Commerce UnionBank
Built on Tradition, Integrity, Community

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September 11, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th 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, DC 20219

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

Re: Basel III Capital Proposals – Impact upon Commerce Union Bank

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 (collectively the "banking agencies"). Through this letter, we would like to provide you with our concerns about how the new proposals will impact our institution, Commerce Union Bank as well as the collective community banking system.

Commerce Union Bank is a small community bank (approx. $220 million in assets) located in northern middle Tennessee. Chartered in 2006, the bank provides commercial and consumer financial services to customers in Robertson, Sumner and Davidson counties in Tennessee. Since its inception, Commerce Union Bank has been an active member in its market areas, providing a significant source of real estate and small business lending. During 2012, Commerce Union Bank was honored by the U. S. Small Business Administration by being selected as the winner of the Financial Services Champions of the Year award for its work with small businesses in the community.

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We believe that community banks are key components in supporting economic growth and development in our communities. Despite the adverse economic conditions that we have endured since the advent of the financial crisis of 2008, we and most other community banks have continued to pursue our mission of supporting the businesses and consumers of our market areas. However, we are very concerned about some of the proposals that have resulted from the Basel III accord. We believe that if they are implemented as currently written, they will have far reaching effects upon financial institutions which will result in a significant reduction in our ability to service the needs of our customers and our communities. Based upon our analysis of the proposals, we have five specific areas of concern which are discussed below.

1. Requiring Unrealized Gains and Losses of Available for Sale (AFS) Securities to flow through Common Equity Tier 1 Capital

Historically, community banks have utilized their AFS securities portfolios as an important component in the Asset-Liability (ALCO) management function. These securities have been particularly relevant in the past few years with the reduction in loan demand and the need to generate acceptable earnings levels.

Under the current rules, unrealized gains and losses that are shown in accumulated other comprehensive income (AOCI) are excluded from the calculation of regulatory capital. We believe that this practice accurately discloses the unrealized nature of "paper gains and losses" and that it is fully consistent with generally acceptable accounting practices (GAAP).

The proposed changes to the rules will have a significant impact upon our flexibility to utilize our securities portfolio as a key component of our ALCO strategies. There are several problems that we believe will arise if unrealized gains and losses are included within our regulatory capital calculations. First, we will likely have to shrink our securities portfolio (currently $ 35.4 million) significantly as interest rates begin to rise. Although we currently have significant unrealized gains in our portfolio ($ 1.3 million) which would benefit us in the short term, these gains will be eradicated as rates begin to rise. Second, we will also have to alter the composition of our portfolio to be more biased toward shorter term investments in order to provide some protection from price volatility. Finally, we will likely have to hold additional capital in reserve to compensate for any increased market volatility. Each of these strategies will have profoundly negative impacts upon our earnings.

Larger financial institutions will be able to mitigate the impact of these changes through hedges or other forms of derivative strategies that are not available to most community banks. We believe that this disparity will create an unfair economic advantage for larger banks at the expense of community institutions. This situation will result in a significant reduction in the ability of community banks to compete in their market areas.

Commerce Union Bank Requests...

We ask that the proposed rules be revised to continue to exclude unrealized gains and losses that reside in AOCI from the calculation of regulatory capital. Alternatively, if this rule continues to move forward, we ask that it be modified to exclude unrealized gains and losses from securities which have little to no credit risk (e.g. U.S. government issues, GSE issues, etc.).

2. Changing the Standardized Risk Weights for Assets – Category 2 Nontraditional Mortgage products

The proposal to change the risk weighting of assets, while well intended, will have significant impact upon the types of mortgage products that we will be able to offer as well as potential impact upon our regulatory capital ratios. Currently, like most community financial institutions, we do not make long term (e.g. 30 year) fixed rate mortgages in order to help mitigate our interest rate risk. In lieu of these long term products, we have been successful at providing shorter term mortgage products (e.g. 7 year balloon loans) that have met the needs of our customers and that have contributed significantly to our earnings.

Under the current rules, our non-traditional mortgage products are risk weighted at 50% (1-4 family loans). We believe that this weighting provides an accurate depiction of the relative risk on these products. However, the proposed rule changes will dramatically increase the risk weighting applied to our mortgage products, ranging from 100% to 200% (depending upon the loan to value ratio). Given the number of loans of this type that we have on our books, the new rule will have an adverse impact upon our capital ratios. To mitigate this impact, we will have to consider reducing and/or eliminating this type of mortgage product going forward, resulting in a significant impact upon our earnings as well as our ability to service the needs of our customers. In addition, we may also have to consider offering traditional longer term fixed rate mortgages, which would hinder our ability to mitigate interest rate risk, particularly in a rising rate environment. None of these strategies will have a positive impact upon the currently depressed housing market and they will likely contribute to additional stress upon our local market economies.

Commerce Union Bank Requests…

Per our discussion above, we ask that the proposed rules be revised to eliminate the additional risk weighting for nontraditional mortgage products.

3. Changing the Standardized Risk Weights for Assets – Non-Performing Assets

Under current rules, asset risk weights do not change when loans become delinquent. Instead, this risk is addressed through the bank's Allowance for Loan and Lease Losses (ALLL) provision. We believe that this treatment appropriately discloses the risk of the non-performing loan and that it is directionally consistent with GAAP.

Under the proposed rule changes, all loans (non-residential) that exceed 90 days past due will be risk weighted at 150%. While we currently have few loans that would fall into this category, we are concerned about how this change would impact us should the economy continue to deteriorate. Like most community institutions, we have traditionally gone "above and beyond" to work with troubled debtors in order to help them avoid default upon their loans. However, under the new rules, we would likely consider foreclosure procedures sooner rather than later in order to avoid the adverse impact of the higher risk weighting upon our regulatory capital.

Commerce Union Bank Requests…

Ultimately, we believe that the current process of addressing non-performing loans through ALLL provides adequate disclosure and accounting for risk and potential losses. Accordingly, we ask that the proposed rules be revised to eliminate the additional risk weighting for non-performing assets.

4. Limitation on Allowance for Loan Losses reserves in Common Equity Tier 1 Capital

Under the existing rules, ALLL reserves can only be included in regulatory capital up to 1.25% of risk weighted assets. While this limitation has not been a hindrance in the past, it will prove to be onerous as the risk weightings are increased for bank assets. ALLL provides the first and best defense against capital consuming loan losses. Given its role in capital preservation, excluding most ALLL reserves from the capital calculation makes no economic or accounting sense. Furthermore, this exclusion will force community banks to maintain a higher level of capital than is necessary in order to compensate for the ALLL reserve. This additional capital represents funds that will not go into new loans and/or investments, resulting in adverse impacts upon community banks as well as the markets they serve.

Commerce Union Bank Requests…

We ask that the proposed rules be modified to remove most, if not all, of the limitation on including ALLL within regulatory capital calculations.

5. Implementation Timeline and Impact upon Community Banks

All community banks have struggled to address the onslaught of regulatory changes that have been promulgated over the last several years. Most, if not all, institutions have experienced significant increases in cost in terms of personnel, systems and processes needed to incorporate new rules and regulations (e.g. Dodd Frank requirements). At Commerce Union Bank, we certainly have experienced both personnel and systems increases (additional staffing, new and upgraded systems) which have been directly related to growing compliance requirements.

Given this environment, we believe that there are several issues related to the proposed timeline for implementing the Basel III proposals. First, we feel that the currently proposed timeline is too aggressive for most community financial institutions. Smaller banks who are still reeling from compliance changes over the past few years are ill-equipped to absorb the magnitude of new rules and regulations as proposed under Basel III. In most cases, including ours, implementing the proposed changes will result in an increase in personnel costs due to additional staffing and training needs. These costs will have an adverse effect upon our efficiency ratios as well as our earnings.

Second, we are concerned about the ability of our vendors to accommodate the modification and/or creation of new systems which may be required to monitor and track many of the new requirements (e.g. changes in LTV requirements and risk weighting). At best the new and/or modified systems will be available on time, but at a significant expense to each bank. At worst, the systems will not be available and community institutions will be required to handle the new regulations on a costly manual basis.

Third, we believe that the incorporation of these new regulations do not take into consideration the current stagnant economic environment. Any new interest rate, financial or systemic shocks that might occur during the phase in period of Basel III could have major unintended consequences for community banks, their market areas and the larger national economy.

Finally, we believe that the increase in regulatory capital ratios will severely limit the growth of many community institutions and that it will further deter healthy merger and acquisition activity. These days, most community bankers believe that their institutions must grow into the $750 million to $ 1 billion asset range just to be able to absorb increasing compliance costs and to provide an acceptable shareholder return. By increasing the minimum acceptable capital ratios, even healthy institutions may find it difficult to conduct merger and acquisition activity.

Commerce Union Bank Requests...

Accordingly, we ask that the timelines by reviewed and modified so as to move the final implementation of the Basel III proposals out to a time when the financial system has recovered from the economic upheavals of the past four years.

Sincerely,

W.R. DeB — William R. Murray

William R. DeBerry, President & CEO
Commerce Union Bank

William R. Murray, EVP & CFO
Commerce Union Bank