October 22, 2012

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

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.

The lawmakers and regulators are once again proposing regulations that pose a real challenge to community banks our size. The Bank of Marion, VA is a $357,000,000 bank located in Marion, VA. Marion is a small community of about 7,000 citizens and located in Smyth County that has a declining population of about 30,000 residents. The Bank was chartered in Smyth County in 1874, and is the second or third oldest, continuous operating bank in the state.

The ongoing implementation of the Dodd-Frank Act has presented challenges for us in every aspect of our Bank, and has taken up a lot of time and resources. The Basel III proposal will add different, but additional challenges. Among other things, the proposal would raise minimum capital requirements, narrow the definition of capital, and increase the risk-weights for various asset classes.

The Bank of Marion is currently a very well capitalized bank ranking as high as the 84th percentile of our peer banks as of the June 30, 2012 Uniform Bank Performance Report. We have modeled our Bank's capital as if Basel III were implemented as of June 30, 2012, and we would remain "well capitalized." We would also meet our capital conservation buffer component, and at first glance all looks well even though our capital ratios decline about 14%. We have also modeled an immediate 300 bp shock to our capital using Basel III rules, and we will experience a 25% decline in our capital but still remain well capitalized and maintain the required "buffer". I am attaching a chart demonstrating our computations.

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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.*

So, why am I writing this letter in opposition to Basel III?

First, we are an originator of home loans that we keep "in house". We do not make loans and sell them in the secondary market. These loans are underwritten to standards not always as strict as loans to be sold. We know the people to whom we are making the loans, we know the properties they are purchasing, and we know how to manage the risks associated with making these mortgages. We make several "first-time home buyers" loans every year. We occasionally bend the "rules" to make sure that the borrower can buy (or build) the house they want. We have always viewed this as applying the breath and intent of CRA. If Basel III is implemented, the risk weightings on these types of loans will be so severe we will not be able to serve the segment of our community that needs a community bank the most.

Second, we would need to reinvent the way we invest our excess funds. Our current loan to deposit ratio is less than 70%, and as a result of that, we have a large investment portfolio. Under Basel III, inclusion of accumulated other comprehensive income (AOCI) in capital would result in increased volatility in regulatory capital balances, and could rapidly deplete capital levels under certain economic conditions. AOCI typically represents unrealized gains and losses on our investment securities that we hold available-for-sale. Because these securities are held at fair value, any gain or losses due to changes in interest rates are captured in the valuation. Recently, both short and long term interest rates have fallen to historic lows generating unprecedented unrealized gains for our portfolio. Once an economic recovery accelerates, interest rates will rise, fair values will fall and the balance of the AOCI will decline and become negative. This decline will have a direct, immediate impact on common equity, tier 1 and total capital because the unrealized losses will reduce capital balances. At my bank, for instance, if interest rates increased by 300 basis points, my banks bond portfolio would show a paper loss of almost $6 million. This would mean my banks tier 1 capital would drop by almost 10%. Large banks are able to hedge this volatility, but our bank does not have the knowledge or expertise to manage these complicated transactions. We should be allowed to exclude AOCI from capital measures the same as we currently do.

Third, implementation of capital conservation buffers for community banks will be difficult to achieve under the proposal and should not be implemented. Unlike The Bank of Marion, many community banks will need to build additional capital balances to meet the minimum capital requirements and the buffer. Even my bank could see its cushion evaporate with several bond losses or bad loans. Community banks do not have ready access to capital that large banks have through capital markets. Since Trust Preferred Securities will go away, the only way we would be able to raise capital is through retained earnings over time. Due to the current ultra low interest rate environment, community bank profitability has shrunk further hampering our ability to increase capital.

It is my hope that community banks will be allowed to continue operating under the current Basel I capital framework. Basel III was designed for the largest, internationally active, and systematically vital banks and <u>not community banks!</u> Community banks did not engage in the volatile activity that severely depleted the capital of the largest banks,

and we did not create the panic in the financial markets. We operate on a relationship-based business model specifically designed to serve customers in our communities on a long-term basis. Our 138 year history is proof that the model is working. Please do not regulate us out of business!

Sincerely,

John E. Stringer

John E. Stringer, President/CEO
The Bank of Marion

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