HIGHLAND
COMMERCIAL BANK

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, D.C. 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 (collectively the "banking agencies").

Highland Commercial Bank is a $130 million community bank headquartered in Marietta, Georgia with a branch office in Smyrna, Georgia. We are a well-capitalized commercial bank offering traditional loan and deposit services to our community. Our focus is relationship banking.

Throughout the economic downturn starting in 2008 and continuing through the present date, financial institutions have seen unprecedented struggles, including loss of income, depleting capital ratios, and tightening net interest margins. All of these factors combined have led to the failure of many community banks, of which our state of Georgia has been one of the hardest hit. Out of this economic collapse have come tremendous increases in regulatory burden, such as Dodd-Frank, which is making it harder than ever for community banks to adhere to their traditional lending models which benefit the local business people and consumers, and have also made it harder than ever for community banks to remain profitable to a point where shareholder value is maximized. Given the economic conditions of the region and the country as a whole, we do not believe it is a good time to consider fundamentally changing the way capital is calculated. We think the impact on banks should be studied closer especially since the impact of the change is unknown.

The implementation of the proposed Basel III capital calculations "as-is", and the above mentioned continued economic issues, which have crippled banks for the past few years, will only progress. Of the proposed new rules, our specific comments regarding the Basel III Capital proposals are listed below.

- As a general comment regarding the regulation change and how it will affect our bank: The new regulation will require more capital at a time when capital is hard to raise. Many banks like ours have adapted by lowering overhead, shrinking assets and managing nonperforming assets out of their operations in an effort to maintain or earn their way back into regulatory thresholds currently in place, but the lack of loan demand and the low interest rate environment have presented significant headwinds to these efforts. Implementing the proposed rules at this time ignores the current realities and consequences of adding further weight to a struggling industry. If the aim of the proposed rules is to strengthen the ability of banks to continue functioning to serve their customers and communities, even during periods of financial stress, we believe borrowers will ultimately be deprived access to credit since banks would be forced to curtail lending. This decrease in lending will further stifle a recovery in the real estate market, which is a key component of economic growth in our region.

- Basel III introduces a new Common Equity Tier 1 risk-based capital ratio ("CET1"), which will include deductions for accumulated other comprehensive income ("AOCI").
    - Under current capital guidelines, AOCI is adjusted from Tier 1 capital, which reduces the volatility in capital due to changing interest rates. It is our practice (and it is most likely the practice of most community banks) to purchase investments with the intent to hold them to maturity. Therefore, the continued application of this adjustment to Tier 1 capital is appropriate. While the inclusion of AOCI may be beneficial in today's unusually low interest rate environment, rapid increases in interest rates can quickly reverse a gain position and have a negative impact on a bank's capital base. Our bank maintains 100% of its investments in available-for-sale and it could be argued that the use of a held-to-maturity designation would eliminate this concern. However, this would severely limit management's ability to adjust our portfolio for ALCO, liquidity and funds management purposes. Additionally, any significant changes in market interest rates or changes in the availability of and yield on alternative investments at some date in the future would inevitably lead to the potential for other-than-temporary impairments, which would ultimately defeat the application of the held-to-maturity designation.
    - Although loan demand has remained at historically low levels, we have avoided large additions to the investment portfolio due to long-term price risk concerns. However, we as many of our peers have continued to add to their portfolios. For example, as of June 30, 2012, our uniform bank performance report showed that our available-for-sale securities represented 19.2% of average assets compared to our peer (Peer Group 6) of 15.3%. As of December 31, 2008 these ratios were 9.89% of average assets for our bank and 7.89% for our peer group (Peer Group 6). Even with our limited investment holdings, a +300 point shock in interest rates could have potentially reduced our positive AOCI position by $1,597,000. This would have translated into a 93 basis point reduction on our Leverage Ratio as of our June 30, 2012 call report. Therefore, it is our conclusion that the inclusion of deductions for AOCI has the potential to more severely impact the capital position of many community banks, which will ultimately translate into less ability to lend in their respective communities.
    - Finally, we believe that applying mark-to-market treatment of the investment portfolio while other balance sheet components do not receive similar treatment is inconsistent from a pure accounting perspective.
- Standardized Approach for Risk-Weighted Assets. The changes regarding the capital calculations for residential loan categories, non-qualifying first lien and junior lien mortgages, and high volatility commercial real estate (HVCRE) will lead to even less lending by community banks. With the passage of Dodd-Frank it has becoming harder and harder for community banks to continue lending to the small business and the average consumer due to the legislative (compliance) requirements that must be adhered to.
    - 1-4 Residential Loan Categories – The proposals currently differentiate between two categories of mortgage lending activity. Then tiers are established to differentiate each category by collateral value or "Loan-to-Value" (LTV) or the amount of the loan outstanding as a percentage of the market value of the mortgage collateral. Under the current capital format, a 1-4 family first mortgage loan is assigned a 50% risk-weight if it is "prudently underwritten". Under the new Basel III standards, dependent on the LTV, risk weighting may rise to the 75% or 100% level. Our bank has provided these types of mortgage as a relationship service to our small business customers. Currently, we no longer provide these types of loans; however, a refinance of an existing mortgage or a balloon structure on a mortgage could easily shift any one of our loans to a higher risk weighted category for either collateral value or LTV. As of June 30, 2012, our bank's outstandings was $8,670,000 and if all adjusted for category 2 risk-weighting this shift would effect a 53 basis point decrease to Tier 1 Risk-Based Capital.

- Non-Qualifying First Liens and Junior Lien Mortgages – The proposed rule to categorize all non-qualifying first liens and junior lines as category 2 exposure with risk weights from 100% to 200% again severely impacts our bank. As of June 30, 2012, our bank's outstandings was $1,235,000 and if adjusted from 100% to 200% this adjustment would effect a 16 basis point decrease to Tier 1 Risk-Based Capital. As you know, many small business owners get the needed capital for their small business by taking second mortgages on their homes.
- High Volatility Commercial Real Estate (HVCRE) - The proposal to risk weight non-exempted HVCREs at 150% ignores the desirability of soundly underwritten ADC loans to borrowers with more than adequate debt service coverage ratios from owner occupied and income producing properties. These requirements will further impact our ability to provide credit to small businesses.
- Delinquent Loan Risk Weights - The proposed rule to assign a risk weight of 150% to nonresidential loans over 90 days past due. This puts the bank in a less than willing position to help our customers on a workout basis, instead pushing towards foreclosure and liquidation of the asset. This requirement ignores the fact that this additional risk is addressed through the Allowance for Loan and Lease Losses (ALLL).
- In summary, with the new structure as proposed in the Standard Approach on the aforementioned comments regarding mortgages, non-qualifying first lien and junior liens, HVCRE, and delinquent loan risk weights, will have the side effect of community banks having a smaller pool of qualified applicants thereby reducing loan volumes and continually tightening earnings. It could be likely that many community banks will walk away from the above mentioned consumer related loans and get away from serving their local communities in the same traditional fashion. Community banks may cease offering second mortgages to small business owners or these product will be more expensive, resulting in less capital available to the small business customer. Finally, the new regulatory burden on community banks to track these LTV ratios and ensure they are always up to date each quarter for reporting purposes. Regional and National banks have the personnel and resources to implement tracking and can absorb the cost of this type of data collection, but for the community banks, the regulatory burden just gets heavier while the number of individuals at the bank to implement the new standards does not change.

In conclusion, the immediate affect that the Basel III changes will have will most likely be the failure of even more community banks. Many banks, which have recently experienced unprecedented losses and have seen capital depleted, but which have made it through the worst part of the recession by shrinking their balance sheets, raising capital and attempting to comply with all imposed sanctions, will now have to fulfill the impossible burden of complying with the new standards. They will also be required to maintain capital ratios at levels far above what they were once told were satisfactory. In turn, more community banks will be forced to close their doors, larger banks will takeover in these markets, and access to funds for the middle class consumer and small business owner will be even harder to come by. This will lead to less jobs and more unemployment in a time where the nation is trying to reverse that trend. In short, we encourage the banking agencies to carefully examine the effect the Basel III standards will have on community banks before moving forward with its implementation. We further ask that the banking agencies perform specific calculations on a number of community banks that represent various areas of our country to determine the overall implications that it will have on these banks. As it stands now, the new standards will change the banking model as we know it and as it has worked so positively for the main street American and small business person in the past. We hope you will carefully consider our comments and the comments of other community banks before proceeding with the full effects of these new changes.

Sincerely,

Beate F. Frank
EVP/CFO