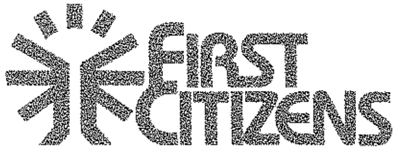

October 19, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

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

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on proposals collectively referred to as Basel III Capital proposals (and formally titled as follows: *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*) that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

First Citizens National Bank, headquartered in Dyersburg, Tennessee since 1889, is a strong $1.1 billion community bank that serves consumer and commercial customers in 19 locations across nine Tennessee Counties. We offer a full range of financial services including traditional loan and deposit products as well as brokerage, trust, mortgage and insurance. Our loan portfolio is heavily weighted in real estate loans which account for approximately 75% of our total loans. We are deeply entrenched in our communities as many members of our board and management team serve on boards and committees of various charitable and civic organizations. We expend at least $250,000 annually in corporate contributions and community projects. One example of such commitment is that our bank ranked 4th for the past two years in overall giving companies to United Way of West Tennessee.

Recognitions are not uncommon for our bank as we strive for excellence in all areas including customer service, employment, shareholder return and risk management. As such, for the past five years, we ranked among the top 200 performing community banks in the U.S. as recognized annually by American Banker Magazine based on a three-year average return on equity for institutions with total assets less than $2 billion that are either publicly traded or file

First Citizens National Bank, P.O. Box 370, Dyersburg, Tennessee 38025, Phone (731) 285-4410

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with the Securities and Exchange Commission. We have maintained profitability and capital levels that exceed minimum requirements to be considered well capitalized by regulatory authorities for decades including during and beyond the recent recession.

As it is our desire to remain profitable and well capitalized for our depositors and shareholders while continuing to grow and provide superior customer service in our markets, we are concerned about possible significant adverse impact to our bank from recently proposed changes to regulatory capital calculations and requirements despite our conservative philosophy and comprehensive risk management system already in place. Recently issued proposals increase required capital ratios, narrow what may be considered capital and increase risk weights on assets already on our balance sheet.

Our specific concerns are outlined as follows:

1. **How inclusion of unrealized gains and losses on our available-for-sale (AFS) securities portfolio will impact our regulatory capital ratios.**

   Fluctuations in unrealized gains and losses are common and due primarily to correlated movements in interest rates and level of activity in the bond market rather than due to credit quality. Considerations of those typical market fluctuations in our regulatory capital ratios will introduce a significant level of volatility to our capital position which does not exist under current rules. The added level of volatility is perceived as significant for a couple of reasons. First, overall volume of the AFS portfolio in terms of total dollars and as a percentage of total assets has increased over the past three years during a period of slow loan growth but strong deposit growth. Currently, our investment portfolio totals approximately $400 million or 36% of total assets. Historically, the investment portfolio has carried a pre-tax market value adjustment of in the range of -3% to +3% of book value. However, in the historically low rate environment experienced in the past three years, that pre-tax appreciation has been in the +3% to +6% range, resulting currently in accumulated other comprehensive income of approximately 9% of total capital.

   Therefore, if new rules were adopted today or at the proposed effective date, capital ratios would likely increase significantly. However, we believe that at some date in the future, interest rates will rise after the unprecedented long period of very, very low interest rates. As a result of interest rate sensitivity in our portfolio, unrealized appreciation that exists today would likely evaporate and possibly even become depreciation depending on timing and magnitude of rising rates. Thus, it becomes increasingly difficult to accurately forecast regulatory capital ratios. The added volatility would negatively impact our customers and shareholders as it would likely force our bank to hold more capital to cushion against unexpected volatility, limit implementation of growth strategies, and could even require alteration of core investment strategy which has been successful and in place for many years.

   Our AFS investment portfolio serves as a major liquidity tool and is used to manage interest rate risk. In order to reduce volatility, the Bank could be forced to classify a significant portion of the portfolio as held-to-maturity which greatly reduces the bank's effectiveness to use the portfolio for its two primary purposes: liquidity and interest rate risk. Flexibility of the portfolio is a critical factor in successful management to achieve desired strategies. That flexibility would be greatly compromised under proposed rule changes.

We feel that the volatility added under this new rule does not accurately reflect risk exposure in the portfolio because we believe that the likelihood of having to realize gains or losses on the entire securities portfolio at any one time is remote.

2. **Phase out of Trust Preferred Securities (TruPS)**

   The proposal is inconsistent with the Collins amendment in the Dodd-Frank Act in that our TruPS would be phased out over a 10-year time frame rather than being grandfathered in. We have two $5 million issuances of TruPS of which one was issued in 2005 and the other in 2007. Both have a 30-year term and we have made and expect in the future to make all payments in accordance with original terms. These account for 10.5% of Tier I Capital at our holding company level as of June 30, 2012. We also hold three securities which are pooled TruPS which account for approximately 1% of our total investment portfolio. Phase out of these types of securities is expected to reduce our capacity to pay dividends to shareholders in order to rebuild dilution in capital caused by the phase out. In addition, phase out will negatively impact our expected cash flows from investments in TruPS to the point that additional impairment may need to be recognized against earnings.

   While our bank is in a strong enough capital position to absorb expected adverse effects of this phase out, we believe that any adverse effect is contrary to the intent and desire of our bank, of our industry, and of our economy which is to implement actions to promote profitable growth (and capacity to lend) rather than to impair or delay it. We respectfully request that the proposed rule be revised to fully recognize the intent of the Collins amendment by permanently grandfathering outstanding Trust Preferred Securities for institutions between $500 million and $15 billion.

3. **Changes to risk weights for residential mortgages**

   The proposal assigns risk weights to residential mortgages based on (1) whether the mortgage is "traditional" category 1 or "riskier" category 2 and (2) the loan-to-value (LTV) ratio of the mortgage. Residential mortgages account for approximately a third of our total loan portfolio and therefore, risk weighted assets could increase significantly under proposed rules.

   Proposed rules do not include any type of grandfather provision, so just the time and expense to examine old mortgage underwriting files to determine the appropriate category and LTV ratio for existing mortgages on the books is overwhelming and may not even be possible if certain data points were not gathered or documented at the time of origination. While technology continues to evolve, thus improving our means and ability to perform the type of robust analysis that will be necessary to comply with proposed rules, such information is not necessarily captured in a way that can be easily data mined for existing mortgages. The complexity of the new rules will not only be a challenge to implement on new loans going forward but a slow, expensive, manual process to apply to the existing portfolio. To comply with proposed rules, the bank estimates additional expense of at least $150,000 if not more at implementation and increased labor and technology expenses ongoing. Estimated costs include expense to train employees, time and expense to review and apply rules to the existing portfolio and programming changes necessary in the core loan application system to track required information.

Under proposed rules, if a bank holds two mortgages on the same residential property and one of the loans is a category 2, the bank would be required to treat both loans as category 2. Thus, potential exists for the bank to have risk weights of at least 100% and up to 200% on a first lien mortgage and HELOC on the same property. Historical experience for our bank and likely industry wide indicates that losses on HELOCs are usually less when the bank holds both first and second liens rather than when one bank owns the first mortgage and another bank owns the second. The new rules actually are a dis-incentive to hold both first and second liens as these loans could end up with a higher risk weight than a personal unsecured loan. Thus, this rule will make us less inclined to extend credit to borrowers under various scenarios even if our risk of loss is reduced and within our tolerance levels.

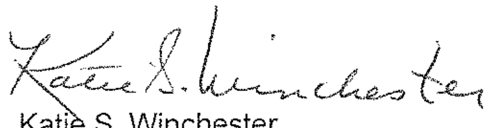
Thus, impact of changes in risk weights is likely to reduce our capacity to lend by reducing our current capital ratios and also deter us from making certain residential mortgages going forward. Reducing our ability and likelihood of extending credit especially as it relates to residential mortgages is in direct contrast to other efforts by our bank, our industry and our government to ensure credit is available for home buyers. Therefore, we respectfully request consideration of grandfathering existing mortgages for any new rules for risk weighting. We also request evaluation and adjustments of proposed changes in risk weights to avoid unintended consequences such as deterring extension of credit for first and second liens at the same institution.

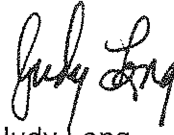
4. **Increased risk weights on delinquent loans**

Proposed rules change risk weights on delinquent loans as nonresidential loans over 90 days past due would be assigned a risk weight of 150%. While this proposal is not expected to have an immediate significant impact at implementation, we feel that requiring additional capital reserves for delinquent loans is unnecessary. Loans that are delinquent or identified to have other credit risk issues are already addressed in the Allowance for Loan Losses. The Allowance for Loan Losses is reviewed by Management and the Board of Directors on a quarterly basis and is reviewed under regulatory examination and external audit at least annually. Given the level of scrutiny and attention already placed on Allowance for Loan Losses to ensure timely and adequate reserves on any credit issues, placing additional capital requirements on delinquent loans is likely to result in nothing more than a reduction in overall lending capacity available in our markets at both a local and national level.

In conclusion, we support initiatives to ensure all banks are well capitalized and generally support an increase in minimum capital requirements. However, we believe that proposed rules were designed for very large, complex financial institutions. The cumulative effects of Basel III proposals are likely to have the most significant adverse impact to community banks instead of very large, complex institutions for which they were designed. We strongly urge you to consider revisions or exemptions for community banks so that your efforts will not only result in well capitalized banks but also enhance our ability to serve our customers and support our communities. We appreciate your time and consideration.

Best regards,





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& Executive Vice President

Sherrell Armstrong
Chief Credit Officer
& Executive Vice President

CC: Senator Lamar Alexander, Senator Bob Corker, Rep. Stephen Fincher,