SFB STEPHENS FEDERAL BANK

October 16, 2012

Mr. 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

To Whom It May Concern:

This letter serves as a summation of my grave concerns about the Basel III proposal currently in the comment period as proposed by the regulatory agencies. As the CEO of a mutual thrift in north Georgia, where the "great recession" has proven devastating to real estate values, and portfolio home mortgage lending is an integral part of our business model partly due to regulatory charter limitations, I am greatly disturbed by several aspects of the proposal. It appears that the interrelationship of this guidance with capital availability, the detrimental effects on mortgage credit availability and servicing, interest rate risk management, and conflicts with GAAP and existing regulation were not fully considered.

First of all, community banks provide a substantial resource in mortgage lending for rural areas, where GSE mortgage guidelines don't always "work". Community banks have knowledge of their markets and customers that allowed them to provide this much needed mortgage credit that has performed well during the downturn. This need has been accommodated during the last decade of historically low rates by balloon notes, which allow for periodic re-pricing. As you will recall, the S&L debacle of the 1980's began with the thrift industry's reliance on short term funding for long term lending, which is certainly still a recipe for disaster if relied upon in this incredibly low yield environment for lending. Balloon loans are not inherently "bad", and simply provide a way for community banks to fill the gaps in mortgage lending left by the secondary market without taking on inordinate interest rate risk. Basel III is proposing that any balloon mortgage will carry a 100% risk weighting rather than 50% currently.

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Compounding this problem for Georgia is the requirement that risk weighting be based on the most recent appraisal value, which at renewal, is not within the bank's control as part of the underwriting. Given the current environment, it will take years for most of these loans to fall below an 80% loan-to-value ratio again, as values have declined significantly and the economy remains weak. The result will be an increase in risk weighting from 50% to 200% for a substantial block of Georgia's mortgage lending at community banks.

At the least, Basel III should be amended to utilize the original appraised value as long as new money is not advanced as FDICIA's high LTV tracking rules have done. That is an obvious conflict between Basel III and existing regulatory practice. As an example, a loan made on a 5 year balloon at $1,200,000 on an appraisal of $1,500,000 at 80% in 2007 is maturing now, and is at a 50% risk weight. The borrower has performed, income remains strong, and credit history is unblemished. The new appraisal has declined to $1,150,000, or about 100% loan-to-value. Under Basel III, simply because this loan was not priced as a 30 year fixed rate mortgage, the risk-weighted asset determination goes from $600,000 to $2,400,000 and the minimum capital requirement rises from $27,000 to $108,000. Examples like this multiplied across portfolios in areas where values have declined result in untenable capital requirements even with a phased in implementation.

Similarly, banks are also required to have robust ALLL practices that account for the risk associated with loans that are truly in peril; if these practices are now functional given the current regulatory focus on them, why should any loan be saddled with a 200% risk weighting, or anything beyond 100%? Requiring both of these hedges against risk will force many banks to give up portfolio mortgage lending entirely, especially in light of the legal uncertainties coming from the Qualified Mortgage definitions and other changes included in Dodd-Frank's implementation. Is this unintended consequence beneficial for the nation or consumers as we struggle to bring the residential real estate market back to health? It should also be noted that most banks don't even track many of the required data elements to implement Basel III's regulatory overlay for risk-based capital. The expense and labor required in establishing them retroactively for little to no economic benefit simply cannot be supported in today's strained economy.

Also in the mortgage lending realm, many community banks have elected to service their secondary market mortgages as a means of retaining the customer relationship while providing the long-term fixed rates that benefit the consumers who qualify for them. Basel III's limitations on servicing rights valuations as a percentage of capital will cause many local and regional banks to exit this part of the business. It is no mystery that community banks "know their customers" and provide a quality of loan servicing that is vastly superior to that of the mega-banks, who have been charged with many servicing abuses by regulators during the current crisis. Why should Basel III encourage quality loan servicing providers to exit or limit this business in favor of large, impersonal, and bureaucratic conglomerates, especially given the current environment? Obviously, the GSE's were not consulted for this segment of the Basel III guidance, as they will confirm (with substantial empirical evidence) that the quality of loans and servicing provided by the community bank sector greatly surpasses that of the mega-banks. While I understand that MSR's represent an intangible asset to some degree, they are an accepted entity under GAAP and the unintended consequences of these limitations are detrimental to consumers and the real estate market recovery.

The treatment of deferred tax assets under Basel III creates similar concerns. DTA's not realizable within one year are already discounted from capital for regulatory purposes, so why would there be additional limitations for what is, yet again, an accepted entity under GAAP? Many banks have experienced losses during the great recession, and being able to realize these deferred tax assets on their books over time will assist in rebuilding capital ratios, a worthy goal. How does the industry and the consumer benefit from this treatment, which again limits availability of credit in the community bank segment where it is needed most?

It must also be acknowledged that in hard-hit areas of the country such as Georgia, Florida, Arizona, California, and Nevada that many community banks have experienced capital depletion. Many have already exhausted their shareholders for additional capital under current guidelines. If Basel III stands, and billions more in capital becomes necessary for community banks, there will be a wave of unnecessary consolidations and failures as yet another consequence of these rules, whether intended or unintended. Capital is scarce to non-existent in rural areas of the country as the economy continues to struggle. I cannot see how further damage to the community banking sector aids in our recovery or benefits the nation and consumers. We have experienced first hand in Georgia that communities are devastated by the loss of local banks, which are replaced by regional and mega-banks whose business models tend to starve rural areas of needed credit and community support.

Basel III as conceived presents many dangers to the economy, consumers, and the banking industry at a time when no further "shocks" can be tolerated. It simply swings the pendulum too far. I believe that the current regulatory demands for capital and Allowance for Loan & Lease Losses have addressed the needs identified during the crisis, and those demands were hardly painless to the institutions and communities affected. Adding these capital requirements with all the unintended consequences and regulatory and accounting conflicts outlined above represents a political and economic debacle.

Sincerely,

Timothy J. Ash

President/CEO