THE CITIZENS BANK OF WINFIELD

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October 18, 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:

The Citizens Bank of Winfield's Board and Executive Management team wants to thank you for the opportunity to provide comment on the Basel III proposals. In our opinion, community banks should be allowed to continue using Basel I for calculating capital reserves and for risk weighting residential loans. Community banks should also be allowed to continue excluding accumulated other comprehensive income (AOCI) from capital measures just as they do today.

We are a community bank ($195 million in assets) in Winfield, Alabama which is a small town located in rural northwest Alabama. We assist with the financial needs of consumers, farmers, and small businessmen and women. Citizens Bank has a relationship with our customers and has served our community for 92 years. Larger banks operate on volume and do not serve those customers that don't fit their business plan. The financial crises our nation has been working through since 2009 was not caused by community banks as we did not participate in or support predatory lending and risky investing. Yet, we have been unfairly thrown under most of the 300 - 400 new regulations requiring increased expense from personnel, hardware, software, markdown to market, increase in ALLL reserves and reduced debit card revenue. True community banks have always been committed to making sound credit decisions that help our rural community customers obtain reasonably priced financial products that are not available from larger institutions. Practical, common sense approaches to managing risk contributes to the success of community banks all over the country. Basel III was designed to apply to the largest banks not community banks. Why should Basel III apply to community banks who do not have the complex and highly leveraged activities of large banks? Tougher capital standards may need to be placed on the larger banks who have caused a lot of the problems in the financial industry

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today but not on community banks. By placing the same standards on community banks, you will cause more of them to go away through merger, acquisition or failures. The resulting consolidation will lead to more larger banks and less community banks to serve of the various needs of the rural communities. Rural customers will be force to bank long distance, via the internet, etc. The financial heart of rural America will be lost to these rural communities.

AOCI for Citizens Bank and most community banks is unrealized gains and losses on investment securities held in available-for-sale. These securities are held at fair value with any gains or losses due to market interest rate changes being reported in this category. Low interest rates, a flight to safety in the capital markets along with increased credit spreads have increased bond valuations. Interest rates are currently at unsustainable long-term lows. As the economy recovers and interest rates rise, fair values will decline causing a negative balance in the AOCI. This decline will reduce capital balances as the unrealized losses will impact common equity, tier 1 and total capital. For example, we are a well capitalized bank with a 47% Total Capital Ratio and $5 million in AOCI. Under Basel III, our capital ratio would increase to 52% due to the $5 million in AOCI. When rates increase and our AOCI is negative $5 million, which it has been in the past, a 10% negative swing will occur in the Total Capital Ratio. What will happen to banks with adequate capital when rates increase? Will the swing in AOCI cause them to be undercapitalized? Including AOCI in capital for community banks will lead to an increased volatility in regulatory capital balances which under certain economic conditions could rapidly deplete capital levels. Community banks should not be required to include AOCI in their capital measures.

Many community banks will need to build additional capital balances if the capital conservation buffers are implemented. Community banks don't have ready access to capital like larger banks who have access through the capital markets. Community banks increase capital through the accumulation of retained earnings which takes time. Community banks' retained earnings have been greatly reduced by the following items: ultra low interest rates, weak economy, loan losses, and regulatory changes which require additional personnel and software expense. There are also numerous problems with Basel III for banks with a Subchapter S corporate structure. The capital conservation buffer would conflict with the requirement that shareholders pay income tax on earned income. Capital Conservation buffers should not be implemented for community banks.

Increasing risk weights under this proposal is too complicated and will be burdensome to community banks. We have spent a large amount of money on personnel and resources to purchase and upgrade software as well as to redefine policies and procedures to comply with Dodd-Franks and CFPB guidelines and proposed regulations with many more changes coming. Significant software upgrades along with other operational changes would need to be implemented to track mortgage loan-to-value ratios with no visible benefit. Community banks offer loan products and financing options which include balloon loans, interest-only loans, and second liens to their customers. Increasing risk weights for residential loan products will deprive customers of many residential loan options and could jeopardize the housing recovery. Most of our residential loans are for customers who are unable to qualify for secondary market financing, for customers who want the "hometown" feel of having local financing from people they know, or for customers who don't want the expense of long term financing. Second liens may disappear as banks choose not to allocate additional capital to this type mortgage or second liens may become more expensive to the customer. Balloon loans allow banks an opportunity to re-price a long term residential loan in order to maintain a positive interest margin as the interest rate environment changes. We as community bankers are being penalized further by increasing risk weights on balloon loans when we are attempting to mitigate interest rate risk which is a safe and sound practice and a regulatory requirement. Both the bank and our customers benefitted by us offering balloon loans during the savings and loan crisis. By increasing this risk weighting requirement, community banks may be forced to discontinue these types of loans, thereby forcing consumers into the secondary market if they qualify. With all the increased regulatory changes and the burden of residential lending, community banks may need to consider exiting the residential loan market entirely or to only originate loans that can be sold in the market. This may result in our rural customers having to look for non-traditional financing, which may be predatory lenders, in order to refinance their homes or attempt to purchase a home. We are certain it is not the intent or purpose of the Basel III proposal to restrict credit to rural consumers. Community banks should be allowed to continue serving our customers and should remain under Basel I for residential loans.

Increasing the risk weighting of commercial real estate (HVCRE) loans will also limit a community banks' ability to serve our small business customer's financial needs. Credit unions have introduced legislation which will increase the percentage of assets which they can lend to small businesses. Credit unions have a greater advantage over banks as they do not pay taxes. Under this proposed change, credit unions would be allowed to provide the same types of financing to commercial customers without being subjected to the same regulations community banks are required to follow. Our concern is credit unions will take on too much commercial debt and eventually the FDIC Insurance, which community banks are paying into, will be bailing them out in the future. (Will this be deja vu? The savings and loan crises in the 1980's. Who bailed them out?)

The Basel III plan is unreasonable and dangerous for financial institutions that serve small communities. We feel strongly that if Basel III is implemented as proposed, it will have a devastating effect on not only consumers and businesses which may no longer have alternative means of obtaining financing in these difficult economic times but also on community banks across the nation. Community banks have played a vital function in our countries past. We have stepped up to aid in the economic recovery of this nation from a financial crisis we did not have a role in creating. Our country, customers and generations to come rely on the services community banks provide.

Community banks maintain the banking industry's highest capital levels. Community banks also maintain a personal relationship with our customers and recognize their unique needs. Why should community banks be forced out of business and leave their customers in the hands of megabanks? Is this in the best interest of the consumer? The increased regulatory burden including the additional burden of Basel III will limit the resources we can lend and reinvest in our communities and will also threaten the country's recovery. The increased expenses involved in complying with the constantly changing regulations along with the changes in Basel III are detrimental to community banks. Under Basel III, a community bank's capital may decrease below the capital conservation buffer during rising rates. Community banks should be allowed to continue using Basel I for computing their capital requirements and Basel III should not be applied to them.

We appreciate you reading our comments. If you would like to discuss this further, please feel free to contact us at 205-487-4277.

Best Regards,

THE CITIZENS BANK OF WINFIELD

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