Community Spirit
BANK®

October 9, 2012

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
550 17th Street, NW
Washington, DC 20429
Via Email to: comments@fdic.gov

Board of Governors of Federal Reserve
Jennifer J. Johnson, Secretary

20th Street & Constitution Avenue
Washington, DC 20551
regs.comments@federalreserve.gov

Re: FDIC RIN 3064-AD95 Basel III NPR and RIN 3064-AD96 Standardized Approach NPR

Dear Mr. Feldman and Ms. Johnson,

I appreciate the opportunity to write to you regarding the NPR on the new Basel III Capital and Standardized Approach NPR being contemplated by regulatory officials. I am Brad Bolton, the President/CEO/Sr Lending Officer of Community Spirit Bank, FDIC #50, headquartered in Franklin County, Red Bay, Alabama. We operate offices in Northwest Alabama and Northeast Mississippi.
Our financial institution was chartered in 1908 and has been fortunate enough to weather many economic cycles in the nation's history. Most recently we were able to weather through the latest recession through sound underwriting and effective management practices that has positioned us well for the future. However, the recently proposed capital standards by the regulatory agencies gives our management team and board of directors extreme concern over the long term ability for our financial institution to continue to be successful in our next 100 years. As my letter will demonstrate, the effect of these rules could be significant on my community bank, and I am strongly urging the regulatory bodies to re-evaluate the effects these capital requirements will have on community banks such as mine. Our community bank **did not** create the financial crisis that led to these proposed capital requirements. We don't have the extremely complex balance sheets that the world's largest financial institutions have and thus, we believe we should not be held to the same capital standards and risk weightings as the most complex organizations in the world.

Our management team has spent extensive time reviewing the proposed rules and participated in the FDIC's "Community Bank Informational Session" and power point to attempt to grasp all that will be required from the proposed rules if implemented. We have searched through our balance sheet to determine what real financial implications these rules will have on our financial institution. I want to convey as much as possible in this letter regarding these implications. We are combining all of our comments into this one letter with regard to both Basel III and the Standardized approach because as a whole, these proposed rules have a negative impact on our financial institution now and for years to come.

Basel III NPR Analysis on our Bank and Comments:

First, I will discuss the effect Basel III has on calculating capital by dollar amount using the new terms of not only Tier 1 Leverage, but also, Common Equity Tier 1, Additional Tier 1, Tier 2 and Total Capital. We used the new definitions based on the NPR to arrive at the new "Common Equity Tier 1 Capital", the "Additional Tier 1", "Tier 2" and finally the "Total Capital" in our calculations.

We have the greatest concern over the new definition of "Common Equity Tier 1 Capital". Under the current standards, there are two items that currently are not accounted for in Tier 1 Capital. First is the unrealized gain/loss on securitized bonds (AOCI). Under the current rate environment, our bank, much like all banks across the nation have large gains in our investment portfolio. Under the NPR in this rate environment, this assists in our capital calculations, but just as soon as rates go up, as they inevitably will, this gain on these bonds will most likely be reduced to an unrealized loss and thus will have a tremendous negative impact on our capital accounts and subsequently the ratios they are based upon. If the NPR is enacted as it currently stands, we as a management team may have to make a decision to take the gains in our portfolio and stay as liquid as we can with our excess funds so that we don't have the risk of this unrealized gain/loss having an impact on our capital calculations. This will mean that our balance sheet will not be as diverse as it is at present and will certainly hamper earnings and pledging ability to obtain pubic funds which could result in liquidity concerns for the bank. For these reasons we strongly believe that the gain or loss on securitized assets should not play a role in calculating our capital because you bring uncertainly and volatility in capital driven by interest rates. We believe we are already accounting for this risk through extensive Interest Rate Risk Sensitivity analysis and rate shocks.

Secondly, another negative impact of the Common Equity Tier 1 Capital calculation on our bank is the proposed treatment of "deferred tax assets". At present our bank currently has a large deferred tax carry forward on our books. Our deferred tax asset relates to a "timing difference", thus it has no effect on capital at this time. However, our fear is that this could change and be treated like the deferred tax assets on operating losses and tax credit carry forwards in the "final rule". We also have concerns about the treatment of "net loss carryforwards" for our peer community banks across our state and nation who have taken losses during the recent financial crisis. In conversations with our accountant, we understand that banks who have a "net loss carry forward" on their books, which assists them with tax advantages going forward, which ultimately would assist them in their capital restoration will actually be penalized by this proposed rule. The penalization is that the deferred net operating loss carry forward will be deducted from capital calculations. If we were ever in a position of taking a loss and had this on our books, we would not believe this would be fair for this to be deducted from capital when it is merely a "carry forward".
Combining these "deferred tax asset issues" with a rising rate environment where the ACOI could become a negative figure and our capital could suffer significantly.

In summation, we believe that the AOCI and deferred tax carry forwards should be eliminated in the final capital rules and not play a role in calculating Tier 1 or Common Equity Tier 1 Capital under any new regulatory rule.

Standardized Approach NPR Analysis and Comments:

The second part of the NPR is the Standardized Approach in which new ways of calculating Risk Based Assets takes effect. In calculating the new risked based standards of our assets, we believe we are being "double hit" on calculating for potential exposures on our balance sheet. We already use an in-depth model to calculate our allowance for loan/lease loss and we make adjustments as necessary through the ALLL. We believe we are adequately accounting for the risk in our portfolio through the ALLL process. The proposed rule brings new risk weight limits to our loan portfolio, particularly changes to our current 1-4 family residential loans, which has been a traditional stronghold of our bank for many generations. Changes to this aspect alone may require the bank to evaluate whether we continue to make home loans.

A primary concern on these new risk weightings is the new expectations for rating 1-4 family mortgage loans. Our bank has thrived on our 1-4 family residential loans with LTV's of 90% or less for generations. Increasing these risk based thresholds on these type mortgages is unsubstantiated and represents the greatest increase in our risk based assets. These loans currently represent around 24% of our total loans. With changes to Regulation Z in recent years whereby we must call most 1-4 family loans we make "high priced" so we don't take the interest rate risk, we have had to escrow for taxes and insurance. This has already taken away a differentiation advantage we had against mortgage companies and brokers. Further, it increased the down payment borrowers had to bring to the table to compensate for the first years' taxes and insurance as well. Add these new risk based guidelines, whereby if we continue to do 90% LTV mortgage loans, the risk weighting may discourage us from going up to this level and thus requiring more to be paid down, which will limit our ability to fund such loans, thus our communities may suffer from having one less lender who is willing to make such loans for the fear of the capital consequences this will have on us. I truly believe this is a real scenario that these rules may push my community bank and other community banks from the mortgage business even though our mortgages are probably some of the soundest loans in the country as compared to those that led to the financial crisis. These proposed rules will force us to make a hard choice as to whether we continue to stay in the 1-4 family loan market or be forced to exit or limit our participation in it. I don't believe regulatory officials contemplated the effect these rules will have on our communities and the consumers on which we serve.

Finally, the increase in risk weighting on non-performing loans is negating the designed purpose of the ALLL and ASC Topic 310. We don't understand how you can have more than 100% risk in any asset, but especially going from 100% to 150% on non-performing loans! We believe the risk weighting should remain at 100% and then be evaluated under ASC Topic 310 as a part of the ALLL calculations. Thus, we would be penalized two to three times for having a non performing asset, when in fact right now that risk is adequately addressed through our ALLL process.

We believe that these arbitrary risk based thresholds are not commensurate with the actual risk these assets represent and should not be changed from the current standards for community banks.

Conclusions and Implications on our Bank:

Using the aforementioned proposed capital guidelines from BASEL III and the Standardized Approach our capital and capital ratios change as follows using the FDIC's recently published spreadsheet for calculating both: (Figures as our most recent month end of September 30, 2012)

Dollar Amount (000)	Current Rules	Basel III Rules Only	Basel III and Standardized
Common Equity Tier 1 Capital	n/a	$12,692	$12,692
Tier 1 Capital	$11,794	$12,692	$12,692
Tier 2 Capital	$987	$1,021	$1,021
Total Capital	$12,781	$13,713	$13,713
Risk-Weighted Assets	$93,314	$93,928	$91,872
Average Assets	$139,177	$139,177	$139,177
Regulatory Ratios	**Current Rules**	**Basel III Rules Only**	**Basel III & Standardized**
Leverage Ratio	8.47%	9.12%	9.12%
Common Equity Tier 1 Capital Ratio	n/a	13.51%	13.81%
Tier 1 Capital Ratio	12.64%	13.51%	13.81%
Total Capital Ratio	13.70%	14.60%	14.93%

This table represents the current "gain" we have on AOCI. You can see that under current and proposed capital guidelines, we are in compliance. However, any number of things could occur that could drastically change this picture, including an increase in non-performing loans, new appraisals that yield loans with higher LTV ratios, thus more allocation for risk based assets and most importantly, <u>when</u> rates rise, the adjustment to AOCI.

As such, I want to show you how my AOCI would affect capital if rates went up 300 Basis Points. I would go from having a 3% unrealized gain in the portfolio to 6.22% unrealized loss. If this took place, let me show you what would happen to my capital ratios:

Dollar Amount (000)	Current Rules	Basel III Rules Only	Basel III and Standardized
Common Equity Tier 1 Capital	n/a	$9,942	$9,942
Tier 1 Capital	$11,794	$9,942	$9,942
Tier 2 Capital	$987	$1,021	$1,021
Total Capital	$12,781	$10,963	$10,963
Risk-Weighted Assets	$93,314	$93,928	$91,872
Average Assets	$139,177	$139,177	$139,177
Regulatory Ratios	**Current Rules**	**Basel III Rules Only**	**Basel III & Standardized**
Leverage Ratio	8.47%	7.14%	7.14%
Common Equity Tier 1 Capital Ratio	n/a	10.58%	10.82%
Tier 1 Capital Ratio	12.64%	10.58%	10.82%
Total Capital Ratio	13.70%	11.67%	11.93%

Thus, we have a 21% swing in our capital just from including AOCI. We feel this is too much risk that regulatory officials are placing on community banks. We don't have the capital market availability that large, complex, and internationally active financial institutions have available to them. We don't have the expertise to play the interest rate hedging game like large international banks can do. Since our means of raising capital is much more difficult than large institutions, we should not be held to the same capital standards.
The largest financial firms in the world will find other ways to position their balance sheets and use hedging and interest rate swaps to manipulate these new guidelines. A small rural bank like ours will not be able to do these type activities and thus the proposed rules puts our long term sustainability to compete and serve our communities in jeopardy. I hope the reader can see how burdensome and complex these issues are going to be on our financial institution.

Buffer Limitations:
Why should a community bank like mine be limited on "maximum payouts" of current year earnings as long as we are above the Basel III minimum ratios? Why bring in three matrixes to determine what limitations on capital there will be? Why should we have to worry about another burdensome and cumbersome calculation to decide if our bonuses and dividends are to be exempt? In our opinion, as long as we are above the minimum ratio requirements, we should be able to declare bonuses and dividends as we see fit to satisfy holding company obligations and shareholder expectations and to retain and provide benefit for internal bank staff. Adding another component to calculate these payouts is too much government control on a bank like ours that is here for the long term. We don't have to jeopardize earnings or capital to meet "Wall Street's" expectations. We simply run our business to sustain the long term survivability of our organization. We understand that there may be instances where dividends need to be limited to avoid being below regulatory minimums but instituting another layer of calculations through this "buffer" only complicates things. We should not be limited to payouts as long as we meet regulatory requirement minimums. Large and complex institutions may abuse the system with large payouts even in times of financial distress, but my community bank uses common sense in our payouts because we know and understand we do not have the government to bail us out if we make bad decisions, thus we don't need regulation to make us limit our payouts to preserve capital. We would preserve capital for our best interest alone. The simpler something is, the better it is in our opinion.

In addition to the implications on our bank in general as discussed above, we believe these notice of proposed rules are wrong for community banks broadly because of the following:

1. These guidelines jeopardize the viability of the community bank model
2. The Risk weights being proposed does not mesh with the community bank model
3. The proposal is not tiered and does not provide any exempted relief for small community banks with simplified balance sheets and customary lending activities such as our own.
4. The implementation of the plan is too soon as many banks are continuing to recover from the latest recession and real estate values.
5. The ALLL should actually be included in Tier 1 capital because it represents the first line of defense against capital-absorbing losses.

At present, our bank meets all the current and proposed capital guidelines but that could quickly change with the volatility inherently built into the new proposed rules.

As you can see, we strongly believe that these Notice of Proposed Rules are not in the best interest of our financial institution, our employees, shareholders, customers, other stakeholders and communities in which we serve. Every regulation and rule passed has far reaching ramifications on a community bank such as mine. We strongly believe that a community bank headquartered in a small rural area should not be held to the same capital and risk weighted standards as a multinational bank that has far more complex balance sheets than we do. We strongly encourage regulatory officials to take a hard look at how these proposed rules will impact community banks such as ours and exempt us from these requirements. We have and will continue to play by the rules we are given, but with our non-complex balance sheets, we believe the current capital guidelines in place along with our Allowance for Loan and Lease Losses adequately protects our bank from volatilities in the economy and risks in the portfolio. It has served us well for the past 104 years and we want to continue for another 100 years and beyond if time lasts. The bottom line is, we agree with FDIC board member Thomas Hoenig who in his recent speech to the American Banker's Regulatory Symposium stated among other things that, "directors and managers will have a steep learning curve as they attempt to implement these expanded rules" and that "to implement Basel III suggests that we have solved global measurement problems that we have not solved".

I appreciate the opportunity to write you on the implications these rules will have on our financial institution. If you would like additional information, please don't hesitate to contact me.

Sincerely,

Brad M. Bolton
President/CEO
Community Spirit Bank

Cc:

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