MACON BANK

September 28, 2012

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Re: Basel III Capital Proposed Rules

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were published for comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The need to address bank capital standards, and how much capital is required relative to the risk of financial institutions is important. 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.

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

As a mutual institution, we are somewhat limited when it comes to raising capital. We cannot 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. Please reconsider this proposal, and permit the capital rules to 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

The level of interest rates and associated bond prices can be fairly volatile. Considering that interest rates are near all-time lows, there is even greater risk of large swings in bond pricing. Macon 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. An instantaneous 300 basis point increase in rates would decrease the value of this portfolio by approximately $9 million, or $5.4 million after tax. The resulting impact on Tier 1 leverage would be approximately 70 basis point decrease, without the Bank taking a single loss.

Three possible reactions to this proposal that have the potential to threaten, not improve, the safety and soundness of banks should be considered. 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 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 including a LTV component on residential mortgages can be a good step in quantifying the risk on an institution's balance sheet, there is a 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. This proposal could have a significant effect on the availability of HELOC lending, which would hurt consumers the most. The past few years have proven junior liens to be riskier but that does not necessarily make the first lien riskier. Perhaps HELOC lending could be reduced in all but very low LTV situations. If a customer had a large first lien at an 80% LTV, an unsecured loan could be made 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

The need to place a higher risk weighting on Acquisition and Development (A&D) loans because their viability is often contingent on the sale of lots is understandable. They do represent greater risk. There is concern, however, that the proposed rules have not adequately defined HVCRE to know whether land and lot loans to individuals are included in HVCRE. This 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 purchase their piece of land and start paying for it while they are still working. 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 as a mortgage, car loan, or personal loan. The ability to repay the loan is not dependent upon sale of the collateral. Please consider excluding these lot loans to individuals from the definition for HVCRE.

Sincerely,

Marcia J. Ringle

Marcia J. Ringle, Vice President/Secretary