October 17, 2012

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

We are writing to express our opposition to implementation of proposed Basel III capital requirements for community banks such as First Federal Bank of Louisiana. Our institution has spent over sixty years supporting home ownership and small business growth in Southwest and Central Louisiana. We have provided a safe and stable place for our citizens to keep their life savings. Over the decades we have been careful stewards of our customers' trust by lending conservatively and staying clear of risky activities. Now it seems as though we've been swept up into a regulatory overreaction to outrageous risks taken by a few large international banks. Basel III is not appropriate to banks like ours, and in this letter we hope to explain some of the reasons why that is the case.

The first and most important reason we oppose Basel III is that it ignores the limitations on capital-raising activities of mutual institutions like ours. First Federal Bank of Louisiana is a federally-chartered mutual thrift institution. Mutuality is a capital structure in which individual depositors are our shareholders; thus, we have no capital stock, but rely entirely on earnings to add to capital. This poses a threat to our existence should Basel III rules require us to seek additional capital. Our likeliest alternatives would be offering ourselves for acquisition by another institution or, if the market permitted, seeking conversion to stock form; either of these alternatives would probably represent the end of our independence, and restrict our role in supporting the local economy. Two particular aspects of the Basel III proposal make this a legitimate threat despite the large capital base we have built over the years:

1. Under Basel III, Accumulated Other Comprehensive Income ("AOCI") is included in risk-based capital, and
2. Under Basel III, our principal lending activity, mortgage lending, is considered more risky than it is under traditional risk-based capital guidelines.

Let's discuss these aspects in greater detail. The issue we have with including AOCI in risk-based capital is that it represents a classic regulatory whipsaw, where we are caught between competing regulatory objectives that pull in opposite directions. On the one hand, regulations reasonably require us to maintain high levels of liquidity. On the other hand, Basel III threatens to punish us for holding liquid investments. High liquidity ensures that our customers can always access their funds, that we can support our community by constant readiness to make loans to small businesses or homeowners, and that we can meet all our other financial obligations. One element of effective liquidity management is careful maintenance of both primary (operating) and secondary (buffer) liquidity. As a consequence, our investment portfolio serves as a principal element of our liquidity buffer. Thus we stay in compliance with both prudent bank management practices and regulatory guidance. But now, with the Basel III proposal, we are effectively punished for careful and prudent liquidity management. This happens because Basel III requires us to include AOCI in risk-based capital. Here is how this becomes a potential capital impairment: In order to serve as a secondary source of liquidity, generally accepted accounting principles ("GAAP") require our investment portfolio to be held in the Available for Sale ("AFS") status[1]. This status signifies that we can liquidate the securities any time we need cash to support lending or other operations. The Basel III trap arises because AFS securities are held at market value, with unrealized gains or losses, net of tax effects, placed into AOCI. This is a trap because the market values of our investment securities are largely a function of market interest rates. Market interest rates are outside the bank's control, but can have a material effect on the value of investment securities. Because interest rates can affect market values, they can also have a material effect on capital, through AOCI. It is not difficult to visualize a circumstance where sudden and dramatic changes in market rates of interest would materially impair our risk-based capital, without a single transaction or any other action on our part, simply because of the effect of market rates on

[1] Like most conservative community banks, we do not engage in trading. Thus, we do not keep securities in the Held for Trading status that is an alternative liquid category.

AOCI. Here are our latest estimates of the effects on AOCI, and therefore on Basel III risk-based capital, of various rate shock conditions:

$1,000s	Rate Shock (Basis Points)				
	0	+100	+200	+300	+400
Estimated Change in AOCI *Assumes a 34% Income Tax Rate*	$0	$(6,357)	$(13,779)	$(22,442)	$(30,476)
Common Equity Tier 1 Ratio	27.98%	24.47%	22.89%	20.97%	19.10%
Change in Ratio		*-3.51%*	*-5.09%*	*-7.01%*	*-8.88%*

Our investment portfolio is extremely short term and our capital level is extremely high. Nonetheless, as illustrated above, we lose nearly a fifth of our Basel III Common Equity Tier 1 Capital even in a 200 basis point rate shock, a shock that is very plausible given that current market rates are at historic lows. Potential effects on capital for our institution are serious, but the results could be disastrous if you were to witness this sort of capital impairment among community institutions that are well-capitalized, but at lower levels than our unusually strong capital position. Basel III, by including AOCI in risk-based capital, threatens the independence of institutions that innocently comply with prudent liquidity guidelines.

The other principal objection we have to Basel III capital regulations is the tiered risk weighting of mortgage loans. As a thrift institution that survived the thrift industry meltdown of the 1980s (as well as the crushing recession of the late 1950s and the 2007-2008 economic disaster), we have proven ourselves to be sensible, conservative, knowledgeable, and prudent mortgage loan underwriters. An assumption seems to underlie Basel III that imprudent lending is a characteristic of all institutions with home mortgages in the 80% and 90% loan to value arena. There seems to be a similar assumption about essentially all home equity lending. These assumptions are invalid, and therefore it is unreasonable to provide a capital penalty for home loans that have been well and carefully underwritten. Regulators already have the authority to require additional capital (or to impose other requirements) on banks that are engaging in imprudent lending. Therefore an automatic capital charge for home mortgage lending is at best redundant and at worst an unjustified burden on banks, especially traditional thrift institutions like First Federal, which have a historic mission of home mortgage lending. In an apparent attempt to manage the systemic risk posed by large Wall Street banks that made junk mortgages and nearly sank the American economy, Basel III pigeonholes into the same vision a prudent community bank with a history of careful support for homeowners in our own towns and parishes (counties). This proposal is misdirected and unnecessary.

As you can see from the discussion above, Basel III standards are a solution to a problem that does not exist - and never has existed - among banks like ours. It is unconscionable to impose a potentially existential threat to community banks with a regulation that has no logical basis. For this reason, we urge you not to adopt Basel III, or, alternatively, to exempt small community banks from its provisions.

Sincerely,

Charles V. Timpa
President and CEO

Darryl G. Drewett
Treasurer and CFO