

October 15, 2012

Honorable Thomas J. Curry, Comptroller  
Office of the Comptroller of the Currency  
regs.comments@occ.treas.gov  
Docket ID OCC-2012-0008, -0009 & -0010

The Honorable Ben S. Bernanke, Chairman  
Board of Governors of the Federal Reserve System  
regs.comments@federalreserve.gov  
Docket No. 1442

The Honorable Martin J. Gruenberg, Acting Chairman  
Federal Deposit Insurance Corporation  
comments@FDIC.gov  
RIN 3064-AD95, -AD96 & -AD97

**Re: *Regulatory Capital Rules:***

***Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action***

***Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements***

Dear Sirs:

Thank you for the opportunity to comment on the joint notices of proposed rulemaking (“NPRs”) referenced above and intended to implement agreements reached by the Basel Committee on Banking Supervision in *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, December 2010 (“Basel III Accord”), consistent with provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).

I serve as a member of the board of directors of New Century Bank, a wholly owned subsidiary of New Century Bancorp, Inc. New Century is a community bank with seven offices in eastern North Carolina and approximately \$580 million in total assets.

### ***Costs of Compliance***

As you are well aware, Basel III is an international framework intended for systemically important institutions that compete on a global scale. Its forced application to the community bank sector will result in disproportionate costs of compliance for smaller institutions. The issue

is not simply one of increased cost of compliance, but whether the typical community bank has the management resources and time to comply with the 700 pages of new regulations in the NPR at all. Most community banks lack the management resources and systems to comply.

Institutions with less than \$5 billion in total assets should be exempted from the proposed regulations.

### *Available for Sale Securities Portfolio*

The Basel III NPR proposes to reflect unrealized gains and losses on available for sale ("AFS") securities in regulatory capital. This approach would be better if unrealized losses on AFS were always due purely to the credit rating of the issuer, but the value of AFS are also impacted to a large degree by interest rates. This proposed capital recognition would, therefore, be impacted to a large degree by temporary impairments resulting from fluctuations in market interest rates.

Given the current historically low interest rate environment, it is fair to assume that rates will rise significantly at some point in the future. When this occurs, virtually every bank in the county will experience a reduction in regulatory capital that is not truly linked to their respective risk profiles. Most community banks in this position would be forced to shrink their balance sheets just at the time that economic recovery is hitting its full stride or increase their capital levels to cover unrealized losses that would never be recognized if those securities were held to their maturity.

One obvious solution to the capital volatility problem that would be created by this new rule would be to reclassify the securities portfolio as held to maturity. This would address the problem of capital volatility; however, it would also severely curtail the utility of the securities portfolio as a tool to manage interest rate risk. Ultimately, this too would have an adverse effect on safety and soundness.

We suggest a carve out from the proposed rule that exempts unrealized gains and losses that predominately result from changes in interest rate risk. The Agencies should also consider filtering unrealized gains and losses for securities that do not have a credit risk, namely securities that come within the definition of "Type I Securities" under 12 CFR Part 1.2(j).

### *Risk Weightings*

The NPR would require the collection and reporting of information on numerous asset categories and the assignment of updated, ongoing risk weightings in real time. The increased capital levels that the proposed risk weightings require, not to mention the added cost and burden of compliance with these provisions, will only make it harder for community banks to compete.

If financial institutions are adequately addressing the risk for delinquent loans through allowance for loan and lease losses, then adding a risk weight of 150% should not be necessary. We suggest that this provision be revised to require financial institutions to adequately address this risk through allowances for loan and lease losses, and not by increasing the risk weight of

delinquent loans. This provision, as proposed in the NPR, amounts to a credit sensitive, after the fact penalty. The better, and more transparent, approach would be to adequately address troubled credits through reserve loss settings.

### *Home Equity Lending*

The NPRs would require that all junior liens secured by 1-to-4 family residential real estate be classified as Category 2 exposures with risk weights ranging from 100% to 200%. In addition, a bank that holds two or more mortgages on the same property would be required to treat all the mortgages on the property as Category 2 exposures, even a first lien mortgage.

While there is a proposed exception if (i) a bank holds both the first and junior lien on the same property; (ii) no party holds an intervening lien; and (iii) the combined exposure meets all requirements of a Category 1 mortgage, we suggest a broader exception that would apply where a bank holds two or more mortgages on the same property and the first lien is a Category 1 exposure.

### *Mortgage Servicing*

Under the NPR, mortgage servicing assets in excess of 10% of common equity tier 1 will no longer be counted at Tier 1 capital. Further, financial institutions would be required to hold capital against assets with credit enhancing representations and warranties, including mortgages in the process of being securitized. This will clearly have an adverse effect not only on community banks, but also on the availability of residential mortgage loans to consumers. It will likely also push the origination of mortgage products out into under-regulated origination channels where consumers are less protected.

Existing mortgage servicing assets should be grandfathered and the Agencies should allow banks to include 100% of the fair market value of readily marketable mortgage servicing assets to reduce the impact of the proposed rule. In addition, there should be no deduction from capital for mortgage servicing rights.

### *Trust Preferred Securities*

The Dodd-Frank Act explicitly preserves the capital treatment for outstanding trust preferred securities issued by smaller bank holding companies like New Century. The phase out proposed in the NPR appears very clearly to be contradictory to Congressional intent in the Dodd-Frank Act, which clearly states that bank holding companies with assets of less than \$15 billion as of December 31, 2009 will be permitted to continue to include trust preferred securities that were issued before May 19, 2010 as Tier 1 capital.

The proposed phase-out would have a disproportionately adverse, if not punitive, effect on our community bank and hundreds others like it, because smaller institutions simply do not have the access to the capital markets that regional, super-regional and global institutions enjoy. Most community banks will struggle to replace this capital due to their small market capitalization levels.

Furthermore, since these securities are already outstanding (in New Century's case, issued nearly six years before the Dodd-Frank Act was enacted by Congress), it is unclear what supervisory purpose the disqualification of qualifying capital that is on the balance sheet and available to absorb losses could possibly serve.

This element of the NPR should be removed.

### *Capital Conservation Buffer*

The NPRs would require a bank to maintain a "capital conservation buffer" of additional common equity Tier 1 capital equal to 2.5% of risk weighted assets in order to avoid restrictions, or outright prohibitions, on capital distributions and discretionary bonus payments to executive officers.

This provision will cripple the ability of community banks to compete with larger market competitors by making it more difficult to recruit and retain personnel. It will also adversely affect the return on equity (ROE) of banks, which will in turn make it even more difficult for community banks to attract investors and access the capital markets.

There are already regulatory provisions in place that restrict the payment of dividends, the repurchase of securities, and the payment of bonuses under prompt corrective action and the Agencies already have a full complement of regulatory tools at their disposal to regulate distributions and bonuses when needed, ranging from board resolutions, memoranda of understanding, written agreements, consent orders and orders to cease and desist.

If a financial institution is "well capitalized" under applicable regulatory standards, then it should not be required to hold additional capital in order to pay dividends or bonuses. Excessive risk taking within multinational investment banks may have been a major contributing factor leading to the financial crisis, but excessive risk taking and excessive compensation within community banks was not. While all can agree that the financial services industry is, and should be, highly regulated, it is also still a for-profit business. Banks should not have to apologize if they play by the rules and realize a profit and they should not be required to hold additional capital in order to distribute a portion of that profit to investors and employees.

The proposed "capital conservation buffer" should be not be included in the final rules.

### *Conclusion*

The application of the proposed rules described in this letter would severely undermine the ability of our community bank to compete with larger competitors. Basel III was intended to provide a framework for institutions that compete internationally. Our bank and hundreds just like us compete in small communities and do not have the same risk profiles and access to capital as these large institutions. We should not be subject to identical standards.

We believe that this proposed regulation threatens the continued viability of community banks in the United States. If the intent of this regulation is to drive consolidation and eliminate small banks from the competitive landscape, it will have its intended effect. If, however, the Agencies are interested in the continued ability of community banks to provide financial products and services to consumers and small businesses, many of whom are underbanked by regional, super-regional, and global institutions, then we urge the Agencies to revise the NPRs, if not abandon them altogether.

Thank you for your time and attention. New Century Bank appreciates the opportunity to provide these comments for your consideration.

Sincerely,

A handwritten signature in blue ink, appearing to read "D. Ralph Huff", with a long horizontal flourish extending to the right.

D Ralph Huff  
Director

New Century Bank and New Century Bancorp