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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:

The purpose of this letter is to provide comment on the changes to regulatory capital requirements now under consideration.

While we believe CNB would continue to exceed all capital requirements, including the new so-called "buffer capital" levels, we are opposed to the proposed changes in the regulations. We believe the changes are both unnecessary, as well as harmful to the mission of serving our community by providing loan capital to consumers and businesses in a safe and sound manner.

The proposal is not necessary:

> The current regulatory framework empowers regulatory agencies to require capital levels at individual banks at levels higher than the minimums contained within existing regulations. High capital is required at higher risk institutions, as deemed appropriate following extensive due diligence in safety and soundness exams that considers all relevant information for that bank. Such requirements are "soft" when risk is barely elevated, and is provided in both discussions as well as in written examination reports, and is reflected in the CAMEL ratings. As risk becomes elevated, such requirements are more forceful and may be contained in such formal agreements as Cease and Desist orders.

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Similarly, a buffer process already exists. If risk is rising, this will be accompanied by declining earnings. Existing regulations limiting the payment of dividends, as well as the regulatory processes described above, provides a buffer process that has proven effective.

A key element is ignored:

If a purpose of the proposed regulation is to encourage higher capital and Allowance for Loan and Lease Losses (ALLL), then existing impediments to this should be explored. Today, ALLL is a component of Tier 2 capital, but only up to a level of 1.25% of loans. This cap should be eliminated.

The community may be deprived of a valuable loan alternative it now has access to:

Community banks throughout many regions of the country, including ours, provide residential mortgages to their local client base. Generally, we cannot and do not attempt to compete with the secondary market products that include 30 year fixed rates, at interest rates far lower than a bank finds profitable. Frequently we are financing homes that do not fit into the neat policy boxes of the secondary market, which may be as simple as homes on land with acreage sizes larger than approvable in the secondary market. Frequently we are providing financing for self-employed borrowers whose financial situation is excessively complex to be approved in the secondary market. Frequently we are providing financing for borrowers with a temporary blemish in their financial history that our bank is qualified to underwrite safely, but the secondary market will not consider.

The secondary mortgage market has proven over time to be fickle. It is at times excessively bold. It is at times excessively fearful of risk. It has proven to be an uncertain source of loan capital for consumers. Community banks, however, have proven over time to be a more stabilizing influence on the community it serves. Community banks need to retain the flexibility to use product types that fit the specific needs of specific clients, and this may include the use of "bullet" maturity residential mortgages. If forced to use unprofitable product types and structures or none at all, we may well choose none at all, and the community, the clients, and the national economy will be ill-served.

Risk based capital restrictions that punish banks for extending higher loan to value residential mortgages will have the *unwelcome side effect of eliminating programs for first time home buyers*, who rarely have a down payment equal to 20% of the appraised value. This aspect will interfere directly with CRA initiatives, and is counter to all existing public policy initiatives to date.

There are better and more direct alternatives:

There are alternative methods to inhibit lending by banks in sectors or products deemed to carry excessive risk, and such methods can be more direct and targeted to the risk. The use of concentration limits on "acquisition and development loans" is a recent example, that is proving effective, and especially so when coupled with a robust regulatory safety and soundness examination process.

The new capital regulations would shut off the flow of loan capital more extensively during downturns:

There has been much written and said with a certain level of public frustration that "banks won't lend" during the worst of the recent economic crisis. If new capital rules are enacted that employ formulas requiring higher capital for higher levels of past due loans, these new rules will insure banks cease lending at the precise moments in time that the Federal Reserve and other governmental bodies are most anxious to see banks lend more. The capital rules will run precisely counter to other stated public policy goals.

Community banks differ from their larger brethren in two different but related ways: first, we do not have ready access to capital markets, and being therefore unable to simply acquire more when needed, we must plan carefully and husband the capital we have to insure its sufficiency throughout good times and bad; and second, we do not access the capital markets to securitize and sell the loan assets we generate. *The proposed regulations will make capital planning through the business cycle nearly impossible.* We extend loans to borrowers within our community, to hold rather than sell, and we will be inhibited from serving the consumer and small business clients that are least well served by secondary market lenders, precisely at those moments when we are most needed.

Higher capital levels will translate into higher interest rates to borrowers:

There is no "free lunch" in any proposal whose impact is a requirement for higher levels of capital across the business cycle. In order to achieve the same level of ROE on a higher capital base, higher levels of profitability must be obtained. This translates quickly into a higher level of interest rates and net interest spreads on loans, and / or lower rates paid to depositors on interest bearing deposits. Higher fees on services are similarly likely.

The biggest issue of all still needs to be addressed:

It is a given that a business cycle exists. Since community banks cannot raise new capital at will, we must take care to build our balance sheet strength during the stronger years of the cycle, in preparation for the weaker years that will surely follow. Current

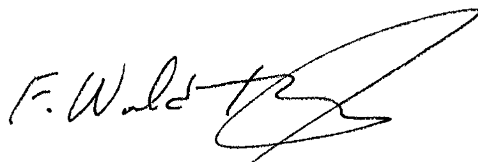
accounting rules are based on the concept that ALLL levels may not exceed the amount calculated to be "needed" based on recent loss history. Community banks should be allowed more freedom to build or retain ALLL during stronger periods. This will reduce the cyclical swing extremes of bank performance and failure. Arguably, the recent period of high levels of bank failures can be traced to a forced reduction of ALLL levels immediately prior to the recessionary period the industry has faced.

Serious consideration should be given to the establishment of a methodology to create a minimum level of ALLL, even during periods where there is no recent history of losses that can be used to justify a quantitative component of ALLL, and when current economic aspects used for the qualitative component are too favorable to justify an ALLL at a safe and sound level.

In summary, we at CNB strongly believe the proposed regulations do not "fit" the public policy goals for the mission of community banks. The regulations appear to be constructed purely with an eye toward global financial institutions. Most importantly, a healthy regulatory examination framework and process already exists that fulfills the function of the proposed regulations, and does so better due to the fact capital requirements and dividend restrictions are tailored to the specific facts of specific banks.

We strongly urge the proposed capital regulations *not be adopted* for community banks.

Respectfully yours,



F. Winfield Trice, Jr.
President and CEO