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October 22, 2012

Robert E. Felman, Executive Secretary
Attention: Comments/Legal ESS
FDIC
550 17th Street NW
Washington, DC 20429
RIN 3064-AD96

Office of the Comptroller
250 E Street, SW, Mail Stop 2-3
Washington, DC, 20219
Docket ID OCC-2012-0009

Jennifer J. Johnson
Secretary, Board of Governors of Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1442;
RIN No. 7100-AD87

Ladies and Gentlemen:

Thank you for allowing the Bank of Sunset & Trust Co. (BOS) the opportunity to provide comments on the following:

1. Notice of Proposed Rulemaking (Basel III NPR) to implement the Basel III Capital requirements;

2. Notice of Proposed Rulemaking (Standardized Approach) to adjust the agencies general risk-based capital requirements for determining risk weighted assets.

Chartered in 1906, BOS is a $120 million community bank with 4 offices located in south Louisiana. We are a traditional community bank that takes a great deal of pride in serving all stakeholders in the community. BOS primarily serves the small businesses in our market. In addition, the bank is committed to serving individuals with consumer and mortgage loans. We provide both secondary mortgage loans and portfolio loans to our mortgage clients.

First, I will provide comments on my concerns with the Basel III NPR:

General Comments

It is my understanding that the international agreement was never intended to apply to all U.S. institutions. The agreement is intended to cover the same institutions covered under Basel II. If my understanding is correct, it appears reasonable to assume that the agencies would modify this rulemaking to apply to the intended institutions. It must be noted that community banks did not cause the most recent financial crisis therefore should not be the targeted institutions to pay the price.

The Basel III NPR is a direct reaction to the economic crisis and does not provide a long-term path that is in the best interest of the banking industry, particularly community banks. While higher capital requirements may be appropriate for larger institutions that pose a systemic risk to the economy, the application of these requirements on community banks will force these institutions to limit the deployment of resources to small businesses, the housing recovery and consumer credit.

Unrealized Gains and Losses

The United States is in an unprecedented period of low interest rates. At this time, many banks across the country are experiencing significant unrealized gains in their investment portfolios. As rates rise, the gains will diminish and the gains will convert to unrealized losses. With the proposed Basel III NPR, while very little has changed on the balance sheet, an institution's capital ratio could be reduced to levels unacceptable to regulators, despite no change in the risk profile of the bank.

The investment philosophy of BOS is conservative however implementing this change could have drastic effects on our institution. Presently our bank holds government sponsored agency paper which includes mortgage backed securities, collateral mortgage obligations and bullet bonds. In addition, the bank invests in U.S. Agencies (SBA pools) and General Obligation Municipal Bonds. Our holdings amount to approximately $40 million and, as of September 30, 2012, we have an unrealized gain of $1.4 million on the portfolio.

An interest rate shock of +300 basis points on the portfolio would create a decrease in market value of $3.5 million. This shock would result in an unrealized loss on the portfolio of $2.1 million. Our tier 1 capital ratio would decrease from 9.03% to 7.14% and the only change would be a rising rate environment. The risk profile of the bank would remain the same however we would be forced to convert to a "manage capital mode". The bank would retain the well capitalized status however additional spikes in the interest rate would continue to contribute to capital deterioration and possibly lead to non-compliance with the new capital standards.

Under this scenario, the bank would have to limit or forgo growth opportunities in order to comply with the new capital standards. This would in turn lead to restricting the availability of credit to consumers and small businesses. It is important to note again that at inception most community banks will experience a higher level of capital due to the unrealized gains in the investment portfolio. Over time rates will rise to levels where the portfolio will suffer from unrealized losses and the reduction in market value will be punitive to some community banks. The investment portfolio will no longer be used to manage liquidity and interest rate risk.

Capital Conservation Buffer

I am a proponent of banks having high quality instruments in its capital base. With the proposed Standardized Approach, a bank's risk based capital ratio could go down drastically by having to comply with the proposed risk-weights. In addition, a proposed buffer of 2.5% must be maintained in order to avoid restrictions on capital distributions and certain discretionary bonus payments. It is my understanding that the agencies have the authority to require institutions to hold capital commensurate with the risk profile of the entity. Rather than enforcing a buffer, it appears as though the examination and supervisory process can address the issues associated with compensation and capital distributions.

Below you will find my comments on the proposed Standardized Approach:

General Comments

Presently, community banks do not manage their assets according to the current risk-weighting system. It is merely an exercise that must be completed in order to file the call report. The proposed NPR will force community banks to exclude certain loan products from their asset mix due to the heavy risk-weighting of the products (i.e. Category 2 mortgage loan) and the punitive effects on risk based capital. Community institutions will be forced to manage capital and loan product offerings by risk-weights.
Bottom line – Under the Standardized Approach, regulators will decide a community bank's product mix.

Under the NPR, the process to determine the appropriate risk-weight on all loans is overly complex and cumbersome. In order to accurately measure the effect of this proposal, community banks would be required to risk-weight each loan and this task would be very tedious and expensive. Subsequent to this process, a monitoring process must be employed in order to adequately address the progress of the loan in future months and years. Changes in collateral values, past due status and other factors will require monitoring over the life of the credit. I would certainly envision additional software and personnel costs to achieve and monitor compliance with the new system.

I am unaware of any study performed outlining the support for the proposed risk-weights applied to the different asset classes. It would appear reasonable to require the agencies to disclose the empirical support for the increased risk-weights. If a study has not been performed, I believe it is warranted in order to support the additional burdens placed on community banks.

Residential Mortgages

Mortgages will be separated in 2 categories (Category 1 and 2) and the risk-weighting will be applied according to the loan to value (LTV) ratio of the loan in that respective category. Category 2 loans, which include portfolio loans and adjustable rate loans, will carry significantly higher risk weights (100% to 200%) than the current system. The proposal will effectively categorize all portfolio loans at a community bank as a category 2 loan thus requiring a minimum risk-weight of at least 100%.

Because of the structure of the loans, all residential loans on the balance sheet at BOS will have a minimum risk-weight of 100%. Since 2008, BOS has experienced very few losses in this category yet we will be forced to increase the risk-weighting of the category. It is unreasonable to believe that we will be required to assign equal or higher risk-weights to portfolio mortgage loans (a safe investment that is secured by a dwelling) than to unsecured loans. This concept contradicts all risk management practices and banking principles.

At a time when community banks are exiting the mortgage business due to the recent onerous compliance requirements, this proposed highly punitive risk-weighting system will force many other community banks out of the market. This will in turn negatively affect the availability of credit for consumers and small businesses that may use junior liens in order to operate their entities. The elimination of community banks from the market place will certainly lead to a longer recovery for the housing market and the economy.

Delinquent Loans

BOS is very fortunate in that the economy in our market area has been stable and our delinquent loans are minimal. The economy in our area for the most part is driven by the oil & gas industry, which in past years has been volatile. During a soft market, in some instances, we may be required to work with our borrowers in order to protect and maximize the interest of both parties. This provision may very well force banks to be more aggressive in its collection efforts in order to remove assets from the balance sheet because of the higher risk-weights required on past due loans.

In fact, the exposure related to delinquent loans, as proposed in the NPR, will be "double counted". Presently, the exposure is accounted for in the Reserve for Loan Losses calculation which in effect lowers the capital base of banks. As stated above, we will also be required to increase the risk-weight of the delinquent asset. This results in an adjustment to both the numerator and denominator of the ratio resulting in a "double negative".

Conclusion

As I stated above, I am a proponent of the banking industry having higher levels of quality capital. I am very confident that the NPR's are attempting to address these very important issues in light of the country going through the worst recession in history. I do not believe that the agencies should attempt to place the entire banking system under one umbrella. The banking system is very diverse and the community bank model is unique and should be separated from the proposals above. The community bank model is fairly simple to understand and the associated capital requirements and risk-weighting system should be simple as well.

As the agencies consider the proposals, I believe it is very important that the impact on the economy and industry be considered. As written, the proposals could have a major impact on the availability of credit and the existence of many community banks.

The proposals above have the effect of not only placing higher capital limits on banks but also directing what products banks can offer to its community. Some community banks offer only specific products because of its market. Placing a huge barrier to entry after the fact (i.e. risk-weight of category 2 loans) on a community bank catering to the needs of its market could certainly have devastating effects on its existence going forward.

Thank you for the opportunity to comment on the above proposals.

Sincerely,

K. Brent Vidrine
President and CEO