From: Johnny Irvin [mailto:jirvin@rabuncountybank.com]
Sent: Wednesday, September 12, 2012 2:47 PM
To: Comments
Subject: Basel III (RIN 3064-AD95) and Standardized Approach NPR (RIN 3064-AD96)

We appreciate the opportunity to comment on the proposed rules associated with Basel III and the Standardized Approach ("the proposed rules").

Based upon our review of the proposed rules and the information that was presented at the FDIC's community bank information session on July 26, 2012, it is our position that the proposed rules in their current form will greatly reduce our ability to serve the credit needs of our community. The application of Basel III, including the new Common Equity Tier 1 capital measure, will place additional pressure on our capital base, which will limit our overall lending capacity. The application of the Standardized Approach, especially the risk weighting of 1-4 family residential mortgages and high volatility commercial real estate, will significantly impact the availability of credit to borrowers who cannot qualify for conventional mortgage financing and borrowers who wish to purchase lots or acreage for their own future use.

The community banking industry is still struggling to emerge from the economic downturn, and many banks are under regulatory orders to raise capital. There is a great deal of uncertainty in the current economic environment, and many banks simply cannot raise the capital at this time.
Many banks like ours have adapted by lowering overhead, shrinking assets and managing nonperforming assets out of their operations in an effort to earn their way back into the regulatory thresholds currently in place, but the lack of loan demand and the low interest rate environment have presented significant headwinds to these efforts. Implementing the proposed rules at such a time ignores the current realities and consequences of adding further weight to a struggling industry.

The proposed rules aim to strengthen the ability of banks to continue functioning as financial intermediaries, including during periods of financial stress. However, it is our

opinion that borrowers would ultimately be deprived of access to credit since banks would be forced to curtail lending, further stifling a recovery in the real estate market, which is a key component of economic growth and employment in our community.

We agree with the Independent Community Bankers of America's position that Basel III targeted the largest internationally active banks, which ultimately benefited from extraordinary government intervention due to systemic considerations. Therefore, we recommend that a tiered system be devised to exempt smaller community banks (perhaps with assets less than
$1.0 billion) and/or eliminate or amend the specific provisions addressed within this letter. We also ask that the inclusion of the entire allowance for loan losses in Tier 1 and total capital be considered due to its loss-absorbing qualities as a first line of defense against capital loss.
While one single community bank is not systemically important, in the aggregate, community banks are vitally important since they represent a critical source of funding necessary to facilitate the economic activity in the communities they serve, especially in rural areas like ours.

Basel III
Basel III introduces a new Common Equity Tier 1 risk-based capital ratio ("CET1"), which will include deductions for accumulated other comprehensive income ("AOCI"), deferred tax asset carryforwards and non-significant investments in another financial institution's capital instruments.

AOCI. Under current capital guidelines, AOCI is adjusted from Tier 1 capital, which reduces the volatility in capital due to changing interest rates. It is our practice (and it is most likely the practice of most community banks) to purchase investments with the intent to hold them to maturity. Therefore, the continued application of this adjustment to Tier 1 capital is appropriate. While the inclusion of AOCI may be beneficial in today's unusually low interest rate environment, rapid increases in interest rates can quickly reverse a gain position and have a negative impact on a bank's capital base. It could be argued that the use of a held-to-maturity designation would eliminate this concern. However, any significant changes in market interest rates or changes in the availability of and yield on alternative investments at some date in the future would inevitably lead to the potential for other-than-temporary impairments, which would ultimately defeat the application of the held-to-maturity designation.

Although loan demand has remained at historically low levels, we have avoided large additions to the investment portfolio due to long-term price risk concerns. However, many of our peers have continued to add to their portfolios. For example, as of June 30, 2012, our uniform bank performance report showed that our available-for-sale securities represented 5.21% of average assets compared to our peer (Peer Group 5) of 21.48%. Even with our limited investment holdings, a +300 basis point shock in interest rates could have potentially reduced our positive AOCI position by $233,000. This would have translated into an 11 basis point reduction in our Leverage ratio as of our June 30, 2012 call report. Therefore, it is our conclusion that the inclusion of AOCI has the potential to more severely impact the capital position of many community banks, which will ultimately translate into less ability to lend in their respective communities.

Deferred Tax Asset ("DTA") Carryforwards. It is our position that the proposed departure from the current treatment of DTAs is unnecessary and eliminates a potential source of additional capital for banks, especially in an environment where capital is not readily available. Banks are required to support their DTA levels and adjust the levels as needed through charges to the income statement. For example, based upon our internal analysis during the fourth quarter of 2011, we elected to recognize a charge of $2.3 million, establishing a valuation allowance for the full balance of our DTA.
It should be noted that this was done independently and not under the direction of our bank regulators or auditors.

While the economic downturn has provided significant challenges to sustaining a consistent level of profitability, it would be naive to assume that these conditions will persist indefinitely. As economic conditions improve, the ability of banks to generate taxable income and support their DTAs should improve as well, which has the potential to allow many banks to improve their capital positions. As of our June 30, 2012 call report, our
$2.3 million DTA (if supported) would have improved our Leverage ratio by
106 basis points. Therefore, we feel that a deduction for DTA carryforwards is unnecessary due to current standards requiring support for DTA levels, and it would eliminate another source of capital, further impacting our ability to lend.

Non-Significant Investments in Another Financial Institution's Capital Instruments. This CET1 deduction may present challenges for banks that hold investments in the trust preferred securities ("TPS") issued by other banking organizations, especially if these holdings exceed the proposed threshold of 10%. Amounts not deducted would be subject to a 250% risk weight under the Standardized Approach. According to Sandler O'Neill, which is an investment banking firm and broker-dealer focused on the financial services industry, banks have been active investors in TPS since the time they were approved as Tier 1 capital by the

Federal Reserve in 1996, and while the exact level of participation of banks in this market is not tracked, U.S. banks may own a significant amount of these investments.
Based on our own experience with these investments, we feel that it is unnecessary to require a deduction for holdings of TPS due to current fair value accounting rules and impairment testing requirements. It is our opinion that the potential impact of TPS investments on a bank's capital position is already reflected under current accounting rules and further adjustment serves to penalize the investing bank for holding these types of investments although the credit quality of the investments is normally equivalent to other investment grade corporate debt.

We strongly suggest that the adjustments and deductions discussed in the preceding paragraphs be eliminated due to the significant reduction in lending that would result from the application of the proposed rules in their current form.

Standardized Approach
The revisions in the Standardized Approach for the calculation of risk weighted assets, particularly as they apply to 1-4 family residential mortgages and high volatility commercial real estate, will significantly limit our ability to serve the specific credit needs of our community.

1-4 Family Residential Mortgages. Traditionally, community banks have successfully provided much needed financing in this arena since many borrowers cannot qualify for conventional mortgages. Historically, losses associated with these types of loans have been limited. As a result, 1-4 Family Residential Mortgages represent a significant portion of community bank loan portfolios. As of June 30, 2012, Rabun County Bank's 1-4 Family Residential Mortgages to average gross loans was 48.01%. Although our peer (Peer Group 5) had a smaller percentage, it was still a significant 29.24%.
Our net losses as a percentage of 1-4 Family Residential Mortgages between
2008 through 2011 averaged less than 1% with most of the losses experienced in 2011. Prior to 2011, net losses ranged between 0.06% in 2008 and 0.58% in 2010.

The Standardized Approach proposes two categories for risk-weighting 1-4 Family Residential Mortgages based upon certain loan terms and loan to values. One immediate challenge for community banks will be the identification of the specific characteristics that will qualify loans for either Category 1 or Category 2 treatment. Loans with balloon features or adjustable rate mortgages ("ARMs") with interest rate changes greater than 2% per year and/or greater than 6% over the life of the loan will not qualify for the lower Category 1 risk-weights. This rule does not adequately consider that balloons and ARMs are the primary tools utilized by community banks to limit sensitivity to interest rates. Additionally, balloons provide banks with the opportunity to re-underwrite matured loans, which further limits credit risk.

Under current rules, these loans are risk weighted at 50%. Under the proposed rules, our preliminary estimates indicate that a significant portion (85%) of our Residential 1-4 Family Residential Mortgages will be subject to at least a 100% risk-weight. The other 15% will likely be subject to a 150% risk weight or greater. As of our June 30, 2012 call report, this provision would have decreased our total risk-based capital ratio by 268 basis points, which would have represented a $34.2 million reduction in potential lending capacity.

We strongly suggest that this portion of the Standardized Approach be eliminated altogether or at least amended to exclude balloons and ARMS.

High Volatility Commercial Real Estate ("HVCRE"). The Standardized Approach proposes a 150% risk weight for HVCRE except 1-4 family residential properties and projects meeting certain criteria for loan to values and borrower contributions. The proposed rule does not adequately consider the broad range of lending that could be subject to the higher 150% risk weight.

Community banks, especially those that are located in communities with an active second/vacation/retirement home market, could potentially be significantly impacted by the proposed rule. For example, Rabun County Bank has a large portfolio of loans secured by lots or land. This portfolio was $22.9 million at June 30, 2012. Many of these loans have been extended to borrowers who wish to purchase property with the goal of constructing in the future a secondary or vacation home or primary residence in retirement.
During the past few years, the general category of construction, land development and other land loans has fallen out of favor from a regulatory perspective. Subsequently, many banks, especially larger institutions, have actively reduced their portfolios (and new lending) in this category, which has served to lessen demand in an already weak real estate environment. The proposed rule may further limit or worsen a segment of the market that has already been significantly impacted during the real estate downturn. As of our June 30, 2012 call report, this provision would have decreased our total risk-based capital ratio by 105 basis points, which would have represented an $11.5 million reduction in potential lending capacity.

We strongly suggest that this portion of the Standardized Approach be eliminated altogether or at least amended to exclude the financing of lots or land.

Again, we thank you for the opportunity to comment on these proposals. If you have any questions regarding the comments within this letter, please do not hesitate to contact me by phone at 706-782-4571 or by email at jirvin@rabuncountybank.com.

Sincerely,

Johnny Irvin
CEO
Rabun County Bank
Clayton, GA

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