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October 4, 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

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

The Basel III Capital Proposals were originally conceived and to be applied to only the very largest, systemically important, international financial institutions with very complex balance sheets and with complex financial instruments on their balance sheets. As I review the rules, I believe it will put the very banks it was trying to regulate at a competitive advantage over the community banks that have very "plain vanilla" balance sheets with few, if any, complex financial instruments. I also firmly believe that the rules may serve to hinder credit availability and increase costs to bank customers in rural and underserved markets in which the large banks do not currently have a presence.

My first concern is with the revised definition what qualifies as capital. The inclusion of "Accumulated other comprehensive income" is very troublesome. By doing this, you are valuing only one set of assets on a banks' balance sheet and creating extreme volatility in a banks' capital ratios. Under the proposed capital rules, a banks' capital would naturally fall in a rising rate environment. It ignores the effect of rising rates on the "value" of the liability side of the balance sheet. For example, the value of low cost core deposits increases during that same period. I am not advocating "fair-market-value" accounting standards, but use this as an illustration. Fair value accounting for a community bank with assets that are basically not readily marketable makes fair value accounting rules impossible for a community bank. Interest

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

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rates have fallen to historically low levels that will probably rise rapidly once an economic recovery accelerates. As these interest rates rise, fair values will fall causing the balance of "Accumulated other comprehensive income" to fall dramatically. At my bank, for example, if interest rates increased by only 300 basis points, which would still leave rates at or below historical averages, my bank's bond portfolio would show a paper loss of $22,750,000 versus a gain as of today of $7,450,000. This volatility of rates would reduce my capital by over 25%. My capital would drop from 11.1% to 8.3%. Large financial institutions may have the ability to mitigate the risks of capital volatility by entering into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swaps, options, and futures contracts. Community banks do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry. As we have also seen, even those large banks that do this type of transaction are not immune from actually increasing the risk on their balance sheets by entering into these derivative transactions.

In regards to Allowance for Loan and Lease Losses, the limitation of 1.25% of allowance for loan and lease losses for inclusion in the capital ratios does only one thing. It discourages a bank from having a loan loss reserve greater than 1.25%. Banks that do have an extra capital buffer within their reserve are penalized in the capital calculations. As we have learned in the very recent past, banks should be encouraged, not discouraged, from having adequate loan loss reserves.

Another area of concern is the "Threshold Deductions". In particular, the Mortgage Servicing Assets limitation of 10% to Tier 1 Capital is of great concern. In my opinion, this would deter many small community banks from entering or remaining in the mortgage servicing business. In addition, the excess servicing asset over the 10% Tier 1 Capital limitation would now be subject to holding 2 ½ times (250% risk weighting) more capital. The mortgage servicing business is a very low margin business and is done primarily by community banks in order to provide a better customer service experience than can be found at the large servicers. As we have seen in the current economic downturn, the large servicers have not done a good job of servicing mortgage loans and everything should be done to encourage, not discourage, competition in this marketplace. The current consolidation in the mortgage servicing area is not good for the mortgage business nor is it good for the consumer.

An area of grave concern is the treatment of "Additional Tier 1 Capital" items. Under Section 171(b)(4)(C) of the Dodd-Frank Act, trust preferred securities issued before May 19, 2010 by institutions with less than $15 billion in assets as of December 31, 2009 were specifically grandfathered in as Tier 1 capital throughout the life of the securities. The regulatory bodies that are proposing this rule believe they have the authority to overrule Congressional Law that is signed by the President of the United States. I do not believe that regulatory bodies have the constitutional powers granted to them to override law. In any event, this will serve to hinder our future growth and reduces our Tier 1 Leverage Ratio by 2.73%. Although, we still remain "well capitalized", our future growth would be required to be scaled back which would have the effect of limiting loan growth. The effects of this would be felt greatest in the rural and underserved markets in which we operate. In many cases, we are the only financial institution in the town. I also believe that this would have the effect of increasing costs to the consumer, long term, as banks struggle to raise or increase capital. Community banks already have the most difficult

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time raising capital. I find it ironic that two instruments were ignored in this portion of the proposal: 1) The Small Business Lending Fund and 2) Troubled Asset Relief Program. In both cases, the Trust Preferred Securities are longer term, cheaper, and are much less restrictive than either of these programs. In other words, they truly look like capital when compared to both of these government run programs. This also penalizes those banks that, throughout this economic down-turn, did not turn to the government for assistance.

The implementation of the capital conservation buffers for community banks will be extremely difficult to achieve under the proposal and therefore should not be implemented. Many community banks will need to build additional capital balances to meet the minimum capital requirements with the buffers in place, especially when coupled with the new proposed treatment and volatility of Accumulated Other Comprehensive Income that now is proposed to be included in the new capital calculations. Community Banks, especially smaller, closely held, community banks, such as ours, do not have the ready access to capital that the larger banks have through the capital markets. Typically, the only way for community banks to increase capital is through the accumulation of retained earnings over time. Due to the current low interest rate policies and added regulatory costs that community banks now face, community bank profitability has diminished further hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be a allotted in order for those banks that need the additional capital to retain and accumulate earnings accordingly. I would think that since we are requiring banks to effectively raise their minimum required capital ratios 30% in order to maintain a status of "Well Capitalized", a 10 year phase in period would seem appropriate, with interim stair-steps to the ultimate capital goals of the regulators. Ultimately, these higher capital ratios will cause the price of service to go up for the consumer as banks. In order to compete with the return on equity demanded by investors in bank stocks, banks will need higher earnings generated to satisfy the investors. This will naturally increase costs to the consumer.

The proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks who offer these loan products to their customers and deprive customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates and increase the interest rate risk exposure at community banks. This interest rate exposure risk could duplicate the problems that were seen in many Savings and Loans during the 1980's. Many community banks will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE. Second liens will either become more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages. Many mortgages in our markets are in rural and underserved markets on properties

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that will not qualify for secondary markets. This proposal will serve to reduce credit in these rural and underserved markets as community banks, which are typically the only banks in these markets, curtail their residential lending. In addition, the higher risk weights for delinquent loans only duplicate the purpose of the allowance for loan losses. Banks are already making higher loan loss provisions as delinquencies increase.

Thank you for your time and consideration.

Sincerely:

Jack E. Hopkins

Jack E. Hopkins
President & CEO