THE PEOPLE YOU TURN TO. THE BANK YOU TRUST.

MACON
BANK

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

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 Proposed Rules

Ladies and Gentlemen:

Thank you for the opportunity to share my thoughts on the proposed capital rules and how those rules will affect our bank, our employees, and our customers. As a community banker, I certainly understand the need to address bank capital standards, and how much capital is needed relative to the risk of financial institutions. A number of the proposed rules appear to satisfy that need without negatively impacting community banks and their customers. However, there are a handful of proposed rules that I feel will have a significant negative impact on both our Bank and our customers.

Background

Macon Bank was founded in 1922 as a North Carolina chartered mutual savings and loan association. In 1992, it converted to a North Carolina chartered mutual savings bank. Then in 1997, it converted to a stock savings bank that it owned by Macon Bancorp, a North Carolina chartered mutual holding company. Since its founding, the institution has always been a mutual institution, owned by its depositors. I feel that this mutual ownership allows the Bank to operate in a more conservative manner, with a long-term focus rather than the short-term performance demands that shareholders often demand. We currently have approximately $800 million in assets and operate 11 branches in the western North Carolina mountains and foothills, smaller communities that are largely ignored by the larger regional and money center banks.

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Phase-out of Trust Preferred Securities (TruPs) from Tier 1 Capital

As a mutual institution, we are fairly limited when it comes to raising capital. We cannot simply issue common or preferred stock, either on a small scale or in a private placement offering. Our current Tier 1 capital structure is approximately 75% from retained earnings and 25% from a TruPs that we issued in 2003 to allow for growth of our institution into new markets. This instrument has served as a reliable, cheap source of capital, especially over the last few years when the capital markets have been largely closed to smaller community banks. Our TruPs does not mature until 2033, carries a rate of 3 month Libor +280, and has a five year deferral provision for interest payments.

Since the Dodd-Frank bill passed, the larger banks have been able to issue common stock and redeem their TruPs with little trouble. However, community banks have found it much more difficult to raise the common equity needed to improve their capital levels for the current rules, much less be able to establish a buffer to redeem TruPs. I would like to ask that you reconsider this proposal, and that the capital rules match the legislation, which grandfathers any outstanding TruPs for institutions with less than $15 billion in assets. Alternatively, if the greatest concern over TruPs is that it has a maturity date, and is therefore not a permanent capital source, please consider phasing it out of Tier 1 capital to the maturity date of the TruPs. For example, the rules could require banks to start excluding 10% of the TruPs each year of the final 10 years to its maturity date.

Inclusion of Unrealized Gains and Losses on Available-for-Sale Securities in Regulatory Capital

Generally speaking, the level of interest rates and associated bond prices can be fairly volatile. When you consider that interest rates are near all-time lows, there is even greater risk of large swings in bond pricing. Our bank's $153 million investment portfolio is very conservative, consisting mostly of short-duration agency mortgage-backed securities (MBS), and a smaller level of agency debentures and municipal bonds. When you consider an instantaneous 300 basis point increase in rates, the value of this portfolio would decrease by approximately $9 million, or $5.4 million after tax. The resulting impact on our Tier 1 leverage would be approximately 70 basis point decrease, without the Bank taking a single loss.

I personally see three possible reactions to this proposal from myself and other bond portfolio managers, and all three have the potential to threaten, not improve, the safety and soundness of banks. First, many banks will choose to hold more securities as held-to-maturity (HTM) instead of available-for-sale (AFS). The downside of this is that it will hurt liquidity in banks by holding fewer AFS securities, which can be pledged as collateral for borrowings or sold to generate cash. Second, portfolio managers will tend to stay much shorter in their investment portfolios when selecting AFS securities. The downside for the Bank is that yields will tend to be lower, which will hurt net interest margin and overall profitability. The downside for the customer and the overall economy is that there will be less appetite for longer duration securities such as MBS and municipals, which could particularly cause fixed-rate mortgage rates and municipal bond yields to rise. A third possible reaction by portfolio managers could be to add more credit risk in order to compensate for the reduced yield on shorter-duration bonds, which would tend to raise the overall risk of an institution.

An alternative recommendation that I would suggest is to exempt unrealized gains and losses on AFS Treasury bonds and agency-issued MBS, CMOs, and debentures from regulatory capital. The result is that those securities that contain credit risk would be included in regulatory capital calculations, but those risk-free securities would not be included.

Combination of first- and junior-liens on Residential Mortgages for loan-to-value (LTV) purposes

While I believe that including a LTV component on residential mortgages is a good step in quantifying the risk on an institution's balance sheet, I do have one major concern about combining the liens for LTV purposes and the effect it would have on consumers. The biggest concern comes into play when you have a large first lien combined with a relatively small second lien. For example, if you had a $320k first lien and a $20k second lien on a $400k value, that would be a combined LTV of 85%. Under current rules, the first lien would be weighted 50% and the second lien would be weighted 100%, resulting in risk weighted assets of $180k. Under the proposed rules, the 85% CLTV would move the entire exposure to a 75% risk weighting, which would result in risk weighted assets of $255k, which would require 42% more capital to keep the ratios equal. I personally feel that this proposal would have a significant effect on the availability of HELOC lending, which would hurt consumers the most. While I understand the fact that the past few years have proven junior liens to be riskier, they do not necessarily make the first lien riskier. My reaction to this proposal would be to reduce HELOC lending in all but very low LTV situations. If a customer had a large first lien at an 80% LTV, for instance, I would prefer that we make an unsecured loan instead of a HELOC to keep the risk weighting down. The result could be more risk for the Bank, and a higher interest rate and reduced credit availability for the consumer. An alternative to combining the loans would be to use the LTV methodology for the first lien, then separately rate the junior lien according to the combined LTV, or a standard risk weight.

Clarification on the Definition of High Volatility Commercial Real Estate (HVCRE) Loans

I fully understand the intent, and need, to place a higher risk weighting on Acquisition and Development (A&D) loans. Because their viability is often contingent solely on the sale of lots, they do represent greater risk. The past five years have proven this. My concern with the proposed rules is that HVCRE has not been adequately defined to know whether land and lot loans to individuals are included in HVCRE. The question was raised during an informational call with the FDIC, and there seemed to be a difference of opinion between two of the members of the FDIC panel. As a community bank that operates in a second home and retirement market, making lot loans to individuals is a common practice. Many individuals plan to retire to our area, and would like to "lock-in" their piece of land and start paying for it while they are still working. I personally even got a lot loan when we found a lot that we knew we wanted to build on, but were not ready to begin construction. Within the following 18 months, we paid off that lot loan when we built our primary residence. These types of loans are not commercial real estate loans, and should not fall into that category. These are loans to individuals, underwritten in much the same way that a mortgage, car loan, or personal loan is done. The ability to repay the loan is not dependent upon sale of the collateral. I would ask that you clearly exclude these lot loans to individuals from the definition for HVCRE.

Sincerely,

Ryan Scaggs

Ryan Scaggs, Chief Financial Officer and First Vice-President
Macon Bank, Inc.