



Farmers & Merchants Bank of Western PA

October 16, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> 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, D.C. 20219

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

RE: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comments on the Basel III proposals 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").

Farmers & Merchants Bank of Western Pennsylvania, N.A. is a \$400 million community bank headquartered in Kittanning, Pennsylvania with 7 branch locations. As a community bank, our primary business is providing deposit and loan services to individuals and businesses. Our bank has been serving the needs of our customers and communities for over 100 years.

We are deeply concerned the proposed Basel III capital rules will negatively impact our ability to continue serving our customers by requiring us to accumulate and hold additional capital above our current "well capitalized classification". The tremendous increases in regulatory burden that have emerged from the near economic collapse has made it an ever increasing challenge for us to adhere to our traditional lending models and has made it harder than ever for us to remain profitable.

Our specific comments regarding the Basel III Capital proposal are listed below:

1. According to the proposal, **all unrealized gains and losses on available for sale securities (AFS) must flow through to common equity tier 1 (CET1)**. Our bank is a typical community bank that primarily holds debt securities. The values of these securities fluctuate primarily with the change in benchmark rates, as opposed to changes in credit risk. The inclusion of this proposal will add a significant amount of volatility to capital ratios as these benchmark rates change with the economic conditions. Specifically, for our bank an immediate 300 basis point increase in rates would reduce the value of the available for sale investment portfolio by approximately \$7 million. Under Basel III, this would represent a 16 percent decline in our current Tier 1 capital.

Under this proposal, managing the capital position will become a challenge. To avoid erratic fluctuations banks may opt to classify their entire portfolio as Held-to-maturity (HTM) thereby avoiding the gain or loss flow through to equity's Other Comprehensive Income. However, this action will severely impede a bank's ability to strategically manage the portfolio for liquidity purposes and through various economic and interest rate cycles.

Given the issues outlined above, Farmers & Merchants Bank is opposed to the inclusion of gains and losses on available for sale securities in CET1.

- 2. Revisions in the Standardized Approach for the calculation of risk weighted assets**, specifically as they apply to 1-4 family residential mortgages, will significantly impact the bank's ability to serve the credit needs of our community.

The current Basel III proposal segregates mortgages into Category 1 for "traditional" and Category 2 for "riskier". Within each category four tiers further segment the portfolio by "loan-to-value" (LTV), which is the amount of the loan outstanding as a percentage of the market value of the mortgage collateral.

Under the current capital format, a 1-4 family residential mortgage is assigned a 50% risk-weight if it is "prudently underwritten". The proposed change could raise the risk-weight to 200%. This completely disregards the high credit underwriting standards our bank maintains. This will significantly restrict our ability to continue offering mortgages with a greater than 80% LTV regardless of the quality of the credit. Specifically, this proposal will, at a minimum, increase the bank's risk weighted assets by \$31 million.

We strongly urge the agencies to reconsider this complex evaluation structure for community banks.

- 3. Increasing the risk-weighting for delinquent loans is unnecessary and punitive.** Delinquency is already addressed through the allowance for loan loss calculation. This proposal will double the impact on banks by requiring them to set aside even more capital. The unintended consequence of this proposal will be the community bank's reluctance to help their customers on a workout basis; instead we will be forced to proceed directly to foreclosure and liquidation of the asset. Given the unfortunate economic cycle we are operating in, this proposal makes absolutely no sense.

We strongly urge the agencies to reconsider this change in risk-weighting for delinquent loans.

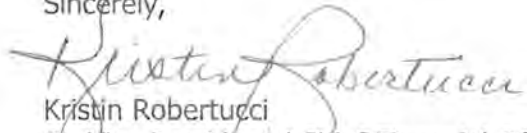
Furthermore, the scope and granularity of the proposed capital changes will require manual review of over 1,700 files and modification of existing systems for future tracking. Our community bank does not have the personnel or resources available to larger banks.

We believe that the proposed capital changes, if implemented as they are currently written, will have an unnecessary detrimental impact on community banks across the nation. This will lead to more community bank failures. The punitive nature of the current proposal will reduce the

availability of credit, further squeeze already tight net interest margins, and have a significant negative economic impact.

Thank you for the opportunity to comment on these proposals. If you have any questions regarding the comments within this letter, please do not hesitate to contact me by phone at 724.548.9250 or by email at [kristinr@fmbwpa.com](mailto:kristinr@fmbwpa.com).

Sincerely,

A handwritten signature in cursive script that reads "Kristin Robertucci". The signature is written in dark ink and is positioned above the typed name.

Kristin Robertucci  
Sr. Vice President / Chief Financial Officer  
Farmers & Merchants Bank of Western Pennsylvania, N.A.