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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

Dear Secretary Johnson:

Please help protect our ability to serve the citizens and small businesses fighting to survive and hopefully thrive again someday within our community. Mechanics Bank is a \$200 million asset locally owned bank serving Yalobusha and Lafayette counties in Mississippi. Our bank operates four full-service offices in two small towns, including our headquarters located on Main Street in Water Valley since 1892. We appreciate the opportunity to provide input on this important set of capital proposals that could impact those living in our community. Mechanics Bank has provided traditional banking products, including residential mortgages, and small business and consumer loans, for over 120 years. These products have allowed generations of our citizens to own their own homes, start their own businesses, secure quality jobs, and support the local community. We believe the proposed Basel III capital and risk weighting rules will have a major negative impact on our ability to provide these services.

A substantial portion of our bank's loan portfolio is comprised of residential mortgages that would not meet the proposed definition of Category 1 loans. Many of our customers prefer these "in-bank" mortgage loans. Many others do not qualify for the conventional Category 1 mortgage products due to various reasons, such as; no appraisal due to lack of comparables, size of the loan, or credit history. These loans are competitively priced and made on three to five year notes in order to match with the traditional funding model common to community banks.

We currently have almost \$47 million of loans secured by 1 to 4 family residential properties representing 36.50% of our total loan portfolio and 23% of our total assets. Under the proposed risk-weighting rules, the increase in risk weighting of most of these loans will double from 50% to 100% and in some cases will triple to 150%. This will have a substantial impact upon our Tier 1 and Total Risk Based Capital. If these proposed rules are applied to community banks, we will have to curtail or possibly stop entirely providing these loans. Banks our size have limited access to additional capital other than through profits and these loans represent a significant portion of our income.

More importantly, our customers would have to seek financing from large banks that have previously proven unwilling or unable to make these loans. This scenario truly does turn the rural customer into simply a number because most large banks are unwilling or incapable of getting to know these customers in order to successfully weigh the risk and return. Ultimately, our customers will be forced to accept high cost financing from nonconventional lenders. Having served the same communities for over 120 years, Mechanics Bank, like other community banks, is precisely qualified to measure and accept the risks associated with these loans. Please help us preserve this vital source of home loan financing.

In addition, the proposed increase in risk weighting of "High Volatility Commercial Real Estate" loans will further reduce commercial development in our market. Mechanics Bank has served as the primary small business lender in Yalobusha County and a major business lender in Lafayette and surrounding counties for over a century. These loans have helped many local entrepreneurs to realize their dream of running their own businesses. These loans have assisted those willing to invest in our community to create jobs that improve the lives of all local residents. The negative effect on business lending caused by the proposed rules will only increase the distress on our already struggling local economy.

Finally, the addition of Accumulated Other Comprehensive Income to the capital calculation adds unnecessary volatility to capital planning. Our AOCI is currently \$2,069,498. A 100 basis point shock reduces our capital for calculation purposes by \$1,695,845, while a 300 basis point shock diminishes our capital by \$5,586,307. This volatility represents only a snapshot in time and does not have any significant impact on our liquidity or risk to the Bank. Our bond portfolio, while held available for sale for contingency liquidity purposes, has always been managed for balanced sustainable return. The inclusion of AOCI in the capital calculation will potentially restrict our traditional lending activities in order to offset the capital impact from the bond investments. Community banks will also be forced to shorten the traditional duration of our bond portfolios, limiting our ability to invest in municipal bond issues that are so important to our local and state communities.

Many regulators have stated that community banks such as ours did not cause the recent financial crisis. Initially the proposed Basel III capital rules were constructed for the largest, internationally active financial institutions. These institutions have substantially different capital profiles and channels to raise capital than most community banks. They also do not have the first hand knowledge of the many rural markets that we serve. Applying the

same standards that may be appropriate for large institutions to banks like us will weaken the community bank environment and push many hard working American citizens outside the banking system with no affordable place to turn.

We have confidence in the existing approach to capital adequacy and are hopeful that the current system will be maintained. If the proposed rules are finalized, we ask you to consider adopting the following revisions that have been proposed by many community bank representatives:

- Exempting banks under \$15 billion in total assets from the Basel III minimum capital and risk weighting rules, or, at a minimum, exempting such banks from the proposed rules as they pertain to residential mortgages, commercial real estate, and AOCI;
- Allow existing assets to be grandfathered in using the current risk weighting rules; or
- Revising the risk-weighting and capital rules to more accurately reflect the risks imposed by institutions such as ours and the realities of our operations.

Mechanics Bank has remained strong through the recent difficult times by continuing to serve our communities and trust in our customers. Our numbers and the related impact detailed in this letter may seem minute in relation to the entire banking system. However, the numbers are huge in the lives of the people and businesses we serve.

Thank you for allowing us additional time to evaluate and comment on these important proposals. We know that you are giving your full consideration to the effect these rules will have on our bank, customers, and local community.

Sincerely,



Cam Tyler  
President and CEO