September 25, 2012

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

RE: FDIC BASEL III NPR (RIN 3064-AD95)

Dear Mr. Feldman:

At the request of and on behalf of the Board of Directors ("Board") of Parkway Bank ("Bank"), (see attached Board resolution), I am writing to comment on our Bank's concerns regarding the implementation and passage of BASEL III. We are a $110 million community bank located in Lenoir, NC.

Regulatory Burden

The proposed rules to implement BASEL III capital standards would impose undue regulatory burdens on community banks without materially reducing the industry's risk profile – a profile dominated by the nation's largest financial institutions.

BASEL III is a complex and cumbersome proposal, and the requirements for compliance will significantly add to an already high and increasing level of regulatory burden and cost for community banks.

Community banks are the primary source of credit to small business customers, and these are the businesses that create the bulk of the new employment opportunities and economic activity which is sorely needed in this country. These new regulations will likely result in consolidation, reducing credit availability for Main Street borrowers. Further consolidation and concentration of the banking industry should not be a goal – intended or otherwise – of public policy. The BASEL III proposal is the epitome of unnecessary regulatory burden, and will have severe and immediate consequences on the community banking sector.

Unrealized Gains/Losses

The proposed rules will require all banks to include unrealized gains/losses on Available for Sale Securities ("AFS") in Common Equity Tier 1. This change will introduce potentially serious volatility in the regulatory capital ratios, if and when interest rates begin to rise. Penalties for falling below mandated regulatory capital levels are severe, and banks will likely move to shorter maturities, sacrifice liquidity and/or forgo expansion or growth based upon inevitable pricing swings.

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Unrealized security losses caused by interest rate swings should not be included in the regulatory capital calculations. With the current artificially low interest rate environment, the only movement in rates will be upward, which will negatively impact capital ratios for all banks. The industry has operated for decades without including these unrealized losses in regulatory capital ratios, and recent banking failures were not caused by unrealized security losses.

The cost of borrowing for already strapped municipalities and other government entities will increase as banks become unwilling to hold longer maturity securities for fear of interest rate swings and capital degradation.

The current Accumulated Other Comprehensive Income ("AOCI") proposal will definitely result in countercyclical capital volatility relative to market interest rates. This volatility will create confusion in the industry for bankers, regulators, investors, depositors and others. Merging real gains or losses with unrealized gains or losses creates more confusion than transparency, especially when applied to only one subset (AFS) of class of an institution's assets.

If the current AOCI proposal is implemented, bankers are likely to respond in three ways: 1) shorten the duration of the securities portfolio to reduce price risk, 2) hold additional capital to offset AOCI risk or 3) transfer price-risky bonds into the Held to Maturity (HTM") category. The first option reduces earnings, requiring additional risk in other areas to maintain a stable income stream or resulting in lower earnings. The second option lowers ROE and ROI, reducing the amount of free market capital available to financial institutions. The third (and most likely) response does nothing to change the institution's risk profile, relying on an accounting election to hide the risk this proposal attempts to bring to light. By transferring securities from AFS to HTM, bankers constrain their liquidity options in order to protect "on paper" capital ratios – a trade off with questionable value.

Impact on Economy

The ultimate losers are consumers, small businesses and local government entities, who will face higher borrowing costs and diminished availability of both credit and bank services.

The proposed changes to risk weightings, especially in the mortgage loan category, are excessive, and will further dampen activity in an already challenging market. Rules already in effect and proposed, including escrow requirements, balloon note limitations, appraisal standards, additional disclosures and new "zero tolerance" on the Good Faith Estimate, among others, have significantly curtailed mortgage lending among community banks, especially for loans held in portfolio.

Big Banks vs. Small Banks

Large banks have the ability to hedge the interest rate risk exposure on their securities portfolios. Community banks don't have that luxury and are unable to do so in an economically feasible manner.

The proposed risk weightings will create unnecessary reporting burdens for community banks and limit their ability to provide flexible lending solutions to customers. Larger lenders that use highly structured, computer model-based lending platforms will be able to rely on technology to ensure compliance with desired risk-weighting criteria, while community banks will be forced to check each loan against a long list of technical parameters or risk unintentional violation of a risk threshold.

Community banks are struggling to keep up with the costly and burdensome load of regulations and edicts coming from Washington, D.C. Large banks have the ability to absorb these compliance costs more efficiently.

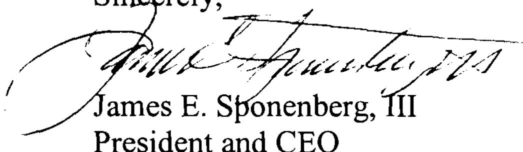
Even under existing capital rules, there is a disconnect between the capital levels required of community banks and what the large banks have been required to keep. Regulatory requirements for small banks have always been higher, and there is no reason to believe that this disparity will not continue under this new proposal.

Allowing community banks under $1 billion in total asset to continue using current risk-based capital rules would provide a great relief to community bankers and their regulators. 90% of all institutions fall below the $1 billion threshold, yet these institutions hold only 10% of total industry assets. The goal of establishing improved risk-sensitivity and quality of capital is at least 90% accomplished through application of the proposed rules to only 10% of all market participants. The inevitable trickle down of regulatory expectations can be effective in preventing any significant unintended consequences of this segmented application of the standardized approach. If necessary, subsequent application of the new approach to smaller institutions can be proposed as appropriate.

The easiest approach to determining which institutions are allowed to continue using the current risk-weighting methodology is asset size. Whether through a linkage to the small bank holding company threshold (currently $500 million) or one of the Dodd-Frank size thresholds, this method produces a very clear line in the sand for all parties, with no room for interpretive disagreements. Form a statistical standpoint, 90% of all FDIC-insured institutions have assets of under $1 billion, while the remaining 10% of institutions hold 90% of industry assets. A 90/10 solution seems to provide the best "bang for the buck". Recognizing the desire of regulators to constrain risky behaviors, another reasonable segmentation could be based on a combination of Commercial Real Estate concentration, non-government/Government Sponsored Entity security concentration and non-core funding mix. A review of the balance sheet characteristics of the 400+ recently failed institutions should provide a good foundation for these types of concentration thresholds.

We appreciate the opportunity to participate in the regulatory rule making process.

Sincerely,



James E. Sponenberg, III
President and CEO

RESOLUTIONS
OF THE
BOARD OF DIRECTORS OF
PARKWAY BANK

WHEREAS, the Federal Regulators have issued proposed rules ("BASEL III") for the maintenance of capital levels by financial institutions both nationally and internationally; and,

WHEREAS, a review of BASEL III by management and the Board of Directors indicates that adoption and compliance with these rules would be onerous and burdensome on all financial institutions, most especially community banks such as the Bank; and,

WHEREAS, the vast majority of community banks have expressed concerns over the passage and implementation of BASEL III in its present form; and,

WHEREAS, the Board of Directors desires that its views and comments on BASEL III be communicated to the Federal Regulators.

NOW, THEREFORE, BE IT HEREBY RESOLVED, that the Board of Directors directs management to communicate their written concerns in the form of a comment letter to the appropriate regulators as attached hereto.

This the 25th day of September 2012.

Jackie W. Reynolds, Recording Secretary

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