From: Joanna Hooker <jhooker@FirstCommunitySC.com> on behalf of Mike Crapps <MCrapps@FirstCommunitySC.com>
Sent: Tuesday, October 16, 2012 10:37 AM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: Proposed Regulatory Capital Rules: Regulatory Capital, Implementation of BASEL III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (R-1442, Docket ID OCC-2012-0008, RIN 1557-AD46, RIN 3064-AD95)

Proposed Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements (R-1442, Docket ID OCC-2012-0009, RIN 1557-AD46, RIN 3064-AD96)

Ladies and Gentlemen,

We appreciate the opportunity to submit these comments on the above-referenced notices of proposed rulemaking (NPRs) on behalf of First Community Corporation and First Community Bank. The NPRs were released on June 12, 2012, by the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), (together, the "Agencies"). We recognize the challenge that the Agencies face in developing a system that accurately reflects risk across the diverse universe of financial institutions that make up the United States banking system. We fully support insuring that capital requirements provide for a banking system that can withstand the impact of significant economic stress such as has been experienced during the last four years. Our comments are specifically designed to outline the significant impact that these NPRs will have, if fully implemented, on our institution. Although we have limited our discussion to the sections that we find most troubling for our community bank, we believe that these, as well as other sections, have the potential for adversely impacting the vital role of the community banking system in the United States.

First Community Corporation was formed in 1994, to establish First Community Bank, a de-novo community bank, to serve the midlands of South Carolina. The bank was opened in 1995 and currently operates from eleven branch locations, a mortgage loan production office and a financial advisory/consulting office. All of these locations are within the midlands of South Carolina. Our total assets have grown to approximately $605 million and, as a result, we are a significant provider of financial services to the midlands market area. Our target market is to provide a full range of financial services to the small to medium size businesses in our market area. Many of these businesses are locally owned and are a very vibrant part of the economy in the Midlands.

The following summarizes our concerns with the specific sections of the NPR as we believe they could impact or hinder or limit our ability to serve our markets in the way we have in the past:

Proposed Rule: Accumulated Other Comprehensive Income (AOCI) as a component of Tier 1 capital - The NPR provides that AOCI, which includes unrealized gains and losses on available for sale securities (AFS securities), would flow through to Tier 1 capital. Under current capital regulations these gains or losses are excluded from the Tier 1 capital calculation.

Impact

- The inclusion of AOCI related to AFS securities will result in significant volatility in Tier 1 capital, particularly during periods of rapidly changing interest rates. This could result in a bank maintaining Tier 1 capital ratios substantially above the levels that would be otherwise required in order to avoid falling below capital conservation buffers or incurring other sanctions. Depending on changes in interest rates, a bank could find itself well above required capital ratios in one reporting period and below the levels in the subsequent period.

- Treating this element of a financial institution's balance sheet differently than other balance sheet elements, for regulatory capital purposes, will significantly hinder a bank from engaging in prudent and economically appropriate asset-liability management decisions.
- A bank that classifies all of its investments in the held-to-maturity portfolio would not be affected by this provision, even if it had the exact same securities portfolio and risk profile as an institution that included the investments in an available-for-sale portfolio. Classifying the investments in a held-to-maturity portfolio significantly impacts the ability to appropriately manage liquidity.

Our bank currently has a sizable investment portfolio in comparison to our overall asset size. This provision of the NPR will result in significant volatility to our regulatory capital ratios in a rapidly changing interest rate environment. This could be even more pronounced as we are in a historically low interest rate environment and, when rates rise, our ratios will be negatively impacted. An estimate of the impact of an immediate 300 basis point increase in interest rates would decrease our Tier 1 leverage ratio by 1.8% and our Tier 1 risked based ratio by over 3.0%. We are significantly impacted by this provision of the NPR, despite the fact that we have a very conservative portfolio from a credit risk perspective. Due to this potential volatility, we may be forced to either:

1. Maintain buffers well above the required amounts, which limit our ability to meet the credit needs of the communities we serve. This is in direct opposition of what is needed in this current economic cycle.
2. Reclassify all or a portion of our investments to the held-to-maturity portfolio. This negatively affects our ability to manage liquidity appropriately.
3. Significantly shorten the average life of the portfolio, which will have a significant impact on future ROA and ROE.

Recommendation/Summary:

The NPR should be revised so that unrealized gains and losses, resulting from changes in market values in the AFS investment portfolio that reside in AOCI, do not flow through to regulatory capital. This does not hinder the ability of the regulatory agencies from evaluating the overall risk profile of an institution based on interest rate risk, as this is already captured in the CAMEL based examination approach. In fact, evaluating the interest rate risk and capital adequacy is more appropriately evaluated on an overall balance sheet. Singling out the AFS portfolio for disparate treatment, as compared to other components of the balance sheet such as loans and structured liabilities, hinders management's ability to manage overall risk. We also believe that this provision could adversely impact the community banks more significantly, as they do not typically utilize or have all of the tools and resources available to manage interest rate risk as do the super regional and larger financial institutions.

Proposed Rule: Phase out of Trust Preferred Securities as Capital Instruments – The NPR does not grandfather Trust Preferred Securities for institutions between $500 million and $15 billion as was the intent of the Collins amendment. The NPR provides that10% of these instruments will be phased out annually beginning in 2013.

Impact:

- Many community banks have relied on this source of capital as part of their capital planning strategy.
- Community banks, particularly privately held community banks, do not have the substantial access to capital markets as do other larger publically traded institutions.
- Dodd-Frank never intended for this type of instrument to be phased-out for community banks. Excluding this as a permissible component of regulatory capital has the effect of limiting a community bank from fulfilling a vital role in the communities they serve. This phase out period significantly impacts the ability to leverage this capital component by providing loans and other services to the communities served. This is particularly important during this period in which most communities are attempting to fully recover from the economic crisis over the last several years.
- Many holding companies have Trust Preferred that was then pushed down to the bank in the form of common equity. This phase out of the Trust Preferred component will significantly impact the difference between capital ratios at the holding company level and the bank level. Although, due to Tier 1 limitations on the Trust Preferred component, there can be differences in the regulatory components of capital ratios between a bank and holding company, this rapid phase out will likely make those differences more pronounced. A community bank ratio may reflect that it has capital levels for fully phased in buffers where the holding company

has significantly lower capital ratios. For a single bank holding company, in particular, there will be more instances where the holding company regulatory agency is evaluating the institution on significantly lower capital ratios than is the bank regulatory agency.

Our holding company currently has a component of Tier 1 capital in a Trust Preferred instrument. At the holding company level, this represents approximately 20% of our Tier 1 capital. This phase out significantly shortens the period that this component of our capital structure can be included by more than 12 years. Based on our current asset size, this rapid phase out, over the next ten years, reduces our leverage ratio at the holding company level by approximately 22 basis points per year. As a result, it significantly impacts our capital planning strategy and our ability to utilize this capital to provide loans and other services to the communities we serve.

Recommendation/Summary:

The proposed rule should 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. We appreciate the desire to have higher levels of the capital component in common/permanent equity versus other components of capital. We believe this is addressed in the addition of the common equity Tier 1 capital ratio included in the NPR. We do not believe that the addition of existing Trust Preferred in capital, as currently permissible, provides any additional substantial risk to the financial system or to well run community financial institutions. Eliminating this source of capital over a substantially shortened period does hinder the ability of these institutions in meeting the needs of their communities.

Proposed Rule: Exclusion from Capital of certain Deferred Tax Assets – The NPR eliminates certain deferred tax assets entirely and others may have much stricter limitations placed on their recognition for capital purposes than currently exist under the regulation.

Impact:

- The NPR completely eliminates the ability to recognize the amount of deferred tax assets in capital related to net operating loss carry-forwards or tax credit carry-forwards. This deduction from capital ignores the fact that these items may be fully recoverable based on current operating performance.
- The stricter limitation on other elements of deferred tax assets is not based on anything other than a arbitrary percentage, regardless of the ultimate recoverability and current operating performance of an individual institution.

Our bank incurred a net operating loss over two quarters, primarily as a result of a write-down on holdings of Freddie Mac preferred stock. Absent this transaction, we would have substantially no net operating loss carry-forward. The fact that we do have this net operating loss (NOL) carry-forward has resulted in certain tax credit carry-forwards that will be realized in future periods. Our bank has been profitable nearly every quarter since inception, other than the quarters these securities were written down. From a GAAP perspective, as well as a regulatory perspective (based on current regulatory limitations), the recoverability of these deferred tax assets are continually documented and clearly supportable. The impact of this section is to reduce our Tier 1 capital by approximately $2.0 million.

Recommendation/Summary:

We recommend that the current formula of looking back to previously paid taxes that are recoverable and a look forward 12 months to estimated taxes be retained. This can significantly limit the amount of a deferred tax asset (DTA) recognized in regulatory capital (potentially significantly less than can be recognized for GAAP financial reporting purposes) but is an amount that is supportable based on reasonable assumptions. We agree that the realization of DTAs is based on assumptions; however, setting an arbitrary limit of 17% of Tier 1 capital for timing differences, after excluding operating loss carry-forwards, is clearly not based on potential for recoverability. It would seem that, under this proposal, if an institution had no ability to recover deferred taxes as a result of carry backs and no prospects for earnings in the next twelve months, but had Tier 1 capital to support the 17% limitation, the institution would be able to realize more of a DTA than under current regulations. The ability to realize an asset based on reasonable assumptions should be the criteria for including or excluding these items from tier 1 capital. The facts are that, once an institution gets to a point where regulatory concerns are that it may not be viable, the DTAs should have probably been excluded well in advance. DTAs have been routinely excluded from regulatory capital calculations, as they have not been supportable under current regulatory guidelines, regardless of whether they resulted from NOLs or other timing differences.

Proposed Rule: Minimum Capital Ratios, Capital Conservation Buffer - The NPR provides a new common equity Tier 1 capital ratio and establishes a “Capital Conservation Buffer” in addition to the minimum risk-based capital requirements.

Impact:

- Setting an arbitrary buffer of 2.5 % over and above the "well capitalized" as a basis for restricting capital payouts has the effect of treating a well run high asset quality institution the same as an institution of the same size that is of lesser asset quality and not as well managed. This additional layer of restrictions limits the ability to properly manage capital based on the overall risk tolerances that the Board and management establish.
- The additional conservation buffer restricts well managed growth and, as a result, restricts the ability to meet the credit needs and provide other services to the communities we serve.

Recommendation/Summary:

We recommend that this "Capital Conservation Buffer" be eliminated from the NPR. The changes to the risked based ratios, addition of the common equity Tier 1 risk based ratio as well as adjustments to risk weightings of assets, should provide the desired resilience of institutions to changes in financial cycles. In addition, we believe that the various Agencies' current enforcement powers provide adequate ability to restrict capital distributions when appropriate.

As previously noted, we have limited our comments to those items that we believe have the most immediate and significant impact on our institution. Other provisions of the NPR will also have an impact on our institution both from a cost of compliance, cost of administration and a higher cost of capital. The additional cost will come at a time when the industry is continuing to recover from the most recent economic events. The level of capital in the industry, at the start of this economic cycle, was not the cause or the problem with the financial industry. The permissible level of risk taking, historical declines in valuations, improper oversight of activities by all constituencies, and dramatic declines in economic activity were the primary contributors to the stress on the industry. We support the desire to strengthen our industry. We also believe taking a reactionary approach to these events by establishing significantly higher capital ratios in an effort to totally immunize the industry in the event of another significant economic downturn will have many short- and long-term unintended consequences to the community banking industry.

We thank you for the opportunity to comment on the NPR. We further appreciate your thoughtful consideration of these comments, as well as all of the responses that are being submitted by the industry.

Sincerely,

Michael C. Crapps / President & CEO / **First Community Bank** / 5455 Sunset Blvd / Lexington, SC 29072 / 803-951-0501 / mcrapps@firstcommunitysc.com and
Joseph G. Sawyer / Sr. Vice President & CFO / **First Community Bank** / 5455 Sunset Blvd / Lexington, SC 29072 / 803-951-0508 / jsawyer@firstcommunitysc.com

cc: Senator Lindsey Graham
Senator Jim DeMint
Congressman Tim Scott
Congressman Joe Wilson
Congressman Jeff Duncan
Congressman Trey Gowdy
Congressman Mick Mulvaney
Congressman Jim Clyburn