MainStreetBank

October 22, 2012

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

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

Office of Comptroller of the Currency
250 E. Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to 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.

MainStreet Bank is a five-branch community Bank serving the financial needs of citizens in and around the Washington DC Metropolitan area. We received our banking charter from the Commonwealth of Virginia and our certificate of insurance from the FDIC in March 2004. Since that time we have grown to an asset size of approximately $260 million. We currently service over 5,214 accounts owned by our customers in the communities we serve, and we have 60 employees.

[1] The three proposals are (i) Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action ("**Basel III Numerator NPR**"), 77 Fed. Reg. 52,792 (Aug. 30, 2012); (ii) Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements ("**Standardized Approach NPR**"), 77 Fed. Reg. 52,888 (Aug. 30, 2012); and (iii) Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule ("**Advanced Approaches NPR**"), 77 Fed. Reg. 52,978 (Aug. 30, 2012). Collectively, these are referred to in this letter as the "**proposals**."

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MainStreet Bank opposes the application of the new proposed "Basel III" and "Standardized Approach" rules to community banks for a number of reasons. The proposals, which the Agencies propose to extend to all U.S. banking organizations,[2] would represent the most comprehensive overhaul of the U.S. bank capital framework in over two decades and would start to take effect at a time when the United States is only beginning to recover from a deep economic recession.

Basel III was designed to apply to the largest internationally active banks and not to community banks. Community banks have a very straightforward balance sheet structure with nominal off-balance sheet activity. Community banks operate on a relationship-based business model that is specifically designed to serve customers in their respective communities on a long-term basis – in good times and in bad times. This model contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. Large, internationally active banks have a transactional model with much less attention to the customer relationship. It is nearly impossible to model the value of "relationship" banking relative to capital adequacy, yet that is a fundamental difference between the large internationally active banks and community banks.

The application of the proposed rules to all banks, rather than just to the largest, internationally active banks for whom they were originally designed, will create a number of negative consequences. These negative consequences will directly conflict with the Executive and Congressional objective of fostering the recovery of the economy of the United States.

A few examples of such unintended negative consequences include:

1. Community banks will withdraw from certain "bread and butter" type loans which require a higher capital charge and/or for which the loan pricing to reflect the capital charge will become cost prohibitive for the underlying consumer and small business. This will have a direct impact on the speed of our economic recovery.

2. Community banks will withdraw from certain investment markets for which they have historically provided liquidity, such as municipal securities. The purchase of municipal securities will no longer

[2] The Agencies propose to apply the revised capital framework to all national banks, state member banks, state nonmember banks, state and federal savings associations and top-tier bank holding companies domiciled in the United States not subject to the Federal Reserve Board's Small Bank Holding Company Policy Statement, 12 C.F.R. Part 225 Appendix C, as well as top-tier savings and loan holding companies domiciled in the United States, regardless of size.

provide a sufficient return to augment the capital charge against them. With no other institutional investors at the ready, the municipal securities market will suffer irreparable damage.

3. The inclusion of Accumulated Other Comprehensive Income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for most community banks represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. This decline will have a direct, immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce capital balances.

Large Financial institutions have the ability to mitigate the risks of capital volatility. They can enter into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Generally, community banks do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry. Community banks should continue to exclude AOCI from capital measures as they do today.

4. This proposal will force community banks to declare that the bulk of their future securities purchases be placed in the "held-to-maturity" category which effectively eliminates the contingent liquidity provided from a community bank's investment portfolio. Furthermore, the proposed rules unfairly penalize community banks by reflecting the fair value changes of a single balance sheet component in Tier 1 capital (e.g. AFS securities), while excluding fair value changes of other balance sheet components (e.g. Time Deposits) which typically move in the opposite direction and would serve to offset or mitigate the effects of AFS securities fair value changes.

5. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks offering these load products, depriving their customers and potential customers of many financing options for residential property. These higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. Many community banks like

ours will either exit the residential loan market entirely or originate only those loans that can be sold to a GSE. Second liens will become either more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages. Finally, second lien credit facilities are an important financial liquidity product currently available to prudent and credit-worthy consumers. Community banks should not have to police the prudence of consumers indirectly through the de facto elimination of financial products via regulatory capital regulations.

6. The proposal requires higher risk weights for certain types of equity exposures, such as investments of common stock in an unconsolidated financial institution (unless already deducted), and investments in publicly traded companies and companies that are note publicly traded. Higher risk-weighting requirements for these equity investments will reduce the ability of community banks like ours to support small business lending through these very effective vehicles. Again, this negative unintended consequence, limiting the financial resources of job-creating small businesses, is in direct conflict with the objective of fostering the recovery of the economy of the United States.

7. The capital conservation buffers for community banks will be difficult to achieve under the proposal. The volatile earnings histories and outlandish compensation payouts present in the Wall Street banks do not exist in community banks, yet many community banks will be forced to accumulate additional capital balances to meet the buffer requirements. The ability for a community bank to raise additional capital at a time when the knock-on effect of the buffer precludes the bank from paying dividends simply exacerbates the problem, (e.g., a zero dividend reduces the perceived share value).

8. The capital markets environment is not currently an efficient source for new capital for most community banks. The effects of the recent recession and the global economic environment have impacted the earnings of community banks and the underlying marketability of community bank stock in general. If Basel III standards must be met by community banks in 2013, community banks will be forced to substantially dilute the investments of many community-conscience small bank stock investors simply to stay in business. The best way for community banks to increase capital is through the accumulation of retained earnings over time. If regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) to allow those banks that need additional capital to retain and accumulate earnings accordingly.

Conclusion:

The current Basel III proposal is simply too complex for community banks and the unintended consequences are too far-reaching for the national economy. Changes in lending and investment decisions will significantly upset certain markets that have historically been in the wheelhouse of community banks. There is no need to throw the baby out with the bath water - for community banks, Basel I works extremely well.

Sincerely,

Jeff W. Dick,
Chairman, CEO & President