



# *Exchange Bank*

*Milledgeville - Gray - Lake Oconee*

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October 19, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve  
System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

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

Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation,  
550 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

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.

Exchange Bank, Milledgeville, GA is a small community bank in Central Georgia, 90 miles Southeast of Atlanta, and we have been in business since 1903. Milledgeville is a small city, with a population of 19,000 +, located in a small county with a population of \$45,000 +. We are not agricultural, and have depended upon state facilities, industry, and small business to provide employment to residents of Baldwin County and surrounding counties. We have 3 offices in Milledgeville, and 1 each in Jones County and Greene County respectively. We have been hit hard by the loss of jobs in our area, with over 3,500 jobs lost through the closing of state facilities and the movement of industrial jobs to Mexico. Our market has been primarily small business, commercial real estate, and mortgages to homeowners. We established a mortgage operation in our bank about 19 years ago to originate mortgages and fund these through Freddie Mac, while still servicing the mortgages for local customers.

A sizable portion of our loan portfolio also consists of 35 month balloon loans secured by real estate. With the impact of the recession still affecting loan demand, our percentage of earning assets has shifted more toward our investment portfolio, with spreads tightening resulting in reduced income.

Basel III capital standards will have a number of adverse effects on the balance sheet and earning capabilities of Exchange Bank:

1. The change in risk weighting for residential mortgage loans, especially on the 35 month balloon loans, will have a significant effect on the capital calculation, due to the large amount of loans to our customers which fit this criteria. This will have a negative impact on risk based capital ratios, at a time when we are having positive earnings and our Tier One Capital Ratio and Leverage Ratio is moving up in a positive scale due to our Net Income this year. The change in risk weighting will now negate a large portion of the improvement we have realized in risk based capital ratios.
2. The effect of risk weighting changes mention above and the potential volatility of Regulatory Capital due to changes in how Unrealized Gains and Losses on Available For Sale securities are considered, will also have a significant effect on our capital ratios when interest rates do start an upward trend, and the gains which are in our investment portfolio turn into losses. These are only paper gains/losses right now, but they will turn into real effects on capital under Basel III, due to the significant size of our investment portfolio.
3. These increased required capital ratio levels will further reduce the pool of funding available to providing lending to small businesses and residential mortgage customers. This combined with the dissolution of balloon loans will further reduce loan options to mortgage customers, particularly from community banks. Community banks have utilized balloon real estate loans in the past to help manage interest rate risk by not putting 20 to 30 year fixed rate loans on the books, but being able to adjust rates on loans by having them mature every 3 years and being able to reprice interest rates at that time.

These higher risk weighting changes to assets, particular to real estate loans, will hurt lending drastically, and individual businesses and consumers do not need this additional hurdle to overcome as they try to jumpstart the economy. Some banks will probably be forced out of making certain types of real estate loans, such as balloon real estate loans, in their communities.

We understand that certain safeguards and minimum capital levels must be in place in the banking industry, but there is a major difference between Main Street Community Banks and Wall Street Banks/International Banks. There should then be major differences in how regulators view the controls and capital requirements between the two groups. Another major implication to our operations will be the difficulty in tracking all the data we will now be required to assimilate in the new calculations. We will have to incur additional software costs to either acquire new banking software or have our software

company write new programs to extract the necessary data to perform the required calculations.

All of these changes are coming at the end of the worst time in the recent history of banking, coming off the Great Recession, and in the midst of times when some community financial institutions such as ourselves are just now starting to realize profits and beginning to increase capital levels, and could find themselves being viewed in a negative light by regulators, with no options to increase earnings or raise capital by selling stock to investors in this current environment.

Because of these effects on community banks, it is my opinion that Basel III should not be implemented, or at the very least not be applicable to community banks under \$1 billion in assets.

Thank you for the opportunity to present these views from a community banker.

Sincerely,

A handwritten signature in blue ink, appearing to read "H. J. Pope, Jr.", written in a cursive style.

Henry J. Pope, Jr.  
President and Chief Executive Officer