SECURITY FEDERAL
SAVINGS BANK

JOE H. PUGH
PRESIDENT & CEO

October 2, 2012

Lamar Alexander
United States Senate (TN)
455 Dirksen Senate Office Building
Washington, D.C. 20510

Bob Corker
United States Senate (TN)
185 Dirksen Senate Office Building
Washington, D.C. 20510

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

Re: Basel III Capital Proposals

Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The Officers of Security Federal Savings Bank are greatly concerned about the effect of the proposals on our business model. The Bank has always prided itself on being a community-oriented institution specifically designed to serve customers within our local community. Long-term relationships with our local customers are the foundation of our business strategy. By developing these long-term relationships with our customers, Security Federal can operate with a practical, common sense approach to managing the risk in our portfolio. Basel III was designed with the large, international banks in mind, not community banks.

Security Federal will be greatly impacted by the new proposal changes to the risk weighting of mortgages. Our real estate loan portfolio has typically consisted of non-conforming loans. Although non-conforming, the portfolio has been well-managed with the use of co-signors or additional collateral. The proposed changes to the risk weighting based on loan-to-value ratios will stall our ability to lend. This in turn will not only hurt the bank's earnings going forward but will also impact our small local community. Bridge loans for home purchases or slightly higher loan-to-values will not be accessible for most local borrowers. Bridge loans and balloon mortgages also provide the Bank tools for managing its interest rate risk. Our residential loan portfolio has experienced less than half of one percent in losses even through this economic crisis. The proposal does not reflect the true risk that community banks experience and will curb our ability to generate these types of loans.

[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; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

In addition to our balloon mortgage and bridge loan products, we have operated a very successful mortgage department that originates loans for sale in the secondary market. The Bank has had this product for several years and has incurred very little loss associated with these loans. Under the proposed rules, the bank would be required to treat arrangements with an early default clause as an off-balance sheet guarantee with a 100 percent credit conversion factor. This new rule will impact the amount of credit we can make available to the local community for housing. Due to the limited risk we urge the banking agencies to retain the 120 day safe harbor rule that is currently in effect.

As of June 30, 2012, Security Federal had a Total Risk-Based Capital Ratio of 14.54%. This ratio under the proposals will be impacted by more than a 3.5% decrease. Under this estimation, the Bank will only slightly meet the proposed 2.5% capital conservation buffer in the near future.

Security Federal Savings Bank intends to maintain a status of well-capitalized. The new risk-weights and the proposed capital structure will cause the bank to lose the ability to serve the community's real estate lending needs. We foresee limiting the amount of our residential lending; second liens will also become more expensive or disappear. The Bank will not be able to allocate additional capital to offset these types of balance sheet exposures.

We ask that legislators choose not to penalize the community banks for economic events that were not related to our business structure. Community banks should be allowed to stay with the current Basel I risk weight framework for their residential loans. We appreciate your efforts and consideration.

Sincerely,

Joe H. Pugh
President & CEO

Angela D. Brown
Chief Financial Officer