FIRST FARMERS
Member FDIC

Patricia P. Bearden
Chief Financial Officer/Cashier

October 3, 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: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action and Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements.

Dear Ladies and Gentlemen:
We want to take this opportunity to offer our opinions as to why we believe the new capital requirements, as proposed by the federal banking regulators, do not protect but hinder community banks. Part of the new capital proposals focus on changing the risk weightings on 1-4 family home mortgages and home equity loans. According to projections for our bank, these proposed changes in risk weightings cause a 23% increase in our bank's Risk-Weighted Assets. History has proven that community banks typically take a relatively small amount of net charge-offs for these type loans. This has certainly been the experience at our 103 year old bank where we have a large in-house 1-4 family residential portfolio. Overall, community banks should be commended for their underwriting standards and risk management of their loan portfolios. Consideration by the regulators should be given to these standards and risk management as they formulate the new capitai requirements.

Secondly, I would like to address the impact of Available-for-Sale (AFS) Gains or Losses on Tier 1 Capital. The proposed treatment of comprehensive income in the new capital proposals ignore how community banks balance their risk. We have learned that interest rate risk on capital, earnings, and liquidity can be balanced in a way that is profitable and has less risk. The new capital proposals, however, ignore the approach of analyzing all assets and liabilities. The new capital proposals focus on the AFS investment portfolio for community banks. Our bank has a very strong and stable core deposit base. This positive liability structure gives our bank flexibility within its investment portfolio. Our risk is very balanced in a rising interest rate environment and our economic value of equity (EVE) is very strong and stable under shocks and interest rate simulations. If the new capital proposals are approved, our bank will be forced to manage the investment portfolio strictly based on the new demand of managing Tier 1 Capital. For example, projections for our bank show that in an instantaneous shock of +300 bps our net unrealized loss increases over $50 million. While this type of instantaneous stress would be unlikely, under proposed BASEL III guidelines, we would feel the pressure to manage this unlikely event as it could put pressure on our bank to meet our minimum regulatory capital ratios. For community banks, this new capital proposal could reduce their central focus on making loans to members of their communities.

In summary, the new capital proposals are not geared to the community banking industry. The community banking industry needs a risk-based capital system that will protect and nourish each individual community bank. Each community bank must have capital requirements that cover the risk tolerance of the board. Low risk banks should be awarded with lower capital requirements that cover the risk tolerance of the board. Low risk banks should be awarded with lower capital requirements. Higher risk banks should require more capital. However, the level of capital required cannot remain static. The requirements must be dynamic to support the level of risk taken on by a community bank either directly through its strategic plan or indirectly as a result of economic changes. The risks that require the main focus of community banks are credit risk, earnings at risk, liquidity risk, national economic risk and state economic risk. The new capital proposals do not address these issues.

Respectfully,

Patricia P. Bearden

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Chief Financial Officer
First Farmers & Merchants Bank

Robert C. Matthews

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Controller
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