



Member FDIC

FIRST GUARANTY BANK

October 19, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th 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, DC 20219

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

Ladies and Gentlemen:

Thank you for the opportunity to provide comment 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.

First, we would like to emphasize that the Board of Directors and Management at First Guaranty Bank strongly dissent to the Basel III Notices of Proposed Rulemaking issued in June 2012 as it currently reads. The proposal for all U.S. Banks mirrors the Basel III International Accord, which targets only the largest, internationally active banks. Community banks, such as First Guaranty Bank, have a completely different business model than the banks the proposal was designed for. We cannot access capital markets and do not participate in the risky investment activities that have caused issues at the mega-banks and should not be burdened with the same capital standards that are designed for large, complex multi-national banking operations. If implemented as is, the ability of the community bank to compete in the bank marketplace would be greatly disadvantaged. We do not want to believe that is the true intent behind this proposal.

First Guaranty Bank is a community bank of Louisiana that was founded in Tangipahoa Parish in 1934 by local businessmen with capital of \$50,000 and undivided profits of \$5,000. FDIC coverage was \$2,500. Over almost eighty years of operation, we have grown to approximately \$133 million in capital and \$1.4 billion in assets. While other banks may come and go, First Guaranty Bank continues to have the power of three generations of banking trust. First Guaranty Bank is a leader in construction lending and has a large mortgage lending department. First Guaranty Bank understands the needs and wants of our customers, and we strive to give access to loans that fit our customers' personal requirements. With the power to make loan decisions on

a local level, we have the strength to help meet the needs and expectations of our customers in our community.

Our economy is dependent on community banks to provide capital to buy houses and fund small businesses in our communities which benefit the real estate market and produce many jobs for U.S. citizens. We want to make sure we are able to continue serving our communities in the way we have in the past. For this reason, we have strong concerns about the introduction of a revised regulatory framework as put forth by the Basel Committee on Banking Supervision.

The following items of the proposal are changes we would like to highlight from the current capital rules that are most likely to affect First Guaranty Bank:

1. Inclusion of unrealized gains and losses on available-for-sale ("AFS") securities in regulatory capital

The proposed definition of Tier 1 capital includes accumulated other comprehensive income ("AOCI"). For First Guaranty Bank, AOCI is primarily derived from fair value measurements of securities held AFS on the balance sheet. Inclusion of AOCI in Tier 1 capital introduces volatility to our high quality capital framework and would produce inaccurate results. We have significant gains in our investment portfolio. Under the current proposal, AFS securities would in effect inflate regulatory capital. As interest rates begin to rise, the inflated capital would quickly reverse and move in the other direction. So while nothing will have changed in our equity, our regulatory capital ratios could change mistakenly depicting a weak capital position for a well-capitalized community bank, such as us.

First Guaranty Bank's business model includes managing public funds deposits. As of June 30, 2012, public fund deposits totaled \$452.5 million or about 35% of total deposits. The bank has developed a program for the development and management of public fund deposits. Since 2007, the bank has maintained public fund deposits in excess of \$175.0 million. These deposits are with local government entities such as school districts, hospital districts, sheriff departments and other municipalities. Several of these accounts are under contracts with terms up to three years. Public funds deposit accounts are collateralized by FHLB letters of credit, U.S. Government securities, and by eligible U.S. Government agency securities such as those issued by the FHLB, FFCB, FNMA, and FHLMC. Management believes that public funds provide a low cost and stable source of funding for the Company.

First Guaranty Bank primarily deploys its public funds deposits in its investment portfolio. Funds are invested in low credit risk government securities which also serve as collateral for the public funds. These financial instruments are predominately designated in our AFS securities portfolio. Changes in interest rates and the mark to market of our capital ratios would significantly impact our public funds business model. We have a long track record of deploying these funds at a profitable spread. Under Basel III, we would be forced to either reduce this business line or designate a large majority of our government bond portfolio as held-to-maturity ("HTM"). If we are forced to increase our

HTM portfolio significantly, this does reduce our company's flexibility and to a lesser extent our liquidity.

Our regulatory capital ratios should not be affected by our mark to market of low credit risk U.S. Government securities.

First Guaranty Bank also manages an investment portfolio of corporate debt securities. We view these securities as loan alternatives and developed this portfolio as loan demand decreased in the period from 2008 to the present. Each corporate debt obligation receives a credit review prior to purchase that is similar to the credit review conducted on a traditional loan. We have a system for ongoing credit monitoring of these securities. Since there is an active market for corporate debt obligations, these securities do fluctuate in value. First Guaranty Bank purchases corporate bonds with the intention of holding them to maturity. We do not think that market fluctuations in the corporate bond market should count against our capital for this very reason. If a corporate debt security has credit problems that permanently affect its value, there is already an accounting procedure in place. This is called an "other than temporarily impaired write down" or OTTI. An inconsistency exists between the lack of a market for traditional community bank loans and the existence of an active market for corporate securities and making both of these subject to mark to market rules. If Basel III is enacted, First Guaranty Bank would have to change its business model to reduce its corporate bond investments if their market fluctuations affect regulatory capital. Corporate bonds have been a strong source of earnings for our bank.

For the reasons stated above, First Guaranty Bank would like to continue to classify securities as AFS in order to meet our liquidity and funding needs. We should not have to include AFS unrealized gains and losses in Tier 1 regulatory capital because the fair value is expected to recover as the securities approach their maturity or repricing date or if market yields for such investments decline. Securities with unrealized gains are currently performing according to their contractual terms. As a result of uncertainties in the market affecting companies in the financial services industry, it is at least reasonably possible that a change in the estimate will occur in the near term so there is no logical reason to include unrealized gains and losses on AFS securities in Tier 1 capital.

2. Increased risk weighting for residential mortgage loans

The proposal completely revises many of the current risk weights that community banks use to calculate their regulatory capital, particularly for mortgages. There may be a need to strengthen the safety and soundness of the U.S. mortgage market, but the requirements, proposed as they are, could materially impair the business model for creating residential mortgage credit in the U.S., resulting in increased cost to the consumer and/or limited access to funding.

As a community bank, we will need to conduct an analysis of our residential loan portfolios to understand which assets will fall within the associated residential loan categories and how their classification will impact future capital levels. Depending on the

outcome of this analysis, it will affect our appetite for certain residential mortgages in the future. Because much of the information needed to evaluate the effect is not available, it will be hard to perform the massive exercise necessary to evaluate and assign risk weightings to every loan in the portfolio.

The complexity of the mortgage risk weights based on loan-to-value ratios will create a regulatory burden which may likely drive community banks out of the mortgage business entirely. We are concerned that under the proposed methodology, a single loan criterion could trigger an unnecessary Category 2 characterization even though the overall credit profile is clearly very high quality and worthy of Category 1 risk weighting. This single factor v. basket approach to the characterization of Category 1 or Category 2 loans may result in unintended consequences. A risk-weighting framework that is single-factor focused without regard to the overall profile will contribute to the delay in the recovery of our residential mortgage market.

Also, assigning risk weightings to individual loans as opposed to asset classes would be greatly burdensome. First Guaranty Bank would have to add new full time staff to assign and maintain risk weightings on the classes of loans that are identified in the proposal. A bank will not be able to assign a permanent risk weighting when the loan is booked. The bank will have to continually re-evaluate the risk weightings based on changes in collateral values, past due status and other risk factors. The increased requirements will further increase our compliance costs. In order to calculate the newer much more granular risk weighting for assets, First Guaranty Bank will have to invest in additional software and will have to devote more man-hours to the calculation process. We will also have to collect additional information from our borrowers, making the already cumbersome loan application process even more cumbersome.

None of these additional investments of time and money will benefit our customers or the community we serve. Ultimately, banks will have no alternative but to pass the additional compliance costs on to the customers. This increased cost at community banks will be proportionately higher than at large banks, giving the large banks another competitive advantage. Eventually this will lead to a greater consolidation of the banking industry into large banks. This would be unfortunate given most of the lending to individuals for residential mortgages and small business in the U.S. is being done by community banks.

The higher risk weights for residential mortgage assets will further deplete capital levels by requiring additional capital cushions for certain residential mortgage loans that do not fit within a narrow definition of assets qualifying for preferable treatment. This type of capital buffer is not necessary because the ALLL analysis includes risk analysis of all risk factors including LTVs; the impact of credit scores; delinquencies; and local market conditions. The additional risk weights represent unnecessary and redundant scores of capital allocation that will drive up the cost of credit to the consumer and restrict the availability of consumer credit.

We recommend keeping the existing regulatory risk weights as they currently apply to residential mortgage loans.

3. Increasing Risk Weights on Delinquent Loans

A higher risk weight for nonperforming loans only duplicates the purpose of allowance for loan and lease losses (“ALLL”). In order to ensure compliance with GAAP, banks are required under FASB ASC 310-10-35 to develop an ALLL estimate, commonly known as Bad Debt Expense. According to FASB ASC 450-20-25-2, an estimated loss from loss contingency shall be accrued by charge to income if conditions are met. The purpose of those conditions is to require accrual of losses when they are reasonably estimable and relate to the current or a prior period. Community banks are already highly regulated in this regard and criticized severely if not adequately recognizing the need for capital to mitigate the risks of delinquency in the ALLL analysis. If a community bank is deficient in this area the regulators will at minimum make it a Matter Requiring Attention (“MRA”) or place the bank under a Cease and Desist Order and possibly assess civil money penalties. Increasing risk weights on past due loans and requiring banks to develop an ALLL estimate will only result in double counting the same loss. This redundancy in capital calculation is both unfair and unnecessary for community banks.

We feel the current treatment of Bad Debt Expense under GAAP is sufficient, and increased risk weights for past due loans should not apply to community banks.

4. Capital Conservation Buffer

Our final concern is the implementation of the capital conservation buffer which would increase the amount of capital we will need to hold above and beyond the minimum thresholds for “well-capitalized” under the Prompt Corrective Action (“PCA”) framework. It is unclear how this additional buffer would help community banks be more resilient and better able to absorb cyclical risks any more than at the “well-capitalized” level. The proposal also does not appear to address the authority that currently exists within the Agencies’ enforcement powers to restrict capital distributions when appropriate. The Agency already has the power to restrict distributions through the examination process if an Agency determines a specific financial condition exists that demands such action. Codifying this type of restriction in a regulation could impact the ability to exercise appropriate regulatory flexibility. We believe the buffer introduces undue operational complexity for institutions, and the regulators should work to clarify expectations.

Conclusion

The scope of Basel III proposal is too broad and allows too much government interference with our economy. The requirement of Basel III would be next to impossible for most community banks to accomplish. With an increase in minimum levels of required capital, a more narrow definition of capital, and an increase in the risk weights for various asset classes, most community banks would be driven completely out of the banking market while trying to meet the new standards. While the proposed Basel III rules are needed for very large banks and foreign institutions that are allowed to operate with less capital than community banks, community banks

should be exempted from Basel III. Otherwise, home mortgage loans at the community bank level would be significantly reduced.

We suggest the Agencies scale back Basel III to apply only to the intended institutions. We would support a separate rulemaking to address the minimum capital requirements for other banks not covered by Basel II and Basel III. The new proposed rule should be appropriately calibrated to enhance stability while serving to attract capital to the system. The new proposed rule should be easy to understand and simple to manage. We would be willing to participate in an industry-wide empirical study to provide the Agencies sufficient feedback to effectively structure a new proposal. One aimed at striking the appropriate balance of capital and solvency to achieve a stable banking system.

First Guaranty Bank has accomplished its goal of continued growth over the past nine decades of serving Louisiana communities through community banking. As we continue to grow and eagerly greet the future with a bold new vision of community banking, we will retain the values of hard work, community focus, dedication, experience and, most importantly, customer service. These qualities have kept First Guaranty Bank "The Bank" for Tangipahoa Parish, and we hope to continue to be "The Bank" for Louisiana without being burdened by this new proposal.

Thank you for your consideration.

Sincerely,



Alton Lewis
Chief Executive Officer

cc: Senator David Vitter
Senator Mary Landrieu
Congressman Steve Scalise
Congressman Rodney Alexander
Congressman Cedric Richmond
Congressman Bill Cassidy
Congressman Jeff Landry
Congressman Charles Boustany
Congressman John Fleming
Governor Bobby Jindal
Mr. Joe Gendron, Louisiana Bankers Association
Mrs. Ginger Laurent, Louisiana Bankers Association
Congresswoman Shelley Capito, West Virginia Second Congressional District
Mr. Chip Lynch, VP ICBA Southwest Regional Office