Pinnacle

October 5, 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] ("Proposals") 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 (collectively, the "Agencies").

Pinnacle Bank is a $5 billion one-bank holding company headquartered in Nashville, Tennessee. We focus on providing banking services to small and medium-sized businesses, their owner/managers and their employees within the Nashville and Knoxville MSAs. Our primary competitors are the large regional and national franchises which control significant market share in both our markets. Our business mix, culture and strategies are such that we consider ourselves a community bank. Accordingly, we take our obligation to support our local economies very seriously. As a result, my comments regarding the Proposals are from a community bank perspective and are organized along the following topics:

A. Timing of the Proposals
B. Capital Ratio Components
C. Credit Obstacles

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[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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As a community bank, we are not addressing the Advanced Approaches or other matters which appear to be the concern of larger regional and national franchises. Additionally, we are not commenting on several other matters, such as mortgage servicing rights, as we are not engaged in those business lines. Again, thank you for your consideration of our comments.

Timing of the Proposals

It is difficult to understand that on the heels of the most difficult recessionary period in the last 75 years, the most significant bank capital regulations in the last 25 years would be proposed which will further restrict credit to home owners and real estate investors. The Proposals will likely negatively impact job growth during a recovery period that is proving to be a very anemic. Additionally, the fiscal headwinds that our nation faces provide further support that our recovery is uncertain and could be derailed very easily. To impose new bank capital regulations, the scope and breadth of the Proposals, seems ill-advised as such regulations will only exacerbate the current issues facing our nation.

Secondly, Dodd-Frank was only recently implemented and community bankers continue to be concerned about the progress of those regulations and how the yet-to-be-determined regulations will impact our businesses. Additionally, we understand the new liquidity regulations to be issued relatively quickly are not yet known as to the impact on community banks and how those guidelines will impact credit availability in our markets. Also and as you are aware, the CFPB is in its infancy and what new regulations it imposes as it grows and finds its footing are not yet known. It would seem plausible that these matters need to be better known before implementing new capital regulations with the significance of the Proposals.

Several of the items within the Proposals have implementation dates as early as January 2013. This is a very quick requirement given the criticality of the Proposals. We would support deferment at a minimum so that the appropriate studies can be conducted concerning the impact the Proposals will have on credit availability in our markets.

Capital Ratio Components

It appears the Agencies may be sympathetic to most community banks' concerns regarding the inclusion of AOCI in the regulatory capital calculations. We, too, believe that inclusion of AOCI in the risk-based capital calculations will not produce the desired result the Agencies are seeking and add increased volatility to community bank capital ratios at a time when Fed funds rates are at all time lows and the uncertainty regarding how other rates, particularly those that are defined by market forces, will respond over the next few years. I reference the recent issues regarding LIBOR manipulation as an example of the uncertainty in market rates and how such matters will increase the volatility of our capital ratios. Like most community bank bond portfolios, our portfolio is largely MBS pass thru's and municipal securities. Most community banks acquire an investment securities portfolio for on-balance sheet liquidity as well as for managing interest rate risk exposure. However, as you know, in the community bank arena, we also utilize our investment security portfolio to collateralize municipal deposits. For our bank, most of our municipal deposits are general operating accounts from the various cities and counties in our MSAs. By including AOCI in the RBC calculation, the Agencies are adding an increased capital risk component to the pricing and desirability of these deposits. Theoretically, at a minimum, this will increase the cost of these municipal deposits thus reducing the deposit rates we pay to the municipality and, eventually, could mean community bankers debating whether to pursue these deposits at all.

Community bankers were relieved when Dodd-Frank apparently grandfathered trust preferred securities as Tier 1 capital only to be frustrated that the Proposals have determined that TPS are no longer an appropriate Tier 1 capital element. Obviously, we disagree. I appreciate that the pooled TPS programs have been a thorn in the side of regulators who have attempted to unwind failed bank capital structures. However, the pooled TPS program provided a 30-year unsecured preferred capital alternative to the community bank segment which ultimately supported billions of dollars in capital that was levered to provide credit to community bank markets across the country. We all realize that in some cases, TPS was inappropriately levered and provided for increased construction or other lending which suffered during the recession. My belief is that for the most part, TPS was prudently managed by our nation's community bankers and appropriately used to provide needed capital to community banks across this country. As you know, by and large, the community bank segment does not have access to the broader capital markets compared to our larger financial institution competitors who may access the global capital markets on a daily basis. TPS was a suitable alternative as it provided capital when in many community bank markets capital would have been very difficult to obtain – not because the community bank did not deserve the capital but because the local community did not have the capacity to provide it.

The current rules regarding inclusion or exclusion of deferred tax assets in RBC calculations are unnecessarily complex. The Proposals, as I understand them, only make the situation worse. I appreciate that an NOL carry forward component within the DTA may be subject to some criticism. For many community banks like ours, the DTA has been subject to review by an independent audit firm in rendering an opinion on our financial statements. As you know, a deferred tax asset represents a future receivable from the government. If you don't believe the DTA is realizable; the accounting rules are clear, a valuation reserve should be established. Otherwise, why would a receivable from the US government be a deduction from Tier 1 capital? Obviously, by reducing the denominator it only serves to reduce our ability to leverage the amount for lending in our communities. Most DTAs are recorded only after a full expense charge has been incurred by the bank, thus capital has been previously negatively impacted by the event which gave rise to the creation of the DTA.

As to the Capital Conservation Buffer, it seems that the current rules regarding Prompt Corrective Action are adequate and are only modestly less than the CCB ratios. The Agencies currently have the ability to impose capital distribution and other restrictions on their banks as they see fit. I would propose that the CCB be eliminated from the Proposals and the PCA restrictions remain the capital objectives for substantially all banks. Again, the Agencies have the discretionary authority to impose capital distribution restrictions currently.

Credit Obstacles

Most of the 1-4 mortgage loans we issue to our borrowers are first lien with 5-7 year maturities at an adjustable rate of interest with a 15-30 year amortization schedule. My understanding that such loans would be Category 2 loans given we expect a balloon payment or refinancing at maturity. Many of our borrowers are professionals, commission-based sales people, doctors, entertainers, etc. These borrowers' financial affairs do not readily qualify them for the secondary market or they do not want the inconvenience of a rigid verification process. Many of our 1-4 residential mortgages are typically more than the GSE maximum loan limits thus would be categorized as a non-conforming or jumbo mortgage. Our experience has been that the non-conforming / jumbo market has been less liquid with a very limited appetite from secondary market investors. We also secure 1-4 family mortgages as part of a larger credit package for some of our business borrowers. In other words, for many of our commercial loans, we also collateralize the borrower's home as part of the credit package. Our thoughts are that for so long as the mortgage represents the primary residence of the borrower and is less than 80% LTV then the 50% risk weighting is appropriate regardless of the term or structure of the mortgage. Additionally, and in some cases, it appears a better underwriting practice to offer a shorter-term instrument with an appropriate amortization period, thus requiring the borrower to renew the loan at more frequent intervals.

The pricing for most 1-4 family residential mortgage products is very advantageous as mortgage rates remain at historical lows; however, the rigors of the underwriting/compliance processes due to Dodd/Frank have made originating a mortgage loan very difficult thus limiting the supply of credit to home mortgage borrowers. My understanding is that many community banks are currently contemplating exiting the 1-4 family residential mortgage loan market (i.e., on balance sheet mortgages) due to these factors. Additionally, one of the apparent goals of our government is to develop a robust private mortgage loan market so that there is less dependency on FNMA and FHLMC. However, the secondary mortgage origination market has now been condensed into a handful of the nation's largest and most powerful banks that control the pricing models and origination pipelines for the mortgage market. The appetite of these large banks to acquire community bank-originated mortgage loans can be extremely volatile as their resources are diverted to resolving issues that arose during the recent housing crisis. These facts do not bode well for our bank or the nation's community banks. Consequently, the additional burden of increased capital constraints related to 1-4 family residential lending will only require us to reconsider our strategy for this product.

We agree with the Agencies that over the last several years, the HELOC product has been manipulated by some institutions in order to facilitate down payments for new homes and for other purposes. However, we believe combining the 2nd mortgage HELOC with the first lien mortgage for risk weighting is problematic for many reasons. Costly systems will have to be constructed that are able to match precise collateral definitions, thus requiring significant extra effort on the part of our loan operations support units. Also, the HELOC product itself for many loans is the least expensive way to facilitate borrowers who from time to time request funds for various purchases such as a new car, home improvement project, vacation, adoption, etc. Given the Proposal's risk weighting penalties for HELOCs, banks could resort to unsecured consumer credit rather than risk inappropriately risk weighting a HELOC.

The imposition of a High Volatility Commercial Real Estate category is also problematic. Again, systems will have to be created, IT consultants will need to be engaged and thus costs will increase. Additionally, non-banks have exerted an increasing presence in the CRE market. In prior years, insurance companies and REITs restricted their investments to the trophy projects such as malls, multi-story office complexes, convention centers, etc. Today, these non-banks are investing in much smaller projects, including owner-occupied small and middle-market business buildings at rates with extended terms which are difficult to understand much less, match. We have seen similar pricing proposals from several of the larger regional financial institutions as well. For most community banks, this is an asset class that we specialize in servicing. We agree with the Agencies' position that an increased LTV and lack of equity on the part of the borrower represents increased risk. However, such attributes are considered in the monthly/quarterly ALLL assessment and, as such, the loan has been appropriately risk graded, including classification as an NPL or TDR. We believe the governing principle as to the riskiness of these types of credit is whether the cash flows based on rent rolls and/or the business activity of the underlying enterprise are adequate to support the loan. To add excess capital constraints to these credits will further limit our competitiveness for a very significant asset class and/or likely force many community banks to exit this line of business altogether.

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We are all keenly aware of the economic issues facing our nation. Please understand that many of the problems that became abundantly clear during the recent recession were not the work of our nation's community bankers. Our belief is that over-zealous mortgage banking firms designed exotic products that could neither be understood or afforded by their target markets and then partnered with Wall Street to overheat our nation's housing industry. However, it appears that the Agencies have drafted a "one size fits all" solution via the Proposals and have, in essence, deemed the community banks a meaningful contributor to the problems incurred. The impact the Proposals will have on community banks and our bank, specifically, will be significant and make us less competitive to the larger regional banks and other non-bank competitors.

When I speak to your regulators in the field, they mention the few community banks that went overboard on non-core funding and investment in construction lending. Our bank has a noncore funding dependency ratio of 11.4% at June 30, 2012 and a core funding ratio of 71% both slightly better than our peer banks (pursuant to the most recent UBPR). We believe the regulators attention to the perils of concentration risk are well founded and should be the regulatory focus to help prevent future credit crises, not the blanket installation of new capital regulations.

Lastly, we believe that community banks are an essential component to the ongoing prosperity of our nation, particularly with respect to the growth of small and medium-sized businesses. We trust you agree. We believe this is especially true for those small businesses that don't fit the "square peg" philosophy of the larger institutions and non-banks that continue to find their way into our markets. We are proud to be a community bank and believe we play a meaningful role in supplying credit prudently to our markets.

Thank you for allowing me the opportunity to comment on the Proposals.

Very truly yours,

Harold R. Carpenter
EVP & Chief Financial Officer

cc: Commissioner Greg Gonzales, Tennessee Dept. of Financial Institutions
Board of Directors - Pinnacle Bank