New Horizon Bank

A New Dawn in Community Banking

October 22, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Basel III Docket No. R-1442

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Basel III OCC Docket ID OCC-2012-0008, 0009, and 0010

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20219
Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Re: BASEL III Capital Proposals[1]

Ladies and Gentlemen:

New Horizon Bank, N.A. is a single office community bank with less than $50 million in assets. Our founders started the Bank in 2009 with the vision of serving the community with a genuine interest in seeing our customers succeed and our community prosper. Since opening, we have been battered by a seemingly never-ending barrage of new regulations and increased scrutiny brought on by the financial crisis that began in 2008 and in which we and most other community banks had no part in bringing about. The knee jerk reaction of those in Washington to "fix" the banking industry is failing to take into account the fact that much of the financial crisis was brought on by non-regulated, non-bank lenders, and unfortunately, in an effort to compete, some banks followed those non-bank lenders down the seemingly gold laden path of the subprime mortgage market. No doubt, many banks, communities, families and businesses have been hurt, some irreparably so, by the financial crisis of 2008. What we don't need to do now is implement a "one size fits all" capital standard to banks that I feel will lead to further consolidation of the industry, and as a result, further damage to the very stakeholders we are trying to help.

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions; Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements.*

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I have reviewed the proposed capital rules that would apply to our Bank, and I am very concerned by the level of complexity we will have to implement into our MIS records and the reduction in lending capacity the proposals will cause at an economic time when restricted lending could damage an already fragile economic recovery.

Accumulated Other Comprehensive Income "AOCI"

Like most small community banks, New Horizon Bank's Tier 1 Capital consists of Common Stock and Retained Earnings. We do not hold any exotic capital with questionable value. Our Tier 2 Capital consists only of our Allowance for Loan and Lease Losses. The proposal to add AOCI to Tier 1 Capital would introduce a level of volatility to Capital that for a conservative Bank such as ours, has little to do with actual risk.

This proposal seems to take the position that "Available" for sale equates to "Required" to sell. Everyone understands that as interest rates increase, market value of bonds issued at lower rates will decrease. When rates increase, and bonds carry a loss if sold, the viability of this source of liquidity is a decision for management to consider. The decision might very well be to utilize another liquidity source, and retain the devalued bond until maturity at which time, the Bank would be made whole in its investment. Banks utilize AFS securities as an important liquidity tool; however, the addition of AOCI as a Tier 1 Capital component likely will lead to that tool being unavailable for those banks not willing to risk precious capital or put extra capital aside as a cushion to offset this unneeded volatility, thereby reducing the bank's ability to serve its communities.

Currently, our Bank can reasonably predict the path of Capital and therefore, can establish lending limits that maximize the use of available Capital. The addition of AOCI as a Capital component would force us and other small banks to reduce our internal loan limit to provide a buffer to protect the Bank against potential Legal Lending Limit non-conforming loans and the negative impact that required actions to bring those loans into conformity might have on our customers and the accompanying reputation risk from negative customer experiences.

In the chart below I have illustrated a potential impact to our bank based on the June 30, 2012 Report of Condition. While our Bank does not hold a large portfolio of AFS securities, we would in the future look to increase this category. To demonstrate, I used the UBPR information for Peer Group 14—Banks under $50 million with at least one branch in a Metropolitan Area. This Peer Group had 17% of Average Assets in AFS securities. I had our ALM vendor project a rate shock on our AFS portfolio which showed a reduction in value of 13.8%. All of this information was applied to our June 30, 2012 with the following results:

Impact of Inclusion of AOCI in Tier 1 Capital									
Peer group 14 % Avg Assets in AFS	New Horizon Bank Average Assets at 6/30/12	Potential AFS Holdings	Value Change at +400 BP rate shift	$ AOCI	Tier 1 Capital at 6/30/12	Leverage Ratio at 6/30/12	Legal Lending Limit at 6/30/12	Loan Relationships that would be classified Non-Conforming	
17%	$ 43,555,000	$ 7,404,350	-13.80%	$ (1,021,800)	$ 6,024,000	13.83%	$ 954,000	8	
					Tier 1 Capital under BASEL III	Leverage Ratio under BASEL III	Legal Lending Limit Under BASEL III	$ Non-Conforming	Required Reductions in Loan Relationships
					$ 5,002,200	11.48%	$ 800,730	$ 6,997,092	$ 589,092

As you can see, the Legal Lending Limit of the Bank would be reduced by over $150,000 resulting in 8 credit relationships being classified as non-conforming. The Required Reductions of $589,092 is the minimum amount required to return each credit relationship to conformity with the Legal Lending Limit. Finding a participant bank for 8 small amounts is unrealistic, more realistically, we would be required to sell larger portions of those loans to make the participations worthwhile.

The impact of removing banks as purchasers of Government Agency and Government –Sponsored Entities debt should be considered carefully. Reducing demand for those instruments would cause higher borrowing costs for the agencies, and ultimately for the stakeholders that they serve.

I recommend the Agencies consider exempting banks under $10 billion in assets from the proposed rule as it relates to AOCI inclusion in Tier 1 Capital. Changes in value due to interest rate risk on low risk investments such as Government Agency and GSE debt should be excluded from capital calculations for all banks.

Changes to Risk Weightings of Residential Mortgages

I am highly concerned about the impacts of changes to risk weightings of residential mortgages. The proposed rule does not provide any grandfathering of existing mortgages, but requires that banks perform a review of existing loan underwriting files to determine what category the loan would have fallen into at origination, and what the LTV was at origination. The proposed rules require consideration of factors that have not typically been entered into MIS systems at small banks that do not sell loans in the secondary market; therefore, this process would be highly manual and extremely time consuming at a high cost to our Bank.

Another concern is that the proposed rule requires classification of the loan at origination, and precludes reclassification of the loan due to factors such as i.) amortization of the loan, ii.) amortization of senior liens, or iii.) increases in collateral value, which would all reduce the risk to the Bank.

In reading through the proposed rules, I began to jot down policy changes our Bank would need to consider to ensure we are being appropriately compensated for the additional cost to capital many consumer real estate secured loans would entail under the new rules. I've worked at large banks in my career, and the changes we would need to make would take away the very value proposition community banks have been able to offer. No longer would it matter that the borrower has flawless credit, low debt to income and sufficient liquid assets to repay the loan. The sole fact that the loan carries an 80.1% LTV would trigger a risk weighting in excess of that for unsecured credit. The proposed rules would force us to make sure customers "fit into the box" so we don't jeopardize capital levels. The fact that unsecured credit would carry a lower risk weighting than a home equity line of credit at 80.1% LTV would leave most people with any underwriting experience scratching their heads.

With the housing market floundering in many parts of the country, this proposed rule would only create greater hurdles to homeownership. Much like the Durbin Amendment to the Dodd-Frank Act did not fulfill its intention of passing savings to consumers, but merely transferred those fees from the card issuers (who fully bear the costs of card fraud) to the merchants (who bear no expense of card fraud); this proposed rule will not cause Banks to carry more capital, but will have the negative impact of reducing credit availability.

I recommend that the agencies consider an exemption for bank's under $10 billion in assets, allowing those institutions to continue to risk weight real estate loans under the current model.

Delinquent Loans

My greatest concern with this proposal is the added complication in completing the Reports of Condition. Our Bank has been blessed with an extremely low level of loans over 90 days past due, so the proposal would not have much of an impact on us as we are today. I do think that increasing the risk weighting of past due loans is redundant to an effective Allowance for Loan and Lease Losses methodology which should already be assigning extra provisions for those past due loans, regardless of type.

Additionally, I am concerned that the proposed rule would cause some banks, especially those on the verge of a capital reclassification, to pursue more aggressive collection strategies or sell non-performing assets at a loss rather than allowing those loans to impact capital.

High Volatility Commercial Real Estate

1 understand that the intention of the agencies is to create greater capital buffers to institutions engaged in Commercial Real Estate transactions perceived to be higher risk. Rather than attempting to manipulate capital levels of all banks, I believe the agencies should focus on those banks that exhibit the risk factors identified as common among bank failures through this economic cycle—namely *Concentrations* of these types of loans, not merely the presence of any. The existing guidance in place tells banks that they should have additional risk mitigation strategies in place when ADC loans exceed 100% of capital or when total CRE exceeds 300% of capital. I believe a more direct requirement of a capital buffer for institutions that exceed these thresholds would better serve the agencies in mitigating risks of bank failures.

Conclusion

I want to thank the agencies for the opportunity to comment on the impact of these proposals to my Bank and to the industry, consumers, communities and bond market borrowers. I think one thing to keep in mind is that the community bank model is unique to the United States and the application of international standards on small community banks is unnecessary and bound to cause unintended negative side effects.

Sincerely,

Kathy H. Grasty
Chief Financial Officer
New Horizon Bank, N.A.

CC: Board of Directors, New Horizon Bank
James F. Keller, President & CEO
Jeffery B. King, Assistant Deputy Comptroller, Virginia Field Office
James Kendrick, Vice President, Accounting & Capital Policy, ICBA