From: Tom Awtry [mailto:tawtry@sosb-ia.com]
Sent: Thursday, September 27, 2012 1:58 PM
To: Comments
Subject: Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

September 27, 2012

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

Re: Basel III Capital Proposals

Dear Mr. Feldman:

Thank you for the opportunity to provide comment on the Basel III Regulatory Capital Rules 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.

Proposed Basel III Regulatory Capital Rules in conjunction with other existing and proposed regulations jeopardizes the viability of the community banking. Community banks should be allowed to continue using the current Basel I framework for computing their capital requirements. Basel III was designed to apply to the largest, internationally active, banks and not community banks. Community banks did not engage in the highly leveraged activities that the largest banks did. 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. The largest banks operate purely on transaction volume and pay little attention to customer relationships.

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 held available-for-sale. Because these securities are held at fair value, and gains or losses due to changes in interest rates are captured in the valuation. 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 by entering into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Community banks do not have the knowledge or expertise to engage in these transactions. Community banks should be able to continue to exclude AOCI from capital measures as they are currently required to do today.

Community banks do not have ready access to capital that the larger banks have through the capital markets. The only way for community banks to increase capital is through the accumulation of retained earnings over time. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five hears beyond 2019) in order for these banks that need the additional capital to retain and accumulate earnings accordingly.

The proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential loans will penalize community banks who offer these loan products to their customers and deprive customers of many financing options for residential property. Higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in the asset-liability management. Many community banks will either exit the residential loan market entirely or only originate those loans that can be sold to the secondary markets. Community banks should be allowed to stay with the current Basel 1 risk weight framework for residential loans.

Penalizing the existing mortgage servicing assets under the proposal is unreasonable for those banks that have large portfolios of mortgage servicing rights. Any mortgage servicing rights existing on community bank balance sheets should be allowed to continue to follow the current risk weight and deduction methodologies.

Imposing distribution prohibitions on community banks with a Subchapter S corporate structure conflicts with the requirement that shareholders pay income taxes on earned income. Those banks with a Subchapter S capital structure would need to be exempt from the capital conservation buffers to ensure that their shareholders do not violate the provisions of the Internal Revenue Code. I recommend that the capital conservation buffers be suspended during those periods where the bank generates taxable income for the shareholders.

The allowance for loan losses inclusion in total capital should not be capped at 1.25% of assets. Some if not all of the allowance for loan losses should be included in tier 1 capital since it represents the first line of defense against capital-absorbing losses.

These are few of my thoughts on Basel III Regulatory Capital Rules. I would respectively hope that you would consider helping community banks across the country by prohibiting Basel III's implantation. Thank you in advance for your consideration and attention to this matter.

Sincerely yours,

Thomas M. Awtry
President & CEO
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