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ALOSTAR

BANK OF COMMERCE

Michael J. Gillfillan
Chairman and CEO

October 18, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
regs.comments@federalreserve.gov
Subject: "Basel III Docket No. 1442"

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
regs.comments@occ.treas.gov
Subject: "Basel III OCC Docket ID OCC-2012-0008, 0009, and 0010"

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429
comments@FDIC.gov
Subject: "Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97"

Re: Basel III Proposed Capital and Risk-Weighting Rules

Ladies and Gentlemen:

Thank you for the opportunity to comment on the Basel III proposals that were recently issued for public comment by your agencies.

AloStar Bank of Commerce ("AloStar") is an Alabama state banking corporation that was organized on April 15, 2011, to acquire the assets of Nexity Bank in receivership from the FDIC. AloStar is headquartered in Birmingham, Alabama, and has assets of $826 million. AloStar has a national platform of asset-based lending but also as part of its business model has substantial correspondent relationships with 180 bank customers, primarily in the Southeast. Thus, we believe we are well positioned to understand the needs of community banks and the importance of community banking to the health of our economy. We fear that adoption of the proposed capital and risk-weighting rules outlined below will not only diminish AloStar's ability but also the ability of our correspondent bank clients to serve our customers and promote the health of the communities we serve.

As a preliminary matter, we believe that the Basel III proposals present a wide array of implications to institutions that are not yet fully understood. Any one of the material provisions of the proposals could create a substantial change in bank balance sheets and the way that banks do business. If all of the changes are finalized simultaneously, we believe it is likely that the proposals will introduce complementary risks to financial institutions, the consequences of which are not yet fully understood. Therefore, we believe that the regulatory agencies should withdraw

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the proposals in order to take more time to study the potential impacts of various components of the proposals. We believe the regulatory agencies should then analyze those impacts under a variety of market circumstances, which would be consistent with appropriate industry risk management principles.

The impact of the proposed capital rules, such as the inclusion of accumulated other comprehensive income ("AOCI") and deduction of deferred tax assets ("DTAs") and cash flow hedges, and proposed risk-weighting rules, such as the establishment of Category 2 residential mortgage loans, will disproportionately impact many community banks in the Southeast. With that in mind, we provide the following specific comments:

AOCI and DTAs

We are concerned about the volatility that would be introduced to bank balance sheets through the inclusion of AOCI in the calculation of Common Equity Tier 1 Capital ("CET1"). The primary driver of AOCI for most institutions is unrealized gains and losses in the available-for-sale securities portfolio. We believe introducing a rule that causes increased volatility to bank balance sheets and capital calculations during periods of rising and falling interest rates (generally periods of economic expansion and contraction) would be harmful to the industry.

As for DTAs, under the proposed rules implementing Basel III, all banks regardless of size are required to deduct from Tier 1 Capital all DTAs arising from net operating loss and tax credit carryforwards (net of any related valuation allowances). The proposal adds complexity and restrictions on the amount of DTAs that can be included in capital. DTAs arising from temporary differences, which cannot be realized through carryback to prior years, are subject to strict limits: DTAs of this type cannot exceed 10% of CET1 capital, and, when combined with mortgage servicing rights and certain other assets, the aggregate amount of such assets cannot exceed 15% of CET1. Banks will need to carefully monitor the combination of the entire group of assets, including DTAs, to insure that required capital levels are maintained. We believe it should be emphasized that these proposals will have a negative impact on AloStar and many community banks in the Southeast.

Risk-Weighting

We also want to discuss briefly the two specific proposed rules regarding the risk-weighting of Category 2 mortgages and high-volatility commercial real estate ("HVCRE"). The overwhelming majority of the community banks in Alabama and other southeastern states, for safety and soundness reasons, cannot maintain long term Category 1 loans on their balance sheets. Further, many of their customers, due to factors such as the inability to obtain an appraisal due to lack of comparable sales, the credit history of the borrower, or other reasons, cannot obtain such loans regardless. Instead, many of these banks offer customers alternative mortgage loans with features such as balloon payments or variable interest rates, but that amortize over a more traditional period in order to make them affordable to the borrower. Without loans such as these, members of our communities would, in most cases, be shut out from obtaining mortgage credit. The proposed rules would severely penalize these banks for assisting their customers in this regard and may force banks to discontinue offering mortgage credit to many of its customers.

Under the proposed risk-weighting rules, the increase in risk-weighting of these loans may triple in some cases from 50% to 150%.

Likewise, the increase in the risk-weighting of HVCRE will likely prevent would-be business owners from opening a new restaurant, hardware store or retail shop in town that could employ dozens of local citizens. The proposed rule increases the risk-weighting by 50% for commercial development loans unless the borrower can contribute at least 15% of the completed project's appraised value before the bank advances any funds. For the large, national retail borrower or private equity group backing a new business, this requirement is not an issue. For the local entrepreneur or recent college graduate however, this threshold requirement may be insurmountable. It should go without saying that the bank has every objective incentive to make good decisions on these substantial loans, but the subjective part of the process is equally as important.

Many of the community banks with which AloStar conducts business are willing to lend to these borrowers because they know them, and in many cases have known them for years. Sitting across the desk, the borrower can explain his business idea and why it will succeed. If the business struggles or a mortgage holder misses a payment, the borrower knows that he can knock on the president's door and work with the bank to find a way that lets him make payments while protecting the bank's investment. Forcing these banks into a "one size fits all" model would hurt the banks, but it hurts the communities that these businesses serve even more. The citizens of our communities could be forced to look elsewhere for such products. Their choices will be limited to large institutions – who likely won't be willing to extend credit to these borrowers – or other lending institutions that often only give loans with truly punitive terms and conditions.

We are also concerned that the proposed risk-weighting of past due exposures ignores the existing processes by which financial institutions account for past due exposures and is therefore overly burdensome. The proposal requires banking organizations to apply a 150% risk-weighting to assets that are 90 days or more past due or on nonaccrual status to the extent that those assets are not secured or guaranteed in accordance with the requirements of the proposal. We believe the risk inherent in past due assets is already reflected on the balance sheets and in the capital ratios of financial institutions under applicable accounting rules.

The proposal requires banks to apply a 20% risk weight to unfunded loan commitments with durations of one year or less. Under current rules, such commitments receive a zero risk-weighting. We do not believe the proposed change in risk-weighting for these unfunded loan commitments is warranted. We are not aware of capital ratios being materially strained through borrowers' drawing down on unfunded loan commitments of the bank. Banks monitor their unfunded loan commitments on an ongoing basis to ensure that they have appropriate capital and liquidity to fund those commitments. By adding a risk-weighting to these short-term commitments, the proposed rules are further increasing the risk-based assets of banks, which will in turn cause them to manage the size of their assets, most likely through decreasing their use of short-term loan commitments. This reaction by banks would impact small businesses that rely on these lines of credit for liquidity. With the existing economic headwinds facing small businesses, we do not believe action by the bank regulatory authorities to further strain the ability of small businesses to operate is warranted.

Capital Conservation Buffers

We also believe that the restrictions proposed for financial institutions that do not maintain the full capital conservation buffer required by the Basel III proposal should be reconsidered. As more fully described below, we believe the existing regulatory framework adequately addresses these concerns in a more appropriate fashion. Financial institutions that do not maintain the full capital conservation buffer will be subject to restrictions on capital distributions and on the payment of executive compensation. The existing regulatory framework contains appropriate restrictions on the payment of dividends. The regulatory agencies have existing rules or policies in place that require financial institutions to consult with, or obtain the approval of, the appropriate regulatory agency prior to paying a dividend that is in excess of an established percentage of recent earnings of the institution. We believe these regulations and policies provide adequate safeguards against the payment of dividends under circumstances that are not appropriate. We believe that it is appropriate to leave decisions regarding restrictions on the payment of executive compensation and capital distributions to the discretion of the regulatory authorities on a case-by-case basis.

Also, implementation of the capital conservation buffers for community banks will be difficult to achieve under the proposal and therefore should not be implemented. Many community banks will need to build additional capital balances to meet the minimum capital requirements with the buffers in place. 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. Due to the current ultra-low interest rate environment, community banks profitability has diminished further hampering their ability to grow capital. We are concerned that the long-term consequences of raising minimum capital levels in the industry are not yet truly understood and that changes in minimum capital levels should not be implemented until the regulatory authorities have an opportunity to study the impact of the proposed risk-weighting rules on the industry.

Compliance Costs

The compliance costs of implementing the proposed rules will be disproportionately borne by smaller community banks which lack the technical capabilities and infrastructure to successfully implement many of these rules. Faced with the overwhelming prospect of overhauling their capital management processes, many of these banks will undoubtedly look to sell. The International Monetary Fund - no usual advocate of community banks – recently echoed this thought, warning that "[b]ig banking groups with advantages of scale may be better able to absorb the costs of the regulations; as a result, they may become even more prominent in certain markets, making these markets more concentrated." This warning paints a bleak picture as large banks opportunistically step into towns across Alabama and other states to acquire smaller institutions with strong earnings and balance sheets that simply cannot keep up with the increasing cost of compliance. Even more concerning is the fate of banks and communities in markets where there are no potential suitors.

The effects of these proposed rules will be felt even more severely by the communities we and our correspondent clients serve. In Alabama, no industry is more closely tied to local communities than our community banks. Community banks are actively involved in their communities. Virtually every family, in every community, has a family member that works for, invests in, or relies on the local bank. If these banks become branches of regional or international institutions, the towns and communities will be truly harmed as jobs are reduced and community support begins to vanish.

Conclusion

While we understand the proposed rules were not meant to harm community banks and are intended to prevent another crisis like the painful one that we are hopefully exiting, these rules do not match the cause. Alabama's community banks have remained remarkably strong and stable through these tough times. They have continued to look for sound loans and to grow responsibly. They have continued to play by the rules they were asked to play by before the crisis began. Yet since the release of the proposed rules, we have had discussions with many of our correspondent customers that the cost of complying with these new standards will simply be too much, with no increase in the strength of the banks.

We ask that your agencies consider the disproportionate impact that the proposed rules are likely to have on community banks and others around the country. In doing so, we hope that you will consider adopting the following:

- Withdraw the proposals in order to take more time to study the potential impacts of various components of the proposals;
- Exempting, as originally contemplated by the Dodd-Frank Wall Street Reform Act, financial institutions of under $15 billion in assets from the proposed rules;
- Allowing all banks, or at a minimum those with $15 billion or less in assets, to grandfather in existing loans under current risk-weighting guidelines;
- Eliminating or reducing the scope of the revisions to the deductions, such as AOCI, from Capital;
- Eliminating or reducing the scope of the increases to the risk-weighting of residential mortgages, past due loans and HVCRE;
- Allowing existing trust-preferred securities to continue to be counted towards capital at the holding company level for institutions with less than $15 billion in assets as set forth in the Collins Amendment to Dodd-Frank.

Again, we appreciate the opportunity to comment on these proposed rules. We hope that you will seriously consider these comments and the effect that these rules will have on our local banks and local communities.

Sincerely,

Michael J. Gillfillan
Chairman and CEO

cc: John Harrison,
Superintendent
Alabama State Banking Department

Thomas Dujenski,
Regional Director
Federal Deposit Insurance Corporation