September 17, 2012.

To: regs.comments@federalreserve.gov

Re: Basel III Docket No. 1442

Ladies and Gentlemen:

I am a CPA and the CFO of a publicly traded community bank. I have performed these duties over two decades for two different companies. I have served as a director of several banks and a bank holding company. I have also been a major shareholder of a community bank. I understand this industry and its relation to the overall economy. I have lived through and survived several business cycles. I also understand and respect the need for appropriate financial industry regulation.

In that context, I have a number of objections to register about the proposed Basel III capital requirements. I understand that currently the Comptroller of Currency, the FDIC, and the Federal Reserve all have these proposals out for comment.

This accord is an international agreement designed to improve capital levels in all banks. This is despite the fact that industry capital levels, in the U. S., are at a seven decade high. Somewhere along the way we thought this proposal was only going to be applicable to banks over $10 billion in size. I guess that was wishful thinking on our part. In any case, it should be noted that other countries do not have a community bank industry like the one that exists, currently, in the United States. That difference makes it highly undesirable, unworkable, and untenable to adopt a one-size-fits-all capital strategy and compel implementation in this country.

This proposal is clearly going to require more common equity capital for the community banking industry. At the same time, the requirements are going to make it more difficult for our industry to generate earnings and be attractive to investors.

Apparently international banking regulators are concerned about capital levels. So, their solution is to make capital more difficult to acquire, restrict the definition, and make the computation of risk weighted assets exponentially more complex.

You should understand, for large and small banks, the accuracy of all the numbers required for the Basel III capital computation is going to be in inverse proportion to the complexity of said computation. These regulations are fiendishly complex.

Under Basel III, common equity is the premier type of capital. That makes good business sense, but these regulations are going to make it more difficult for our industry to raise capital in the equity markets. Further, capital will include unrealized gains and losses on available for sale securities. Right now, in September 2012, that works to our favor because we have gains of about $13 million on a $330 million portfolio (incidentally about one quarter of our balance sheet). However, a 300 basis point shock to interest rates would result in almost a 10% drop in that portfolio's market value. Can you spell CAPITAL VOLATILITY?

It's been suggested that banks might move some or all of their investments to held to maturity. This would have seriously negative impact on liquidity, not to mention the likely unfavorable reactions of our external auditors and examiners. Further, if GAAP and IFRS eventually converge, HTM will likely go away.

We are also concerned about the possibility of Basel III liquidity rules that, if adopted, will specify the amounts and types of highly liquid, marketable securities we should have on our balance sheet. The likely direction of those requirements will certainly exacerbate the market volatility of our capital ratios. But, that is a comment letter for later.

The 250 basis point capital conservation buffer is a new concept. It is not inherently a bad idea, but it in effect redefines what the requirements are to be "well capitalized". Failure to maintain the buffer can impair our ability to operate the bank without regulatory approvals. But, at the same time, the regulations have created an environment where the numerator and denominator of all the capital ratios are by definition inherently complex and volatile. So, being safe and sound and prudent bankers, we will end up with a buffer on top of the buffer. Just to finish connecting the dots, this will not do good things for return on equity or our ability to raise capital.

The proposal phases our trust preferred as a tier I capital source, over a ten year period. I won't even raise the question of how an international regulatory agreement trumps an act of the U. S. Congress (Dodd Frank). For our bank, our best estimate is that full implementation will reduce our Tier I capital ratio by 400 basis points. We will evaluate what makes the most sense for us – to pay off with a new stock issue, gradually pay it off with cash, or shrink the bank to liquidate the debt, or pay it off at maturity. The point is, this is putting additional pressure on our industry to increase capital, yet at the same time it's more difficult to do so.

The new requirements for risk weighting real estate loans into category 1 and 2 and by loan-to-value percentage are going to necessitate massive, labor intensive and expensive work in our management information systems.

The requirement that unfunded commitments be included in the risk weighted capital computation is going to drive up the cost and complexity of home equity lines of credits and commercial lines of credit.

There is another pending matter outside the context of Basel III that will also put pressure on community bank's capital positions. The accounting for leases is going to change, putting more assets on the balance sheet, and, accordingly, adding to risk weighted assets.

So, what is the likely state of the community banking industry, post Basel III implementation? In my opinion,

- ✓ Basel III will vastly increase the number of community banks that need to be sold,
- ✓ Basel III will decrease the universe of potential buyers of said banks (at least within the community bank industry),
- ✓ Basel III will diminish the attraction of community bank stocks as a viable investment option,
- ✓ Basel III will increase the complexity and expense of bank lending, and
- ✓ Basel III will diminish the availability and accessibility of bank credit.

I realize I have written an editorial. But, what you as our bank industry regulators need to realize is that there is a tremendous disconnect between the macro-economic aspects of banking on a national and global scale and the micro-economic aspects of community banking in small and medium size cities in America. Failure to recognize that difference is going to have a material and negative impact on community banking.

William W. Traynham

Chief Financial Officer

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