applying the complex "one size fits all" Basel III proposals to community banks across the country is misguided and will result in serious unintended consequences. We have very real concerns regarding the sky-rocketing capital requirements for our Bank demonstrated by our pro-forma modeling, the negative impacts on our ability to provide residential mortgages to our local markets, the difficulty of small community banks to attract capital now and in the future, and the increased compliance and regulatory burdens. Basel III will compromise our ability to offer the reasonably priced products our local consumers and small businesses need and can only act to forestall the economic recovery that the country now seeks. We urge you to reconsider the Basel III proposals to correct these damaging impacts to our community banks and local communities.

We appreciate the opportunity to comment on these proposals. Please do not hesitate to contact me if I may be of any further assistance in providing insight into Basel III's impact to community banking.

Respectfully,

Charles R. Haley

Charles R. Haley
President & CEO