

September 17, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals¹ 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”).

First Community Bank, locally owned and managed, opened on August 4, 1997 in Batesville, Arkansas and currently operates 15 full service branches in Arkansas and Missouri, a commercial lending facility in the greater St. Louis, Missouri area, and a standalone mortgage origination office in Craighead County, Arkansas. First Community Bank employs 230 professional bankers and now reports assets of more than \$775 million.

Our passion is community banking. We are truly invested in our customers and the communities we serve. Making decisions in the best interests of our community is ingrained in the way we conduct business every day.

First Community Bank is truly a community bank. Our slogan says it best...First Community Bank, where community comes first. That's our promise to the communities we serve.

The first concern regards the proposed rules for the risk-weighted of residential mortgage exposures under the standardized approach. Calculating the loan to value ratio on all existing residential mortgage loans and the on-going burden associated with the refinancing, modifications, junior lien loans, etc. will result in increased costs on the bank. It is possible that the bank will have to hire a new staff member in the credit department who part of if not all of their responsibilities would be tied to the maintenance of our loan-to-value measures on our residential mortgages.

Secondly, our bank has numerous loans that result in balloon payments instead of exposing the bank to the increased interest rate risk associated with longer term notes or choosing more adjustable rate loans. Thus preventing them from being classified as category 1 and increasing the banks risk-weighted assets being in category 2. With our underwriting standards and due diligence meeting or exceeding all other characteristics of a category 1 exposure and our loss

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.*

history on these balloon payment loans, we feel the increased risk-weighting for these exposures is excessive.

In looking at how the risk weights differ between category 1 and category 2 exposures and amongst the loan-to-value brackets, why aren't all category 2 exposures risk weighted at the same multiplier compared to their corresponding category 1 exposure. The main factor for the increase in risk weight should be the likelihood of default of the borrower. I would argue that the likelihood of default for a category 2 exposure would not be 2 times greater than a category 1 exposure. Additionally, how come for the less than 60% LTV range would the multiplier be greater than 2 (35% to 100%)? If anything, the riskiness would increase less between a category 1 and a category 2 residential mortgage with such a low LTV because in the event of default the potential for an actual loss would be much less.

Lastly and most importantly, our concern lies with including the unrealized gains or losses on all AFS securities in common equity tier 1 capital. The only unrealized gains or losses that should have an impact on capital levels are those unrealized losses due to credit impairment, not those related to interest rate fluctuations. The effect of the interest rate movements should be mitigated through proper asset/liability management. At our bank, the interest rate volatility affecting the market values of our longer term securities is offset by a large amount of fixed rate long-term FHLB advances. In a rising rate environment, these advances will go up in value offsetting the unrealized losses in our portfolio. However, we don't get to mark the FHLB gain to capital. However, if the Agencies are set on requiring unrealized gains and losses to flow through capital, the unrealized gains and losses on securities that do not have credit risk should be excluded from flowing through to capital. These would include low risk securities such as U.S. government and agency debt obligations and U.S. GSE debt obligations. Otherwise it might force our bank to maintain ratios of both CET1 to risk-weighted assets and Tier 1 capital to risk-weighted assets well above the levels that would otherwise be held by our bank to manage the substantial volatility in capital.