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October 22, 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 issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

As an Executive at a Community Bank, the implementation of Basel III will severely punish my organization and cause hardship for my bank and many thousand other community banks to meet the housing needs of our local communities.

Community banks should be allowed to continue using the current Basel I framework for computing their capital requirements as Basel III was designed to apply to the largest, internationally active, banks and not community banks. It is well documented that community banks did not engage in the highly leveraged activities that severely depleted capital levels of the largest banks and created panic in the financial markets. Community banks constantly work with small business owners to advise them that highly leveraged situations create a high level of risk and that risk can result in failure. However, it is documented that certain large banks that highly leveraged themselves and bet on the risk were held somewhat harmless as failure was not a consequence of their action. 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. This model contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. The largest banks do not operate with a focus on customer relationships. This difference in banking models demonstrates the need to place tougher capital standards exclusively on the largest banks to better manage the ability to absorb losses.

Specific topics in the proposed legislation that will serve as a disparate impact to my bank are summarized below.

1. **Incorporating Accumulate Other Comprehensive Income [AOCI] as Part of Regulatory Capital.**

   The inclusion of the AOCI component in capital for community banks will result in increased volatility in regulatory capital balances and will rapidly deplete capital levels under certain economic conditions. AOCI for most community banks represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. With the recent effect where both short-term and long-term interest rates have fallen to historic lows, the result has been the generation of unprecedented unrealized gains for most investment securities. Additionally, demand for many implicitly and explicitly government guaranteed securities has risen due to a flight to safety and government intervention in the capital markets. This increased demand has caused credit spreads to tighten further increasing bond valuations. Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates. 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. At my bank, for instance, if interest rates increased by 300 basis points, my bank's bond portfolio would show a paper loss of **$2,621,272.13**. This would mean that my bank's tier one ratio would drop by **17%**. 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. Unfortunately, community banks do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry. Community banks should continue to exclude AOCI from capital measures as they are currently required to do today.

2. **Capital Conservation Buffers**

   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 be required to build additional capital balances to meet the minimum capital requirements due to the buffers in place. You are very cognizant that community banks do not have ready access to capital that the larger banks have through the capital markets and therefore the only way for community banks to increase capital is through the accumulation of retained earnings over time. Due to the current historic low interest rate environment, community bank profitability has diminished hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) in order for those banks that need the additional capital to retain and accumulate earnings accordingly.

3. New Risk Weights

The proposed risk weight framework under Basel III is complex causing an onerous regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens severely penalizes community banks who offer these loan products to their customers and will deprive customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management. Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. Many community banks will have to decide to either exit the residential loan market entirely or only originate those loans that can be sold to a GSE. Additionally, second liens will either become more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages.

The Basel III Capital proposal is unfair to community banks. It casts the position that "one size fits all" and community banks cannot "fit" into the business practices of the largest banks. Community banks serve a niche segment of the community and I believe the large banks are happy that community banks serve those needs. Community banks have a long tradition of building the communities in which they service through financial resources and volunteer efforts. Imposing Basel III capital standards will force many community banks to cease lending and deprive customers the pride of home ownership. This will cause communities to suffer from lack of financial resources and volunteer support.

Sincerely,

Bryan K. Fehr
Senior Vice President
North Akron Savings Bank