October 18, 2012

Jennifer J. Johnson, Secretary — Via email: regs.comments@federalreserve.gov
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Robert E. Feldman, Executive Secretary — Via email: comments@FDIC.gov
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Office of the Comptroller of the Currency — Via email: regs.comments@occ.treas.gov
250 E Street SW
Mail Stop 2-3
Washington, DC 20219

Re: Comment on proposed Basel III regulatory capital rules/standards
Notices of Proposed Rulemaking (NPRs): Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions (Basel III) and Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (Standardized Approach)

Ladies and Gentlemen:

Thank you for the opportunity to comment on the Basel III proposals that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. As a bank that serves the community bank market, we at The Bankers Bank are deeply concerned regarding the effect the proposed rules would have on our business, our customers, and the banking industry as a whole.

At issue is the general application of the Basel III and the Standardized Approach NPRs to all banks regardless of size and activities. Compared to the types of banks that contributed to the financial crisis, community banks engage in traditional, less risky activities. Community banks typically hold more capital, maintain a generally conservative philosophy, and, as a whole, do not pose a significant risk to the financial system. An approach that requires the smallest institutions to abide by capital standards that are appropriate for the world's riskiest and most complex banking organizations will not help the country's banking system. Many banks will likely make shifts in business models and activities that would hinder credit availability and impede economic recovery. The potential consequences of applying the rules to community banks could be harmful to the financial system and the economy.

Compliance would require multiple changes to systems and processes, placing an unfair burden on community banks that have limited resources. While the hard costs associated with programming can be determined, other expenses are less quantifiable but would be significant. Community banks have

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already been penalized by the crush of regulatory burden emanating from attempts to address issues at systemically important financial institutions.

Traditional banks are disadvantaged by their lack of access to capital markets that are available to larger banks. Decisions by some bank owners to simply exit the business would lead to consolidation, and large and unmanageable banks could become even larger and more systemically risky. Community banks play a vital role in the economy, yet their ability to compete and remain viable will be threatened if regulators are willing to act first and deal with consequences later.

With respect to the Basel III NPR, the proposed capital calculations are complicated and impose more stringent capital deductions. The task of tracking 13 categories of deductions and adjustments to capital will be burdensome and costly. Limits on mortgage servicing rights, deferred tax assets, and investments in unconsolidated financial institutions could cause banks to reassess activities and investments. As a bankers bank, our shareholder base and primary source for raising capital is represented by community banks. The proposed limits on investments and other assets will affect our ability to raise capital if needed.

Inclusion of unrealized gains and losses on debt and equity securities in regulatory capital will create volatility in capital ratios and influence investment decisions. During a rising rate environment, banks will face a significant reduction in regulatory capital that is unrelated to the quality of its portfolio. As a result, many community banks will limit investments in longer duration assets including those that provide funding for the housing market and local governments. The rules would provide disincentive for investment that is sorely needed in these fragile economic times.

Decreased capital associated with interest rate changes could also cause legal lending limits to decline. As a state-chartered bank, our lending limit is defined by state banking statutes, which do not incorporate Tier 1 or Tier 2 capital into the calculation. Instead, capital is based on balance sheet categories, and unrealized gains and losses are not included. However, national banks and saving associations must abide by legal lending limits that are based on Tier 1 and Tier 2 capital. In our state, a bank's charter choice appears to impact its ability to lend.

The rules associated with the Standardized Approach NPR are overly complicated and would require significant changes to banks' information systems. The cost that would be involved with system changes does not justify the perceived benefit. In addition, banks would be forced to reassess activities, investments, business strategies, and balance sheet structures, and the basis for decisions would focus on capital ratio influences rather than sound banking principles.

Our bank has maintained strong asset quality since its inception and will continue to extend credit based on sound lending decisions. The criteria used to develop risk weights for mortgage loans and high-volatility commercial real estate effectively dictate underwriting standards. The ever-increasing reach of regulatory directives is quickly eroding a bank's ability to conduct business in a manner that considers its unique characteristics, business model, and risk management practices. While the prescribed standards are prudent, the degree of specificity could lead to an unintentional shift in decision-making processes as more emphasis is placed on factors that affect capital calculations.

Increased risk-weights on mortgage loans could alter the pricing and availability of a basic consumer product that represents a staple in the economy and influences the health of the housing market. Weighting for mortgage loans depends in part on the loan-to-value (LTV) ratio based on the value obtained at origination or restructuring. These rules could affect credit availability, as banks would be

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incented to fund only the most conventional and low risk mortgage loans. Applying the LTV as a primary factor in the risk estimate is not a sound strategy for residential mortgage lending. Further, homeowners who experience financial difficulties may find lenders unwilling to work with them when values decline as a restructure could affect the bank's capital requirements. Foreclosure is a more likely outcome in these situations.

Additional risk weighting for loans 90 days or more past due is inconsistent. Loans that are at this level of delinquency will have been accounted for in ALLL methodology with practically all banks holding additional reserves for these loans. The effect of requiring a risk-weight above 100% results in double counting those loans for capital purposes.

Given the myriad issues that will likely result from applying the referenced NPRs to the entire banking population, the consequences may not have been fully considered. Bankers have been asked to provide comments explaining how their banks will be affected by the proposed rules. However, an analysis of the potential and expected consequences of broadly applying such extensive changes to capital rules has not been made available.

The stated objective of these proposals is to "improve the overall quality and quantity of banking organizations' capital" and, with respect to risk-weighted assets, "enhance their risk sensitivity and address weaknesses identified over recent years". Community banks already hold sufficient amounts of core capital. They are also traditional lenders and deposit takers whose balance sheets are generally noncomplex and low risk.

I urge regulators to revise the proposals and allow community banks to operate under more reasonable and appropriate capital rules. Standards that are applied as an institution becomes larger and takes on more risk would provide a more appropriate means to accomplish the stated objectives. A more reasoned, risk-based approach would not punish the majority of banks that already hold adequate capital in relation to their risk profiles. Further, the chances for economic repercussions that cannot be fully estimated would be limited.

Sincerely,

Don Abernathy, Jr.

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President/CEO