First Sentry Bank
YOUR TOWN...YOUR BANK™

October 16, 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 Proposals

Ladies and Gentlemen:

I appreciate the opportunity to provide my comments 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.

My name is Geoff Sheils, and I have worked for First Sentry Bank since 1997 and have been serving as its President & CEO since January 2001. First Sentry started in 1996 in my hometown of Huntington, West Virginia, by a group of local citizens that recognized a need for community banking due to the infiltration of national and regional banks in the community. In 1999, another bank started in Huntington for the same reason that was known as Guaranty Bank & Trust Co. In 2009, these two community banks joined forces to continue the battle against the national, regional and super-regional banks in our community. Today, First Sentry is one of the largest financial institutions in the community being directed by a 20 person board and is a driving economic force in the community. It has over 700 local shareholders, none of whom own more than 5% of the bank's outstanding stock. It is truly a widespread community bank who knows its mission and works its mission.

With that background, First Sentry Bank strongly opposes the new Basel III Capital requirements and urges Regulators to continue to allow community banks to use the current Basel I framework for computing their capital requirements. Basel III was designed to curb the risky practices that the largest, internationally active banks employed that caused the economic recession. It has little to do with First Sentry Bank or other community banks, which operate on a conservative model of managing risk while serving its community versus the largest banks acting recklessly to post increasing quarterly profits and reward its employees with excessive compensation. This difference, in and of itself, demonstrates the need for tougher capital standards on the largest

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banks. It does not demonstrate a need to impose these restrictions on community banks that not only refrained from these activities, but also do not cause systemic issues when one fails either.

Proposed Phase-out of Trust Preferred Securities

First Sentry Bank is opposed to the proposed phase out of the tier-one treatment of instruments like trust preferred securities (TRUPS) because it is a reliable source of capital for community banks and would be very difficult to replace. First Sentry Bank believes it was the intent of the Collins amendment of the Dodd-Frank Act to **permanently grandfather tier one treatment of TRUPS issued by holding companies between $500 million and $15 billion**.

Our bank currently has $9 million in TRUPS that has **enabled the bank to grow and invest** (in the form of loans to businesses) in the communities that we serve. Since we first acquired TRUPS in 2002 and refinanced them later in 2007 and acquired additional TRUPS from the merger with Guaranty Bank & Trust in 2009, First Sentry Bank has grown its asset base from $164 million to $489 million on 9/30/12 and its commercial loan portfolio (loans to businesses in the communities we serve) from $101.9 million to $282.7 million on 9/30/12. **TRUPS was a necessary component of this growth and is a necessary component of our capital stability, and furthermore enabled the bank to stimulate our local economy with this loan generation.** Most economists agree that for every dollar lent by a bank to a business for business purpose (purchase building, purchase equipment, finance working capital, etc.), it generates SIX DOLLARS for the economy. It has that type of multiplier effect. It would have a significant detrimental effect to the local economy if we were not able to make loans because we could no longer include TRUPS in Tier 1 Capital. If it was good for us in 2002 when we had equity capital, exclusive of TRUPS, of $11.1 million, why is it now bad for us in 2012, when we have equity capital, exclusive of TRUPS, in the amount of $33.5 million?

This proposed treatment of TRUPS would reduce First Sentry Bank's tier one capital from $38,957,348 to $29,957,348, a **23 percent reduction**! First Sentry Bank's tier one leverage ratio would fall from 7.85% to 6.04% based on September 30, 2012 financials. For us to maintain our ratio at 7.85%, we would have to "shrink" our balance sheet by an amazing $114.5 million solely due to the elimination of TRUPS. Then, to further add "insult to injury", the proposal requires us to risk-weight our assets differently, which would make the required asset reduction even greater. I sincerely urge the banking regulators to continue the current tier one treatment of TRUPS issued by those bank holding companies with consolidated assets between $500 million and $15 billion in assets.

New Risk Weights

As it relates to the proposed risk weight framework under Basel III, we feel that the implementation of such is much too complicated and will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks who offer these loan products to their customers and deprive customers of many financing options for residential property. As the secondary housing market has tightened, First Sentry Bank has used the aforementioned lending products to meet the individual needs of its customers. First Sentry Bank has also utilized balloon products to mitigate interest rate risk as part of its asset liability management. How it can be determined that a five year balloon mortgage has more innate risk than a 15 year or 30 year fixed rate mortgage is quite interesting to me. Higher risk weighting on balloon loans would force First Sentry Bank to originate longer term loans, heightening long-term interest rate risk, potentially forcing us out of the residential loan market. Second liens could disappear due to additional balance sheet exposure imposed by the proposed capital allocation requirements. First Sentry Bank will also be forced to make significant software upgrades and incur operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages.

Elimination of Excess Reserve Requirements

Basel III continues the practice of limiting the amount of the Allowance for Loan and Lease Losses (ALLL) included in the risk based capital calculations to 1.25 percent of gross risk weighted assets. First Sentry Bank continues to adequately provide to the ALLL and believes the entire amount should be included in risk based capital calculations. As of 9/30/12, we excluded over $2 million of the ALLL that arguably should be included in risk based capital. By establishing this arbitrary ratio of 1.25% of gross risk weighted assets, it provides a disincentive for banks to properly fund their reserve based on the inherent risks in their loan portfolios.

Incorporating Accumulated Other Comprehensive Income (AOCI) as Part of Regulatory Capital

Inclusion of accumulated other comprehensive income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for most community banks represents unrealized gains and losses on investment securities held in available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities. Additionally, demand for many implicitly and explicitly government guaranteed securities has risen due to a flight to safety and government intervention in the capital markets. This increased demand has caused credit spreads to tighten further increasing bond valuations.

Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. **This decline will have a direct, immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce capital balances**. At First Sentry Bank, for instance, if interest rates increased by 300 basis points, initial calculations suggest that the bank's bond portfolio would show a paper loss of $5,100,677. Since this proposed regulation would require this unrealized paper loss to be included in regulatory capital, it would have the result of decreasing the bank's tier one ratio by 13.09%, all because of an accounting treatment regulation? While having no desire, no intent and/or no need to sell these long-term investment securities, we would be penalized for investing in them. Banks like us will be forced to consider complicated hedging strategies like interest rate swaps that would lessen current earnings and make the financial statements much more complicated. Community banks would be forced to rely on outside consultants and investment bankers who purport to have the requisite knowledge/expertise to engage in these transactions as community banks generally lack the expertise required to manage the associated risks and costs of such derivative transactions. It is my recommendation that community banks should continue to exclude AOCI from capital measures as it is done today.

Capital Conservation Buffers

Community banks have managed their financial affairs quite well. If a bank is well capitalized, it is well capitalized, and our position is that the imposition of a capital conservation buffer is totally unwarranted for a bank to be able to pay dividends to its shareholders. Why should a bank that is well capitalized in all of the ratios (including the proposed addition of a new, fourth, ratio) not be allowed to pay a dividend if it remains well capitalized after the payment of such? Again, this just complicates matters, and it further injures a bank's ability to attract capital when and if it needs additional capital based on current market conditions and plans for future capital requirements. This proposal would make it that much more difficult for a bank to obtain capital, and I am not sure that is what this proposal intended.

In conclusion, I think it is apparent what damage this proposed regulation can do to my bank, not to mention the community banking industry as a whole. Next month will mark the 30th year that I have been in banking. I have seen a lot of changes in the industry. If Basel III is implemented as is, I think the ensuing 30 months will have more change than the previous 30 years with community banks facing their demise and being forced to sell to the large, national and regional banks. I do not believe this was the intent of Basel III, but I am confident it will be an unintended consequence should it be implemented as is.

Thank you again for allowing me to provide input on this most important matter, and I appreciate your consideration in this extremely important matter.

Sincerely,

Geoffrey S. Sheils
President & CEO

cc: The Honorable Joe Manchin
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Washington, DC 20510-4801

cc: The Honorable John D. Rockefeller, IV
United States Senate
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The Honorable Nick Rahall
United States House of Representatives
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cc: <u>First Sentry Bank Board of Directors</u>
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