October 18, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
Attention: Comments/Legal ESS
20th Street and Constitution Avenue

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Washington, DC 20551 550 17th Street, NW
Washington, DC 20219

Officer of the Comptroller of the Currency
250 E Street, SW
Mail Stop 203
Washington, DC 20219

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.

I have been the CFO and Investment Officer of a mid size community bank in southeast Alabama for the last 17 years. My prior position was as a Senior Financial Analyst for in the Investment Banking Division of Compass Bank (now BBVA Compass). I have over 25 years of banking and capital markets experience. My comments are based on my personal experience and observation and not necessarily from an analytical or academic standpoint. I am sure you have received more than enough comments from the industry in that regard. I am very concerned about the effects of these proposed regulations on community banks and our customer base. I think the effects on lending to mid market and community customers will be devastating in the current economic climate and will have lasting effects that cannot be reversed.

From a community banker's perspective, it seems we are under attack with this proposal. While I understand and appreciate the desire of the regulatory agencies to prevent another financial crisis, it appears that community banks are unfairly painted with the same brush as the large financial institutions ($10 billion and larger) that were one of the primary factors contributing to the crisis. I have seen very little if any documentation that demonstrates that this proposal would have saved any of the large failed institutions like Washington Mutual, Wachovia or Bear Stearns. This leaves a large proportion of the U.S. banking system that will be affected by the drastic capital requirements under the new proposal but were not the primary contributors to the conditions that lead to the crisis.

The ramifications of the reduced lending as a consequence of higher capital requirements will place the nation's small business owners, entrepreneurs and middle class under even greater economic stress. This election season has focused media attention on the gap between the wealthy class and the middle class. The newest Basel proposal as written will move the economic table of wealth creation even further from the middle class and tilt it further toward large business and wealthy individuals. The table will also tilt away from community banks with years of dedication to the service of their customers and their community toward the large money center banks and former investment banking firms (now classified as banks) that created the financial disaster that the whole world seems to be working through.

Available for Sale Inclusion in Tier 1 Common Equity

According to the proposal, unrealized gains and losses on all AFS securities would flow through to Tier 1 Common Equity. This would include those unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate, as opposed to changes in credit risk. This potentially introduces large volatility to capital that community banks will forced to deal with but will have limited options and access with respect to capital markets. In our bank's example, the interest rate risk associated with the AFS portfolio is equivalent to a 3 year treasury security. Under this Basel III proposal, a rising 400 basis point rate scenario would eliminate up to one third of our bank's capital. Should the holding of a short duration security such as a 3 year U.S. Treasury put the survival of a community bank at risk? I can not understand the benefit of such a proposal.

Several consequences emerge as a result of attempting to strategically manage the capital position assuming this rule is adopted. Institutions will likely trend towards greater use of the held to maturity (HTM) designation. However, this action will limit an institution's ability to hold a cushion of marketable liquid assets, thereby hindering its liquidity position. Additionally, for most institutions, the investment portfolio is used heavily as a mechanism to manage an institution's overall interest rate risk sensitivity, shortening or lengthening duration/cash flows when necessary to affect the balance sheet's global sensitivity. A reclassification into the HTM account will constrain an institution's ability to influence the interest rate risk position efficiently. Also, for those institutions maintaining an allocation within the AFS portfolio, they will likely target much shorter durations in order to cushion the effects the portfolio may have on the bank's capital position. This will not only compress the yield naturally achievable by longer duration products (in a steep yield curve environment) but also exacerbate certain balance sheets' rate risk sensitivity (e.g., organically asset sensitive institutions). One could argue that each of these results is counter to the ultimate goal of creating and preserving capital (through retained earnings and balanced risk profiles). Finally, the ancillary effects of this declining demand from financial institutions for longer duration products, such as municipal bonds, could prove detrimental to smaller municipalities' ability to efficiently fund themselves.

I would further argue that inclusion of the AFS adjustment within capital is unnecessary. Given the GAAP requirements relating to other than temporary impairment, the capital position should reflect investments in which the initial investment is not expected to be recovered by way of the permanent impairment recognition process. Apart from that, any residual unrealized gains and losses are temporary by nature. With the passage of time, these instruments will return to par given the intent and ability to hold to recovery.

The logic of choosing one segment of the balance sheet for special capital treatment also escapes me. Why should just the investment portfolio be evaluated in isolation without any consideration to the liabilities funding these assets? Our bank and thousands of other community banks have successfully weathered interest rate changes for over a100 hundred years now without having the millstone of this proposal to deal with. The reduced flexibility discussed above would actually have hindered our bank's ability to weather the current crisis. With trust preferred and a sound AFS investment portfolio, our bank had the flexibility to remain profitable and keep paying dividends to our stakeholders. Our largest stakeholder is a local child health care center dedicated to providing medical care to the indigent children of our rural southern area. This proposal would have severely impaired if not eliminated this bank's ability to provide dividends to this important stakeholder.

Risk Weighting of Assets and the Capital Buffer

I appreciate the effort to link risk to capital requirements and understand the necessity of this restriction. However, the current Basel implementation also attempted this same objective. I must ask the question, "Did the current risk weighting system adequately protect the financial system and would further refinement of this system with the addition of another "capital buffer" prevent the next financial crisis?" My answer at this point to both questions would be a resounding NO. Even more dangerous is the precedent that has now been set in stone of being "too big to fail". If the riskiest institutions had understood that mistakes and errors in judgment of such magnitude as to affect the survival of their institution would be fatal, would they have participated in such activities? My answer again is no. The safety net of the FDIC bank insurance fund should be large enough to contain any failures without risking the entire United States' if not the World's financial systems. The magnitude of the safety net should be funded by insurance premiums paid by the participants (not the taxpayer). As with any insurance product, the amount of premium paid should be proportionate to the risk. Therefore, those institutions participating in high risk activities should pay premiums proportionate to the magnitude of the risk. The burden of risk premium should not be borne by the institutions not participating in high risk behavior and certainly not by the taxpayer.

Summary

I appreciate the opportunity to express my thoughts on this important matter. I hope my direct and somewhat rambling comments will be taken in the spirit with which they are given. The community banking industry has been an important part of my life for the last 25 years and has accounted for most of my working career. The importance of community banks to the nation's financial system and economic success cannot be overstated. Please reconsider the implementation of the Basel III proposal and develop a more targeted proposal that directly addresses the causality of the current financial crisis and the prevention of the next one.

Respectfully,

Jeff Bentley
Chief Financial Officer
Troy Bank & Trust Company