From: Menzo D. Case <Menzo.Case@mygenbank.com>
Sent: Friday, October 19, 2012 3:08 PM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Ladies and 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**.**

After reviewing the proposed framework and assessing the impact on Generations Bank's capital requirements, it is evident that Basel III requirements as outlined in the proposed regulations will have a negative impact on our ability to continue – which is perhaps the intent (i.e., to reduce the number of community banks and to further consolidate the banking industry into four or five quasi-government entities).

The Basel III requirements are intended to apply to the largest, internationally active banks, which operate and profit from transaction volume. Unlike these "too-big-to-fail" institutions, a concept that is abhorrent to community banks, we focus on building long-term relationships with our customers and communities. In this model, we sometimes prudently take greater lending risks than the large banks in order to meet the community needs and to bolster growth in a tough economic climate.

Just this past year, we were approached by a company with a long successful history. This company determined to expand their operations late 2007. Unfortunately, the economy changed dramatically in 2008, and the company fell into difficult times. The business owner worked hard to maintain most of his staff, closed the expansion office, used his personal credit cards to make ends meet and took less from the company personally. His former bank determined to call all his loans, a disaster! He approached us, one of the last locally owned and operated community banks in the region, and asked whether we could help. After carefully reviewing his situation, we were able to work with our local Industrial Development Agency and put together a new financing package. Today, the company is thriving with a full work force.

We are able to take these risks because we know our customers, our local economy and have developed strong bonds with our customers. From a regulatory point of view, we are able to take these risks because we have historically balanced these risks with less risky lending (i.e., small business lending versus residential lending). However, under the proposed capital standards, our residential lending portfolios will be equated to the poorly underwritten and ill-advised residential lending championed by the largest of institutions, via a change in risk weighting for residential mortgages based on LTVs. As a result of the new risk weighting, our stalwart residential portfolio will be considered of greater risk than presently, despite the facts and history proving otherwise, changing our risk profile, and inevitably, requiring us to rethink our entire lending strategy – most likely eliminating those community-friendly programs which indeed have a higher risk profile. We do not have the capability presently to analyze all of our residential mortgages to determine the effect of a change in risk weighting, but we estimate our risk-based capital ratios will decline by 130 basis points.

We are also concerned about the incorporation of accumulated other comprehensive income (*AOCI*) as part of our regulatory capital calculations. Such inclusion will result in highly volatile regulatory capital balances, which could rapidly deplete capital levels due to various changes in economic conditions. A portion of our AOCI represents unrealized gains and losses on our available-for-sale (*AFS*) securities, and any changes in those values due to interest rate fluctuation will be captured in the regulatory capital calculation. We also have AOCI related to our pension which may be adversely affected by changes in rates, reflected in changes in either the long-term yield anticipated on pension

assets or in the discount rate applied to determine our pension liability. Our bank's tier 1 capital ratio would decline by 118 basis points immediately, just with the inclusion of AOCI. Although we would still be categorized as "well-capitalized", as interest rates rise from our currently unsustainable environment, the fair value of AFS securities will fall and thus have a further negative impact on our regulatory capital calculations. Large banks have the ability to moderate these risks by hedging with financial instruments such as interest rate swaps, options and futures contracts; however, we cannot afford these options for a number of reasons. These instruments require a high level of expertise in order to effectively manage their associated risks, costs and barriers of entry, making them infeasible for us. We believe AOCI should continue to be excluded from regulatory capital calculations as they are currently because they do not truly affect the "capital at risk" (i.e., we are not likely to sell our AFS securities or liquidate our pension plan, thus realizing the unrealized losses imbedded in either).

We are also concerned about the addition of capital conservation buffers. Imposing these capital conservation buffers on us will require us to build additional capital balances to meet the minimum requirements with the buffers in place. We have very few feasible alternatives for raising additional capital. The two main means are through retained earnings or by offering common or preferred stock. First, we do not believe that the capital buffers are necessary. Our capital position has not been affected by excessive losses taken from ill-advised schemes concocted by the largest banks (i.e., poor residential lending, inordinate high-risk loans with inadequate allowances and the like). Second, raising capital through a stock offering would necessarily subject our Bank to acquisition. We have no interest in abandoning our communities and having the largest banks continue to increase their footings – with ineffective regulation and with very little direct community ties.

Finally, we are concerned about the additional costs we will incur just in an attempt to properly calculate the new capital ratios! While this type of legislation – a "one brush to paint all" mentality – is the norm these days, small community banks, such as Generations Bank, can scarcely afford the additional burden being contemplated. We would need to have core software upgraded, allocate additional personnel time to compiling the new information required under the proposed calculations – especially the loan-to-value information for each individual residential mortgage and substantially revise our business plan to limit further credit available for commercial, small business and residential lending.

Basel III as currently proposed continues to advance the apparent objective of establishing a banking system similar to that in place in Europe – a few large banks controlled by central government. This model has failed tremendously and is in direct contrast to the American system. The dual banking system – federal and state chartered institutions – has served us well. Small community banks are the lifeblood of communities across this nation. As currently proposed, Basel III stands to constrict customer autonomy by potentially limiting the type of residential products that their community bank could offer them, which could force customers to engage too-big-to-fail institutions in order to provide the product they desire. This will in turn hurt community banks again by forcing customers to do business elsewhere, and thus cut further into already diminishing profit margins.

As demonstrated in this letter, our analysis suggests that if the Basel III guidelines are inappropriately applied to Generations Bank, our capital position would deteriorate immediately – with no change in our profitability, no change in our true risk profile and with very few alternatives available to offset the devastating effects. In order to offset the effects of the proposed changes, we would either have to shrink our balance sheet (i.e., further restrict credit and reduce deposit services) by $26 million or raise $2.8 million of additional capital. Either way, Generations Bank would not be the same institution.

Thank you again for the opportunity to provide comment on the Basel III proposals 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**.** I sincerely hope that you will take Generations Bank, as well as the other small community banks affected by this proposal, into consideration as you move forward in the proposal process.

Respectfully Yours,

Menzo D. Case
President & CEO
Generations Bank

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[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.*