M&F
MECHANICS AND FARMERS BANK

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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

Sent via Email

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently published for comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies"). We ask that you consider the following issues and how their implementation will affect our financial institution and most importantly, our customers.

We believe that as drafted, the Proposed Rules would be harmful at best and fatal at worst for community banks and particularly, minority banks, which do not engage in the types of behaviors with which the banking agencies are concerned. We did not anticipate, nor believe that the Basel III capital requirements should apply universally to community banks and large financial institutions alike.

Mechanics and Farmers Bank is a North Carolina chartered commercial bank organized in 1907 and began operations in 1908. We are a $300 million dollar community bank engaged in the general banking business with seven (7) branches serving the counties of Wake, Durham, Guilford, Forsyth, and Mecklenburg Counties and the surrounding communities. M&F Bank is a Minority Depository Institution and is also a certified Community Development Financial Institution.

Our Bank's mission is to work toward the revitalization of economically depressed communities or communities underserved by mainstream financial institutions and to improve the quality of life of those who live and work in those communities. Since the economic downturn, the Bank has been working diligently with its customers to weather the economic crisis caused by the financial crisis.

We are of the opinion that the capital requirements of Basel III are appropriate for those very large financial institutions, but are not for the much smaller community banks. Whereas the community banks had little to do with the economic down-turn that was a result of the misuse of sub-prime and Alt A residential loans made outside the banking system and securitized by large investment banks. The community bank model is much different than that of the large banks in that we are much more familiar with our customers and the risks associated with each of the markets in which we serve. We are not highly leveraged with off balance sheet liabilities that are significant and common to the large financial institutions.

The following areas of the proposal are of great concern to our Bank:

1. Requirement that gains and losses on available-for-sale ("AFS") securities must flow through to regulatory capital.

    Under this provision, our Bank and other community banks would be forced to reduce the size of their respective balance sheets as the economy begins to improve, simply because interest rates begin to rise. This would serve to undermine the recovery as small banks would be forced to reduce lending and concentrate on pulling back to maintain capital ratios. The local communities would again be impacted from the lack of the availability of credit and thus see reductions in the job market.

    Most community banks would have to consider the sale of their AFS securities and to place all future investments on a basis of Hold-to-Maturity. This action would eliminate the volatility of the proposal but eliminate the banks' ability to manage the investment portfolio through different interest rate and economic cycles. This action could also create greater viability risks for community banks by reducing our liquidity flexibility and opportunities to maximize earnings and capital augmentation. Therefore, instead of mitigating systemic risk, you will enhance it with this requirement.

2. Phase-out of Trust Preferred Securities (TruPS) as Capital Instruments

    Whereas our Bank does not have any Trust Preferred Securities in its investment portfolio, for some community banks this is a cheap source of capital and the phase-out would significantly reduce those banks' ability to spur economic and job growth in their respective communities. TruPS were grandfathered under Dodd-Frank, but are eliminated under the Basel III proposal. We would suggest that financial institutions between $500 million and $15 billion be granted a permanent exemption to this change.

3. Residential Mortgage Risk Weights and the Effects on Banks and Their Customers

    The proposed change in the risk weights will not be a benefit to the community bank industry. This proposal will have a devastating consequence to any small bank. By increasing the risk rate from 1 to 2, the banks would in effect double the risk weights and cut the bank's capital ratios in half and run the risk of not being "well capitalized". The bank will be forced to limit its loans to the individuals and businesses in the community it serves thus bringing further pressure on the local economies and strangling the job and housing markets.

    We urge the Federal Reserve to consider the grandfathering of the provisions for existing loans and private mortgage insurance, as well as what is considered to be Category 1.

4. Home Equity Lending

    Under this proposal, all junior liens will be classified as Category 2 exposures with risk weights from 100% to 200%. Additionally, if the Bank holds two or more mortgages on the same property, and then all of the mortgages will be considered to be Category 2.

    This provision to move most all junior liens to Category 2, along with a large portion of first mortgages will have the effect of limiting the loan activity, if not eliminating the Bank's efforts to serve its communities.

5. Increased Risk Weights and Delinquent Loan Impacts

    This provision would change the existing rule by requiring a risk weight of 150% on any nonresidential loan delinquent in excess of 90 days. Our Bank, as well as most community banks, already provides for the risk on delinquent nonresidential loans via the loan loss reserves. To subject the Bank to additional requirements on the same loan for which we have already provided a loss reserve does nothing but limit our ability to serve our communities with the lending resources they need to continue in business and to expand the community's commerce.

The cumulative effects of each of the items above will severely negatively impact the ability of community banks to serve their communities and to strengthen their economies and stimulate job growth.

Regulators already have adequate rules and tools for the management of the systemic and capital risks in community banks. Community banks already perform on a regular basis capital stress testing, as well as detailed financial multi-year pro-formas and what if testing. In addition, we have developed liquidity contingency plans and continue to update them on a regular basis. The monitoring process is already robust and more than adequate to manage a community bank's non-complex structure and risks. A vibrant community banking system is essential to sustaining and building the country's economy.

We strongly suggest that the community banks be exempted from these new rules under Basel III. We appreciate your consideration to our comments and suggested attention to this very important matter to our Bank and the community banking industry.

Respectfully submitted,

Kim D. Saunders
M&F Bank
President/CEO