October 22, 2012

The Honorable Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
Docket ID OCC-2012-0008 and OCC-2012-0009
RIN 1557-AD46

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Docket R-1430 and R-1442
RIN No. 7100-AD 87

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
comments@fdic.gov
RIN 3064-AD95 and RIN 3064-AD96

RE: Basel III Capital proposals

Gentlemen:

We are writing to tell you about the implications to Midtown Bank from this impending regulatory change. Having survived the latest economic down cycle, we have certainly come to appreciate the significance of maintaining adequate capital levels to support any actions that may be required in maintaining the health of our Bank. We are fortunate that the capital levels we were able to build prior to 2008 sustained these actions. Time and again, we find ourselves in conversation about situations that we specifically jested about just five years ago; i.e. the prime rate ever falling below 7%; the bank's borrowing rate of 3% ever being ill-advised; or the potential to earn more from a securities purchase than from making a loan. As I said, we have been fortunate and so have our clients and community. We therefore appreciate the value of well-managed capital however we also have some very real and significant concerns about over-regulating and over-managing it.

I. Implications to residential mortgage lending

A. Increased risk weighting on residential mortgage loans

Midtown Bank was fortunate to have been founded in late 2003, in the heart of Midtown Atlanta which was enjoying a rebirth and redevelopment. We were able to participate in some small ways in this renovation of our city, by doing construction lending for new housing and commercial properties; C&I

lending to the many local entrepreneurs of the city; and residential mortgage lending to those moving into our re-born city. As a result of our market, many of our assets were already risk-weighted at 100%, but the impact of Basel III will cause more than a 20% increase to our risk-weighted assets calculation driving our Tier 1 and Total capital ratios down to just above well-capitalized levels.

The products that we have chosen to offer were selected to better manage our interest rate risk, a key tenant of our regulatory risk management disciplines, but clearly discouraged here. Some form of variable interest rate risk in the form of an adjustable rate mortgage or a balloon has been both better priced and less volatile from an IRR standpoint.

The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that are generally considered much riskier. Even though there is a phase-in period for this rule, we will need to begin making plans immediately to accommodate it. This could take many forms including discontinuation of some mortgage products; higher rates for this perceived increased risk; decisions to not renew some of our equity lines or second mortgages or to reduce available lines of credit. It is unclear what damage this may do to some of our borrowers and/or our market.

II. *Implications to mortgage lending via correspondent lending format*

Our Bank's market has been especially attractive for new home buyers and those wishing to relocate to the city to be closer to their place of employment. As such, we've developed a successful mortgage lending division that has been a significant contributor to our financial performance. To minimize our interest rate risk, we've formed this line of business around a correspondent lending format, meaning that while these loans are closed in our name, we will likely hold them for only a matter of weeks, as they are pre-sold to a national bank that will hold and service them. These larger banks are subject to the same capital standards, and are simultaneously scrambling to assess the impact of this new rule on their capital. As a result, we have absolutely no ability to plan for this inevitably negative impact on this line of business.

We expect that the product offerings will be severely diminished, including criteria based on ownership; term; interest rates; rate structure meaning fixed versus floating versus balloon; lien position; additional representations and warranties, and finally the length of time that we may be required to hold the loan prior to consummating the sale. This uncertainty is compounded by the uncertain future of the mortgage industry as a whole given the unknown future of the nation's mortgage arms of FNMA and FHLMC.

As a result of this unknown, we must identify other lines of business which may be necessary to supplement earnings should we find it necessary to exit this line of business as our servicers shuffle from their current mortgage lending positions.

A. Requirements to hold capital for credit enhancing representations and warranties on 1-4 family residential home loans which have been sold into the secondary market

This section seems to stipulate that capital must be maintained on the full loan balance, and yet many of the representations and warranties which refer to early default or premium refund clauses do not subject the bank to the repurchase of the loan. Our only liability would be to refund the premium we earned. For example, on a $300,000 mortgage, the premium earned could be around $7,000. This would represent the bank's only liability for early default on the loan. The rule presently seems to state that the bank would have to maintain capital for 100% of the loan vs. the actual liability of$7,000. The capital we maintain should be commensurate with the amount of risk we are assuming.

III. Increased risk weighting on high volatility commercial real estate loans

This rule may become a factor in the decision-process for each new request in this category. The additional criteria imposed on potential borrowers may be considered a lending restriction, and drive qualified borrowers to seek lending elsewhere. Our competitors will be similarly impacted. In the current regulatory capital and accounting environment, we conduct a detailed analysis on much of our commercial real estate loans with special emphasis on construction and acquisition and development loans. These loans by their nature are higher-risk, and as a result, we provide routine loan loss provisions to build our reserves to ensure that our Bank is protected. It is redundant to apply this additional disincentive to lending to these borrowers - these are the very borrowers that are rebuilding our economy.

IV. Requirement that gains and losses on available for sale securities must flow through to regulatory capital

Our country is in an unprecedented period of low interest rates. Most banks have significant gains in their investment portfolios. This proposal would serve to increase regulatory capital in the short term. As interest rates begin to rise, this inflated capital would be quickly reversed and could move very dramatically in the other direction. While nothing will have changed in a bank's equity, their regulatory capital ratios could change very dramatically. This proposal will introduce a significant amount of cyclicality and volatility into this measure.

Our bank may be forced to reduce the size of our balance sheet solely for capital ratio preservation purposes as the economy begins to improve, simply because interest rates begin to rise. This could serve to undermine an economic recovery as banks reduce lending and concentrate on pulling back to maintain capital ratios. Our customers will be impacted by the reduced availability of credit under this scenario.

Our bank's reaction to this may be to transition our Available for Sale securities into Held to Maturity or to stay very short in duration, limiting our risk, as well as our return. This will reduce the cyclicality and volatility due to the proposal, but it will also eliminate our ability to manage our balance sheet and the investment portfolio through different interest rate and economic cycles, a core tool to offset the inherent interest rate risk in our loan and investment portfolios.

V. Exclusion from capital of certain Deferred Tax Assets

In our bank, this could restrict lending by approximately $20 - $30 million or at least 10% of our assets. While this may not be a significant loss to our large community overall, it does serve to restrict our earnings potential considerably, which would serve to increase our capital position.

VI. Issues in attracting new sources of capital

As a community bank, we have been in a unique position of having complementary business motivations, meaning we look to help our community thrive by serving the needs of this diverse market; while serving the profit motivations of our shareholders, who are also members of the same community and expect us to promote its interests. So we are not driven to seek the highest-yielding riskier assets that larger institutional investors would demand. However, our shareholders are savvy investors with many avenues to achieve their mixed investment objectives. We have to be able to deliver a fair return to them, or they will go elsewhere. It may not be possible for us to attract additional idle capital to support these new standards.

VII. Difficulty in interpreting and managing the new rule

In order to prepare for this reporting, we will consider a number of actions, most specifically as it relates to residential mortgage lending. Since none of the provisions are grandfathered, we will begin to review every loan in order to capture all of the data-tracking that will now be necessary. This may involve hiring staff to assist in this effort. There are multiple systems which will need to be evaluated and considered for either replacement, or enhancement, at a cost not planned for. Training requirements for all lending staff can't be stressed enough. The success of implementation will hinge on the quality of the training. Finally, the most difficult decisions will be relative to exiting certain lines of business if we can no longer produce a viable return on required capital investment. This could result in terminating up to 35% of our workforce at a time when this would be most cruel in the economic cycle.

VIII. *Institution size disparity*

The regulatory agencies have long recognized that institutions of different sizes should be treated differently in how capital rules apply to them. As an example, the Federal Reserve has for years maintained its "Small Bank Holding Company Policy Statement," which excludes the smallest bank holding companies from the requirement to maintain consolidated capital ratios. The purpose of Basel III regulations is to increase capital requirements in reaction to the most recent financial crisis. For larger publically traded institutions, the ability to augment current capital with new capital can be done in a variety of ways including new issuance of publically traded stock. Smaller, privately held Banks do not have this option. The community bank is typically formed by a small group of local business owners who want to serve the community and also seek alternative investment strategies that fit their entrepreneurial drive. These individuals have also just been exposed to the same financial crisis in their businesses as the banking industry. To now ask these investors to increase their capital outlay in response to regulatory requirements (rather than for expansion of the business which would then lead to a return on investment) is not realistic. The community bank model is far less complicated than the larger institution and therefore is not in need of such radical changes in the rules governing them.

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IX. In conclusion

It is clear that the philosophy behind this rule is based on many sound principles and good intentions. Basel III is a sweeping overhaul of the capital measurement and maintenance standards for the banking industry. It is aggressive and enormously comprehensive. While this is not a bad objective, it also may not be wise to attempt all at once. Given the complexity of this standard it certainly can't be understood quickly, but more importantly, the unforeseen and unintended consequences can't be predicted either.

While there is a phase-in planned, I suggest that rather than finalizing the entire rule perhaps the rule itself should be implemented in a phased-in process, so that unforeseen consequences are addressed without having to repeal the entire rule. In addition, further segregation by bank size would apply the rule more uniformly, as intended, based upon the degree of risk which is being attempted to manage.

While I fully support an increase of some level in the amount of capital that banks hold, the cumulative effect of each of the items reflected above will have a severe impact on most of the community banks in this country. I strongly urge you to consider this impact and to consider a possible exemption for most community banks from the bulk of these rules. Our nation's community banks need to be able to continue serving our communities and helping to strengthen our local economies.

Sincerely,

R. Stanley Kryder

R. Stanley Kryder
President & CEO
Midtown Bank & Trust Company

CC: Senator Chambliss
Senator Isakson