

# FIRST FINANCIAL HOLDINGS, INC.

October 22, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve  
System  
20th Street and Constitution Avenue, N.W.  
Washington, D.C. 20551  
Via email: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)  
RE: *Docket No. 1442*

Office of the Comptroller of the Currency  
250 E Street, SW  
Mail Stop 2-3  
Washington, DC 20219  
Via email: [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)  
RE: *Docket ID OCC-2012-0008, -0009, -0010*

Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street, N.W.  
Washington, D.C. 20429  
Via email: [comments@FDIC.gov](mailto:comments@FDIC.gov)  
RE: *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

Advanced Approaches Risk-Based Capital Rules; Market Risk Capital Rule

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III Notices of Proposed Rulemaking approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation in June 2012 related to regulatory capital rules.

First Financial Holdings, Inc. (First Financial) is a bank holding company and the parent of First Federal Bank (First Federal), a \$3.2 billion financial institution. Formed in 1934, First Federal, the largest financial institution headquartered in Charleston, South Carolina and the third largest headquartered in South Carolina, has a 78 year history of providing mortgages and integrated financial solutions including personal, business and wealth management services. In February 2012, we changed our charter from a savings and loan association to South Carolina state-chartered commercial bank and became a member of the Federal Reserve.

First Financial is supportive of ensuring that capital for banks in our country is more than sufficient and of good quality to absorb losses and safeguard the financial institution sector. In general, we are not opposed to increasing minimum capital requirements and have historically maintained our capital levels in excess of regulatory minimum requirements. We have reviewed the proposals and their implications, not only to our institution, but also to our community and our entire industry and we are extremely concerned about the unintended consequences which will result in limiting growth and restricting credit or making credit more costly for consumers and small business. We believe this will ultimately have a negative impact on the economic recovery in our markets as well as the country.

Our comments are focused on what we consider the most critical items of the proposals, and those which have the most significant impact on First Federal and the communities we serve, including:

1. Available for Sale Inclusion in Tier 1 Common Equity calculations
2. Treatment of Cash Flow Hedges
3. Trust Preferred Capital Treatment
4. Impact on the Residential Mortgage Market
5. Simplified Supervisory Formula Approach
6. Capital Conservation Buffer
7. Proposed Transition Period

#### Available for Sale (AFS) Inclusion in Tier 1 Common Equity (CET1)

According to the proposal, unrealized gains and losses on all AFS securities would flow through to CET1. This would include those unrealized gains and losses related to debt securities, the valuation of which would primarily change as a result of fluctuations in a benchmark interest rate, as opposed to changes in credit risk. Undoubtedly, this requirement will add a significant amount of volatility to capital ratios. First Federal has an AFS investment portfolio in excess of \$230 million with an unrealized loss of approximately \$5 million, the inclusion of which would have an immediate impact of lowering First Federal's Tier 1 leverage capital ratio by 9 basis points and total risk-based capital by 12 basis points. In a rising rate environment of up 300 basis points, which is not unreasonable given the current extremely low rate environment, our unrealized loss would increase to \$17 million. The impact to total capital would be a 45 basis point decline simply based on interest rate movement, not realized losses or increased risk in the portfolio.

Negative consequences are likely to result from this proposal which could lead to flawed, uneconomic and even unsafe decisions regarding an institution's asset-liability management and investment options, including the following:

1. Inclusion of unrealized gains/losses on the AFS portfolio included in equity as "other comprehensive income" (OCI) in the standardized regulatory capital ratios would

require us to calculate alternative ratios to determine an effective capital position, exclusive of OCI. Our country is in an unprecedented period of low interest rates, thus many banks have significant unrealized gains in their portfolios which would bolster capital ratios if included as proposed. This impact would most certainly be discounted to reflect the potential volatility that might exist in a rates-up environment. The potential for market depreciation counting against capital when rates rise in a potentially improving economy is great given the current low rate. This would be counterproductive as banks would be required to hold more capital given the shift in OCI that reflects a potentially temporary adjustment, rather than lending, growing and contributing to the expansion of an improving economy.

2. To avoid fluctuations in OCI and thus in capital, First Federal and other banks may be driven to hold more securities in the held-to-maturity (HTM) category. This would greatly reduce our ability to properly adjust the portfolio for liquidity and funds management purposes. Additionally, when different institutions place identical securities in AFS or HTM, it creates differing capital treatments even though the relative risks involving the securities are the same
3. To avoid capital ratio volatility, banks such as ours may make shorter-term investment decisions that reduce volatility and increase liquidity. This may help to reduce market risk, but it also could reduce the ability of the investment portfolio to produce income and generate capital appreciation. As a result, banks would be forced to pursue other options to generate yield, which could include diverting investment to other asset classes, with higher levels of credit risk and/or greater levels of unrecorded market volatility.

Finally, we would argue that inclusion of the AFS adjustment within capital is unnecessary. Given the GAAP requirements relating to other than temporary impairment (OTTI), the capital position should reflect investments in which the initial investment is not expected to be recovered by way of the permanent impairment recognition process. Apart from that, any residual unrealized gains and losses are transitory by nature. With the passage of time, these instruments will return par given the intent and ability to hold to recovery.

We request that this portion of the proposal be completely eliminated and that OCI continue to be excluded from regulatory capital. Absent this amendment, First Federal and other community banks may be forced to reduce the size of our balance sheet to offset the capital penalty as the economy begins to improve, simply because interest rates begin to rise. This could serve to undermine an economic recovery as banks reduce lending and concentrate on pulling back to maintain capital ratios for no other reason than volatility created by interest rate movements impacting the AFS investments. Our small business and consumer customer would thus be directly and negatively impacted.

#### Treatment of Cash Flow Hedges

Under the proposal, First Federal and other banks would be required to deduct any unrealized gain and add any unrealized loss on cash flow hedges included in OCI to CET1 which relate to the hedging of items that are not recognized at fair value on the balance sheet. This proposed deduction would have a particularly negative impact in light of the proposed adjustments that require unrealized gains and losses on AFS securities to flow through capital, and would negatively impact a proven and reliable tool that banks such as ours have used for years to manage interest rate risk in a safe and sound manner. Specifically, we have used cash flow hedges for fixing or capping floating rate loans or short-term debt and to hedge short-duration liabilities on our balance sheets. The result of the proposed deduction would lead us to not utilize these effective hedges for our interest rate risk management. These hedges are often designed to provide protection to tangible equity from the negative impact of higher rates on the AFS investment portfolio.

We believe that the type of cash flow hedges which are potentially subject to deduction present little or no economic risk to the bank. Deducting this cash flow hedge revenue would remove one of the most easily implemented ways for banks to protect CET1 from interest rate related losses on the AFS portfolio. The rule as proposed will lead to less use of cash flow hedges and ultimately more interest rate risk in the banking system. We request that this proposed deduction be eliminated from the NPR.

#### Trust Preferred Capital Treatment

Despite the clear exemption within the Collins Amendment for institutions under \$15 billion in total assets, this proposal requires such institutions (with the exception of bank holding companies under \$500 million, to deduct trust preferred instruments from Tier 1 capital based on a phase out schedule.

For a number of community banks, trust preferreds have served as an important source of capital, as we generally have much more limited sources of and access to capital than the larger banks do. Thus, this provision is an additional burden for community banks and inconsistent with Dodd-Frank. Furthermore, despite the grandfathering instruments issued under the Treasury's CPP or SBLF program in the proposal's framework, the contractual terms of these capital instruments requires a fairly significant elevation in the coupon. The effects of both the increased coupon on CPP or SBLF instruments, and the possible exclusion of trust preferred instruments from Tier 1 capital has severe consequences. These two timelines overlapping combine for a large capital need over the foreseeable horizon in a portion of the industry that has limited access to the capital markets.

We currently hold \$45 million of trust preferreds which are at a fixed rate and currently represents a cost-effective source of capital. If the trust preferreds could be refinanced, it would likely be at significantly higher cost. The proposed change will decrease First Financial's capital ratio in excess of 200 basis points. We also hold \$65 million in CPP preferred stock with an increase in coupon effective in February 2014 if these securities are not redeemed. The effect of the higher coupon will be dilution to our EPS, and thus to our capital of \$0.11 per share annually.

The elimination of our trust preferreds from capital and the higher cost of our CPP preferred stock may force us to shrink our balance sheet and reduce our ability to lend in our communities. This consequence for all community banks with trust preferreds will have a profound impact on small business and consumer lending, thus restricting any economic recovery.

Consequently, we request that the proposed rule be revised to remain consistent with the intent of the Collins Amendment and allow for grandfathering of existing trust preferred instruments for institutions under \$15 billion in total assets.

### Impact on Residential Mortgage Market

As a 78-year old former thrift institution, our history in the mortgage market is long and significant. Mortgage banking is a primary business for First Federal. We originate between \$500 million and \$1.5 billion in conforming and nonconforming mortgages annually, and sell between 60% and 80% of originations in the secondary markets. First Federal holds nearly \$1 billion of mortgage loans in our portfolio. In addition, the Bank services a total of \$2.3 billion of mortgages which we have originated for our customers and either held in the portfolio or sold in the secondary market. As such we are well qualified to comment on the numerous implications to mortgage lending in the capital proposals which we believe will have dire consequences on our institution and on this sector of our industry.

The residential mortgage market has been very slow to recover from the economic downturn which began in 2007. Clearly, the health of this sector of the economy will be important to sustain a broad economic recovery, yet there are several Basel III requirements and at least one Dodd-Frank requirement that have the potential to retard the recovery in the residential mortgage market, namely:

- the increase in risk weighting associated with mortgages with higher LTVs or loans that qualify as Category 2 loans,
- the add-back of mortgage loans sold to the U.S. agencies with certain “credit enhancing” representations and warranties,
- the deduction of investment in mortgage servicing rights (MSRs) above threshold levels, and
- the Dodd-Frank requirement of a 5% retained interest in the securitization of non-qualified mortgage assets.

We fully support bolstering the safety and soundness of the national mortgage market, and recognize that there may be some merit in the individual requirements proposed. However, taken together the factors will have a tangible impact on First Federal’s product structure, product pricing and ability to lend. In addition, these factors could materially impair the entire industry’s business model for creating residential mortgage credit in our country, resulting in increased cost to the consumer and/or limited access to funding.

*Increase in Risk Weighting –*

The proposals currently create a set of criteria differentiating between Category 1 and 2 loans (with their respective LTV risk weight buckets). There are two rather impactful and perhaps unintended consequences of the definition as written. The first item relates to the following defined characteristic of a Category 1 loan:

- “The terms of the mortgage loan provide for regular periodic payments that do not:
- a. Result in an increase of the principal balance
  - b. Allow the borrower to defer repayment of principal of the residential mortgage exposure
  - c. Result in a balloon payment”

This last item is particularly troublesome as many of our residential mortgages, as with other community banks, have been originated with balloon payment features. We are able to better manage our credit risk and interest rate risk by using balloon features. Further, our mortgage loans would pass the criteria in a. and b. above. We question the applicability, in isolation, of the “balloon payment” clause. It seems that the intent of this paragraph is to apply a more capital intensive charge to loans commonly referred to as option loans (e.g., Option ARMs). Option ARMs exhibit most frequently all three of the characteristics cited above (or at least two of the three). Commonplace within the industry, residential loans exist that only exhibit the balloon payment portion and which are otherwise underwritten with standard loan terms. We would argue that the default/loss profile of these loans has been much lower over the crisis than the loans (e.g., Option ARMs) that appear to be the intent of this section. As such, we ask that the criteria for Category 1 loans be redefined to exclude loans that “result in a balloon payment.”

We are concerned that under the proposed methodology, a single loan criterion could trigger an unnecessary Category 2 characterization even though the overall credit profile is clearly very high quality and worthy of Category 1 risk weighting. This single factor vs. basket approach to the characterization of Category 1 or Category 2 loans may result in many unintended consequences. For example, a high LTV loan in which the borrower has a very low debt-to-income ratio and/or a high net worth would be evaluated as a Category 2 loan with a much higher risk weighting. Alternatively, a very low LTV loan in which the borrower has a higher debt to income ratio would not be similarly disadvantaged. While there is no doubt that excesses in the residential mortgage market contributed to the financial downturn in 2007, a risk-weighting framework that is single-factor focused without regard to the overall profile will likely contribute to the delay in the recovery of our residential mortgage market.

An additional concern within the residential mortgage loan proposals relates to periodic and lifetime caps. According to the NPR, a residential mortgage loan would qualify as a Category 1 loan if:

- “The terms of the residential mortgage loan allow the annual rate of interest to increase no more than two percentage points in any twelve month period and no more than six percentage points over the life of the loan.”

Practically applying this definition within the HELOC market, as most all of the existing HELOC contracts were not written with either periodic or lifetime caps, results in an overwhelmingly immediate classification into the Category 2 bucket. If this immediate punitive treatment of HELOC portfolios is not the intention of the rule, we ask for an exemption of HELOCs. Most HELOC loans originated by First Federal and other community banks are tied to the prime or LIBOR rate index and float with movements of that index. We believe that these loans can be structured and underwritten to the criteria intended in the proposals for them to qualify as a Category 1 loan, and thus the periodic/lifetime caps criteria should be eliminated as drafted for HELOCs. However, if the agencies' conclusion is to leave this portion of the proposal unchanged, we ask for existing loans to be grandfathered and classified into Category 1 or 2, subject to the remaining components of the definitions (excluding this particular stipulation). Once again, this will allow for the industry to adjust structure or pricing effectively in light of the higher capital requirement.

With regard to the proposal to increase risk weights on delinquent loans, we have already set aside reserves for loans that fall into a past due status of the severity in the proposal. We are concerned that by increasing the amount of capital we hold based on past due status, we are being required to set aside capital twice for the same risk. The risk related to potential problem loans should continue to be managed through the loan loss reserve guidance and not by adding an additional capital requirement.

Finally, with regard to the proposed risk-weighting rules, the imposition of the higher risk weighting on a retroactive basis to all loans outstanding could cause the devaluation of existing residential mortgage portfolios and a substantial increase in risk-based capital requirements for banks involved in residential mortgage lending. Based on our interpretation of the proposal and our analysis of the loans secured by residential properties in our portfolio, this proposed change in residential mortgage exposure will, at a minimum, add \$330 million of risk-weighted assets to our capital ratio calculations. The result of this proposal in and of itself, i.e. excluding the cumulative effect of the other negative implications to capital, will decrease our total capital ratios by nearly 200 basis points.

In addition, while some of these criteria can be measured objectively, other factors – such as documentation and income verification – are a matter of degree, and the specific requirement must be delineated to avoid uncertainty. For these reasons, we make the following recommendations with respect to risk weighting:

- Changes to risk weighting should be applied on a prospective basis as new loans are originated after January 1, 2013. If existing loans are not grandfathered, the lender would have to hold additional capital to support them, or sell existing loans in the portfolio, potentially at a loss of value.
- A methodology for overall credit profile should be developed that takes into account a cumulative view of the credit factors rather than rely on a single factor for determining risk weighting. This profile should also recognize high quality and properly underwritten PMI in the determination of the LTV ratio for residential mortgage exposures. To do

otherwise would severely limit the flexibility of lenders to respond to demand for residential credit in a responsible and pragmatic way.

- The calculations of combined LTVs and risk weighting using a variety of first and second lien loans and various commitment types should be clarified.
- The measurement of documentation and income verification used for making a Category 1 determination should be clarified.

#### *Credit Enhancing Reps and Warranties -*

The proposals appear to be drafted such that in cases where credit enhancing representations and warranties are provided on assets sold with early default clauses or premium refund clauses, a bank would treat this arrangement as an off-balance sheet guarantee with a 100% credit conversion factor (“CCF”) applied to the exposure amount. The proposal wording is silent on whether warranties that permit the return of assets in the instances of fraud, misrepresentation, or incomplete documentation would be considered off-balance-sheet guarantees with 100% CCF, an issue that should be clarified. The proposal is silent on whether the CCF would be removed at the time of expiration of a rep or warranty.

To address these concerns with “credit enhancing” representations and warranties we suggest that the following be considered:

- Consistent with current practice, we recommend that boilerplate representations and warranties explicitly required by the government agencies should be excluded from the definition of “credit enhancing.”
- If not excluded, we recommend that “credit enhancing” representations and warranties should only be included after the implementation of the final Basel III rules.
- We also request that the agencies clarify that the CCF only remains in place for the applicable rep and warranty period rather than the life of the loan as the current NPR wording indicates “there is no grace period, such as the 120-day exception under the current general risk-based capital rules.”

First Federal has sold nearly \$20 billion in mortgage loans over the last 10 years and could be required to set aside up to \$200 million in capital for loans sold over that period. This a punitive and unreasonable capital burden to place on community banks which are actively working to support the economic recovery through mortgage lending in our communities. The rule as drafted threatens to drive every community bank in the country out of the mortgage lending business. First Federal has not sustained losses relative to the clause in this proposal, and there is little evidence that temporary representations and warranties associated with “pipeline mortgages” have resulted in significant losses for the industry as a whole, even during the financial crisis. As a result, we urge the banking agencies to retain the 120-day safe harbor in the current rule.

#### *Deduction of Mortgage Servicing Rights*

A critical component of the residential mortgage banking business model is the value of the MSR created at the time of loan origination. Deduction of MSR above 10% CET1 capital after adjustments means that servicing will become less attractive to banks and will likely move to



nonbank investors that require higher unleveraged returns on investment. If First Federal was forced to sell these assets due to their deduction from CET1, then we would be compelled to charge higher origination fees or coupons in order to maintain similar levels of profitability. The alternative would be a reduced availability of mortgages and reduced profitability for our organization. To lessen the impact of this Basel III MSR deduction on First Federal and the entire U.S. residential mortgage market, we would suggest that the following be considered:

- Grandfather all existing MSRs that are already being fair-valued on bank balance sheets. It is simply unfair to penalize banks with long standing mortgage servicing assets because of a change in position of the Basel committee.
- Increase the permitted amount of MSRs to 20% of CET1.
- Exclude MSRs from the current 15% aggregate basket that applies to deferred tax assets, MSRs, and significant investments in unconsolidated financial entities.

Mortgage servicing is extremely important to community banks because it allows us to maintain relationships with customers whose mortgages have been sold. First Federal currently services in excess of \$2 billion in mortgages that we originated and either hold in our portfolio or sold in the secondary market. Our total MSR asset is approximately \$15 million, which is reflective of the current low interest rates. We believe that this proposal is particularly punitive when combined with other proposals in a rising rate environment, which is likely to occur in the coming years. Specifically, in a rising rate environment, the value of our MSRs will likely increase, thus requiring a larger deduction from capital as proposed. At the same time, the unrealized loss on our AFS portfolio will increase, potentially creating a significant reduction from capital if OCI adjustments are included in regulatory capital calculations. The above recommendations would lessen the impact of the MSR deduction. If these actions are not taken, the market for investment in MSRs will likely continue to shift from banking organizations to non-bank investors that do not face the deduction of MSRs from capital.

#### *Retained Interest in NQ Mortgages –*

The residential mortgage market would also be damaged by the proposed requirement that securitizers of non-qualified, non-agency residential mortgages (non-QRM) retain a 5% interest in such securitization, pursuant to section 941 of the Dodd-Frank Act. While there are a number of alternative ways that this interest can be structured, it has the impact of effectively raising the cost of securitization and, in so doing, reducing the formation of credit and the value of assets to be securitized. While the final rules are yet to be adopted, we hope that these rules would be applied to new originations rather than currently outstanding loans.

#### Simplified Supervisory Formula Approach (SSFA)

In order to comply with provisions of Dodd-Frank and the mandate to move from a reliance on credit ratings to risk weight many assets, the proposals include alternative methodologies (SSFA or the gross-up approach) for risk-weighting securitization exposures, including privately-issued mortgage securities (PLMBS).

First Federal holds approximately \$167 million of PLMBS and, without the ability to rely on credit ratings, we are now faced with a much more complicated process to determine the risk-weightings of these investments. Alternately, we could choose to apply a 1250% risk weighting to these securitization exposure, reducing our capital by over 600 basis points immediately.

Upon review of the proposal, we believe that the SSFA and the gross-up approach both overlook key structural features to securitizations that provide credit enhancement, including the purchase price or carrying value of a security. In our view, the discount generated between par and the carrying value of a security provides an additional buffer against potential loss and should be factored into the risk-weight formula in some manner to differentiate the potential loss exposure among different instruments.

With regard to the requirement for understanding the securitization exposure, the proposal has set forth specific points of consideration to demonstrate and document for the regulators that an institution has a comprehensive understanding of a specific securitization's risk. We concur with these points of consideration; however, we question whether examiners will be able to apply these points consistently across and between all organizations. We request a reconsideration of the capital penalty of 1250% for failing to demonstrate a comprehensive understanding of a particular credit exposure. The penalty should, at least, correspond to the actual risk weight of the asset and not create capital disparities that are grossly dissimilar for assets of equal risk based on an individual regulator's interpretation of assessment during ongoing examinations.

#### Capital Conservation Buffer

First Federal supports the proposed minimum capital requirements, as well as the addition of the new common equity Tier 1 capital ratio. However, it is unclear to us as to why the proposals would create a capital conservation buffer that would exceed the minimum thresholds for "well-capitalized" under the PCA framework. In essence, the proposal suggests that an institution needs a 2% buffer to be "well-capitalized," but it would need a 2.5% buffer to be "resilient" throughout different financial cycles. By establishing this framework, an institution could be "well-capitalized" and free from any restrictive covenants under the PCA framework (e.g., limitations on brokered deposits) but at the same time still have restrictions on capital distributions and discretionary bonuses if it did not exceed the requirements for the Capital Conservation Buffer. This staggered and somewhat parallel layer of restrictive covenants above the PCA "well-capitalized" framework will create a confusing and contradictory set of standards. To avoid confusion and to better link the proposed capital guidelines to the existing PCA framework, we recommend that the Capital Conservation Buffer be adjusted to 2.0%. This would align the Capital Conservation Buffer with the buffers that already exist between "adequately-capitalized" status and "well-capitalized" status under the PCA framework. Banks that fall below "well-capitalized" could be subject to a variety of restrictions, including the proposed restrictions under the Capital Conservation Buffer. However, in the interests of clarity, flexibility and simplicity, we believe the Agencies may even wish to consider eliminating the Capital Conservation Buffer altogether in favor of instead applying existing enforcement authority to restrict capital distributions as circumstances warrant.

### Proposed Transition Period

Under the proposals, many of the transition periods begin on January 1, 2013, giving community banks very little time to prepare for the rules prior to the beginning of the impact period. We are concerned that the cumulative impact of the proposals as drafted will be significant and immediate to our capital position. Given that capital generation from earnings takes time and that access to new capital may be difficult to realize or cost prohibitive to our institution, the immediate solution to ensure we maintain the new capital standards would be to shrink the bank. However, this step would ultimately slow earnings growth. In addition, the elimination of products that require higher capital or the adjusted pricing that will be required to support the higher capital requirements will have a significant negative impact on the customers served in our markets. Ultimately, community banks will be unable to grow or serve the communities in which we operate, which will result in hindering any economic recovery.

We believe that the transition period is too short to allow for increasing capital level through the retention of earnings. In addition, the market (investors and analysts) will expect immediate compliance with the higher capital standards. The transition periods should be evaluated and extended for community banks. Alternately, community banks (below \$15 million) should be exempted from the NPR in its current form.

In conclusion, the proposals as currently drafted will greatly impact First Federal, our community and the industry as a whole. The broad-reaching implications of the proposals as drafted should be reconsidered in light of:

- **Complex Capital Calculation** – The administrative burden of tracking 13 categories of deductions and adjustments to capital and changes to risk weighted assets on a quarterly basis.
- **Potential Volatility of Regulatory Capital** – The inclusion of unrealized gains/losses on AFS securities and exclusion of gains/losses from cash flow hedges have the potential to introduce substantial volatility in capital during periods of rising rates.
- **Reallocation of Capital and Repricing of Risk** – Certain business lines and asset types will be evaluated as to product offerings and pricing, with a potential reallocation of capital to business lines that offer the best returns on risk-weighted capital after giving effect to the proposed adjustments.
- **Higher Cost of Capital** – The increase in tangible common equity required improves the quality of capital, but also raises the effective cost of regulatory capital. Further, the cost to implement and maintain compliance with the proposals, combined with a limitation on growth of our balance sheet to manage the increase capital requirements, will result in depressed earnings and internal capital generation.

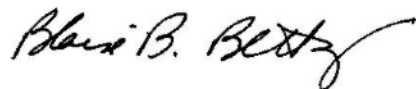
The unintended consequences of the above implications will be to limit the availability of credit due to the increased capital requirements, which will result in a profound negative impact on consumers, small businesses and job growth in our communities. While First Financial and First

Federal support ensuring that banks hold an appropriate level of capital for associated risks, the cumulative effect of the proposals, and specifically the items discussed above which directly impact our institution, will have severe consequences on most community banks in the country.

We strongly urge you to consider this impact and consider an exemption or appropriate modifications to the proposals for community banks. Our nation's community banks need to be able to continue to serve our communities and help strengthen our local economies.

Thank you for the opportunity to comment of the Basel III capital proposals and for your considerations of our requests.

Sincerely,



Blaise B. Bettendorf  
EVP and Chief Financial Officer

cc: Senator Lindsey Graham  
Senator Jim DeMint  
Congressman Tim Scott  
Congressman Joe Wilson  
Congressman Jeff Duncan  
Congressman Trey Gowdy  
Congressman Mick Mulvaney  
Congressman Jim Clyburn