October 19, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

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 Requirements

Ladies and Gentlemen,

I appreciate the opportunity to provide comment on Basel III proposals that are currently being reviewed by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

We have many concerns; however, today I want to focus mainly on the inclusion of gains and losses on available-for-sale debt securities in the Common Equity Tier 1 calculation. Currently, our Bank has a $150 million bond portfolio, with approximately $4.8 million of unrealizable gains. The investment portfolio is primarily made up of government backed MBS and Agency securities. These investments have little, if any, risk of loss, but are subject to interest rate risk, which we manage diligently, and our CAMEL rating reflects that.

A "rates up" 3 percent shock test results in an unrealized loss of $20 million. Based on the results of the shock testing, Tier One Capital would drop below 9% and the Bank would fall from *"Well Capitalized"* to *"Adequate"*. The resulting volatility of capital ratios would almost certainly result in greater regulatory scrutiny, lower legal lending limits, and balance sheet contractions.

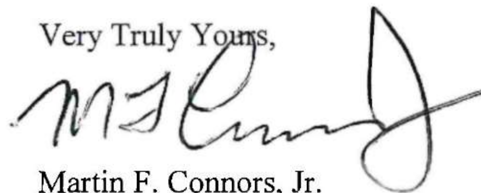
Changes to regulatory capital resulting from swings in interest rates would create additional unintended consequences. To avoid swings in interest rate induced volatility, banks will "shorten up" the durations of their investment portfolios. The outcomes will be less yield and lower total earnings. Banks may be forced to hold these assets as Held to Maturity instead of Available for Sale. Either case will limit the Bank's ability to manage the investment portfolio in a manner appropriate for liquidity, earnings, and interest rate risk.

The unintended effects on lending should also be a considered. Interest rates normally increase as a result of economic expansion. Banks may be forced to reduce the size of their balance sheets just as the economy improves. Banks are not in a position to increase their lending at a time of balance sheet contraction, quite the opposite. As a result, community banks would not be in a position to support increased lending during an economic recovery.

Capital is the main determinant of a bank's legal lending limit. Generally, as a bank's capital increases or decreases, the institution's legal lending limit increases or decreases. In a rising rate environment, banks would find themselves in an untenable situation. Their legal lending limits would start to fall, driving larger, more profitable customers and accounts to larger institutions.

In summary, the inclusion of gains and losses on available-for-sale debt securities in Common Equity Tier 1 Capital would negatively impact the ability of the Bank to appropriately manage liquidity, earnings, and interest rate risk. The resulting volatility in capital and balance sheet size would also lead to unintended effects on lending and profitability. I strongly urge you to consider the impact of these requirements and to consider a possible exemption for most community banks from this Basel III requirement.

Very Truly Yours,



Martin F. Connors, Jr.
President & CEO

MFC/cs