FIRSTATE
BANK

October 18, 2012

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

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, S.W.
Mail Stop 2-3
Washington, D.C. 20219

Subject: Comments on FDIC Notice of Proposed Rulemaking RIN 3064-AD95 and FDIC Notice of Proposed Rulemaking RIN 3064-AD96

Ladies and Gentlemen:

Please accept this comment letter on the FDIC BASEL III NPR RIN 3064-AD95 and the FDIC Standardized Approach NPR RIN 3064-AD96 as each of these proposed changes to the regulatory capital rules will have a significant negative impact on First State Bank.

The proposed increase to the capital ratios to be designated as a well-capitalized bank, while not having much immediate pro forma impact on our bank's leverage capital ratio, will impact First State Bank's Tier 1 capital ratio and the total capital ratio significantly. First State Bank's current Tier 1 and total capital ratio are well above the well-capitalized ratios. However, when the proposed calculation changes to risk weighted assets are considered, these same ratios are decreased by 300 basis points each on a fully phased-in analysis of Basel III proposals based on our June 30, 2012 financial position, and will be well below the new Basel III proposed minimum capital requirements to be considered well-capitalized. We strongly disagree with the proposed changes to risk weighting assets, particularly on 1 to 4-family residential mortgages.

Negative Risk-Weighting Impacts on 1-4 Family Residential Lending – Restrictive Category 1 Definitions and New Loan-to-Value Requirements:

First State Bank is a small community bank with $85,000,000 to $87,000,000 in total assets. Mortgage loans to our local customers make up over 40% of the total loan portfolio of $57,000,000. First State Bank provides mortgage loans to a great many customers who otherwise would not qualify for the secondary mortgage market due to loan size, loan to value and other credit underwriting factors. We make three to five year balloon mortgage loans to manage interest rate risk. Under the proposed changes to risk weights for mortgage loans, these type loans will no longer fit the 50% risk weighting category, but will be shifted into a new Category 2 definition with higher risk ratings. All our mortgages would then be considered 100% risk

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weighted at a minimum, and up to 200% at a maximum, depending on loan to value ratios. Mortgage loans, while impacted by the overall decline in the value of all real estate, were not the primary cause for losses during the on-going credit crisis. Our customers, for the most part, have been able to manage to continue to repay First State Bank on their mortgage loans. The proposed changes to risk weighting of mortgage loans will have a negative impact on First State Bank's Tier 1 and total risk based capital ratios by at least doubling the risk weighted asset total for mortgage loans.

It is critical to the communities First State Bank serves to be able to offer mortgage loans to customers who otherwise will not qualify for secondary market mortgages however we will be forced to reduce the level of mortgage loans made by the Bank if the proposed risk weighting changes are finalized. First State Bank does not, nor do most small community banks, have access to the capital markets to raise additional capital that will allow the Bank to offer mortgage loans in our communities due to the proposed changes to the risk weighting of mortgage loans. We are not in a position to take on the higher interest rate risk that would occur if we carried 20 and 30-year mortgages in the Bank's loan portfolio. This will reduce our ability to offer mortgages in our local communities. Community banks are the backbone of small towns, rural communities and counties, and many other low to moderate income markets. Under these proposed changes, community banks will simply not be able to offer mortgage balloon loans to customers due to constraints on capital.

Complexity and Measurement Burden:
In addition to the impact of the risk weighting asset proposals, the complexity of the proposed mortgage risk weights will create an outsize burden on First State Bank. We do not have the additional resources, employees nor the complex software that would be needed to track, monitor and maintain records on loan to values for every loan that is already in our loan portfolio. This same complexity for capital calculations is continued in proposed changes to risk weights for other assets, especially loans.

Risks Already Reserved through ALLL Analysis:
It should be noted that non-accrual and non-performing loans are already reviewed regularly for changes to values of collateral and customer ability to repay. We carefully assess the risk in our entire loan portfolio on a quarterly basis in a detailed analysis to determine the bank's ALLL reserve balance. Capital has already been set aside to cover any heightened areas of risk that bank management perceives in the loan portfolio, and these analyses are regularly reviewed by our Board, our external CPA firm, and on-site regulatory examiners who are familiar with our markets. Loans in these categories are written down to these market values so why should they also be risk weighted more heavily for capital purposes? Since the goal of the proposed capital requirement changes is to increase capital, why isn't the entire allowance for loan and lease losses included as part of capital instead of being restricted to only 1.25% of total risk weighted assets?

Inclusion of Portions of Accumulated Other Comprehensive Income (AOCI) in Capital Calculations:
First State Bank and most other small community banks maintain investment portfolios that are a significant percentage of the overall balance sheet. Our investments are 15% or higher of total assets. The current interest rate environment is very low, if not the lowest in the past 50 years. When interest rates move higher, this will have a strong negative impact on market values for these investments. Our current interest rate shock reports indicate that if rates were to rise 300 basis points, the market value of our investments would decrease by $1,800,000. If accumulated other comprehensive income is included in the capital calculations, this will have a significant negative impact on our capital ratios. The Bank could easily go from being more than well capitalized under current capital calculations to under-capitalized in the matter of one month under the proposed capital calculations.

The impact on our leverage capital ratio based on our current tangible equity would reduce capital by over 35% and reduce our leverage capital ratio by 200 basis points. First State Bank would be almost reduced to significantly under-capitalized due to a fluctuation in interest rates. In addition, even in the best of times, interest rate fluctuations create wide, volatile swings in accumulated other comprehensive income. Any bank's capital calculations under the proposed capital changes would be required to incorporate this volatility. This would be extremely difficult to manage for small community banks. We would be forced to transfer virtually all investments into the "held to maturity" category rather than "available for sale" as the investments are currently carried. This would reduce the Bank's ability to manage its portfolio, impact liquidity and create needless complexity for all small banks.

Detrimental Impacts to Our Customers and Our Communities:

Another critical issue with the proposed risk weighting of loans is the impact to overall lending in our markets. First State Bank is a small community bank operating in two small rural counties in Georgia. Our customers and loans range from small consumer demand for loans up to loans for commercial borrowers that are near the legal lending limit of the Bank. This includes a vibrant agricultural market. Increasing the risk weights for loans in various categories will either reduce our ability to make loans of this type in our markets due to capital restrictions or we must increase the interest rates and fees that we charge our customers on these loans. In either scenario, our customers will bear the cost.

Small Community Banks' Lack of Access to Capital Markets:

First State Bank as with many other small community banks does not have access to the capital markets available to large regional and national banks. In our situation, First State Bank would not be able to raise capital to meet the higher proposed capital ratio minimums. Even if the Bank was able to obtain a 1.0% return on average assets which is highly unlikely due to increased regulatory requirements for compliance and in other areas of banking which have impacted overall profitability, First State Bank would be very unlikely to retain the earnings with which to meet the proposed new capital minimum ratios for each of the capital tiers that are included in the proposed rulemaking. And this doesn't include the volatility impact of rising interest rates over the next few years and the resulting reductions in accumulated other comprehensive income and total capital.

Conclusion:

In summary, the proposed changes to the risk weighting of various assets, particularly mortgage loans, the inclusion of accumulated other comprehensive capital in regulatory capital totals, and increases in the total amount of capital that must be held by banks will have a deleterious impact on small community banks such as First State Bank. It will reduce the available credit that may be extended in our local markets. It will increase the rates that will be charged when credit can be extended to our customers while reducing the Bank's ability to structure that credit to reduce interest rate risk. It will reduce the Bank's ability to manage its investment portfolio to meet the dual goals of liquidity and earnings and increase the volatility of the capital ratio measurements simply through market swings for interest rates.

Respectfully,

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