Ju

OFFICE OF THE CHAIRMAN
CORRESPONDENCE ASSIGNMENT

OC 12-0224

ASSIGNED TO:
COMMENTS

DATE: 09/11/2012

CORRESPONDENT: JOHN L. LEWIS
CHIEF EXECUTIVE OFFICER
VERITY BANK
94 W. ATHENS STREET
P.O. BOX 647
WINDER, GEORGIA 30680

MR. LEWIS OF VERITY BANK PROVIDES HIS CONCERNS REGARDING RISK-WEIGHTING CAPITAL STANDARDS.

THE ATTACHED CORRESPONDENCE HAS BEEN ASSIGNED TO COMMENTS FOR INFORMATION.

IF YOU HAVE ANY QUESTIONS RELATING TO THIS ASSIGNMENT, PLEASE CONTACT THE CORRESPONDENCE UNIT OF THE OFFICE OF LEGISLATIVE AFFAIRS AT 898-7055.

DISTRIBUTION:
MS. RYAN

FYI... Chuck 9/5/12

OC 12-224

VERITY BANK

Mr. Thomas Hoenig
FDIC
550 17th Street NW
Washington DC 20429

August 27, 2012

Dear Tom:

Please find this letter to express our concerns over the proposed Basel III and to let you know how we believe it will impact our bank specifically. I believe there are two areas that will impact our institution significantly and adversely. I have detailed these below with examples.

The primary concern for our bank is the 1-4 family loans and how the risk weighting will be changed. Currently 1-4 family risk weighting is 50%. Under this new regulation, the risk weighting could increase to as much as 200% with no change in credit quality. One of the primary drivers for this increase is if the loan has a balloon feature. The majority of our 1-4 family loans have balloons to protect us, a small community bank, against interest rate risk. We do not have the luxury of using derivatives or accessing other funding like large financial institutions. Banks our size may use Federal Home Loan Bank lines but those are typically viewed with suspicion by regulators because the funds are not core deposits. Since most of our loans do have balloons we would be penalized by our risk weighting going automatically to 100%. Below I have detailed the current categories, LTV's and associated risk weighting:

Category 1
<60% = 35% risk weighting
60-80% = 50%
80-90% = 75%
>90% = 100%

Category 2
<80% = 100% risk weighting
80-90% = 150%
>90% = 200%

As you can see if our loans have an amortization of 30 years or less, have documented borrower income and have an LTV of 80% but also have a balloon, then our risk weighting goes from 50% (currently) to 150%. If Basel III was in effect, this same loan is 75% in Category 1 versus 150% in Category 2 just because the loan has a balloon. Also, our total portfolio of 1-4 family loans is approximately $23 million.

Basel III would calculate our risk weighted assets at approximately $35 million. Our risk weighted assets under Basel III **are more than the actual assets we have on our books.**

The preliminary impact to our capital would be the following, based on 6/30/12 numbers:

Current Common Equity Tier I – N/A	New Common Equity Tier I – 12.22%
Current Tier I – 14.57%	New Tier I – 12.22%
Current Total Capital - 15.82%	New Total Capital 13.37%
Based on 6/30/12 numbers	

Verity Bank has been very blessed to be a clean and healthy four-year old bank. Our recent FDIC exam in May 2012 went very well, our Texas ratio is zero and we do not have any past due loans. Additionally, we are pleased that Verity Bank was recently recognized by MSN Money as one of the "Safest Banks in America". We continue to strive to be a sound and profitable community bank in the state of Georgia. However, under the proposed Basel III requirement, our capital would be reduced by approximately 250bp yet our cleanliness and our risk profile would not have changed

As you can see, this new regulation has a tremendous impact on Verity Bank, a clean and healthy organization. To put this into more perspective, if I made a loan to you and underwrote it as unsecured the risk weighting would be 100%. So under this new regulation, an 80% LTV, 1-4 family loan would be a greater risk, (150%), than the same loan unsecured that would have a weighting of 100%. Again, this does not make sense.

I also believe ADC loans will be curbed because they will automatically be risk weighted at 150% versus the current 100%. This again will reduce our ability and the industry as a whole to meet the needs of our clients.

The second concern I believe exists in this model is in the calculation of the current leverage ratio. Below is how we would look, as of 6/30/12, if this regulation is in force.

Current Leverage ratio – 10.56%	New Leverage ratio – 10.67%

You might look at this and think this is positive, but I would have to disagree. The up-tick is due to the gains showing in our bond portfolio as a result of being at the bottom of the interest rate cycle. When we move into a rising rate environment, which will be sooner rather than later, this ratio is expected to be reduced. Once again, a negative impact on our bank with no change in our risk profile.

Outside of the numbers, the impact on our organization if this regulation goes into force would be, 1) growth will be curbed 2) our ability to meet the needs of our clients will be reduced going forward 3) we will be at a competitive disadvantage in our industry.

So, are there any solutions in my mind? I believe the best way to manage credit risk is through the ALLL. The analysis of the loan portfolio is more granular instead of being based on specific types of assets. FASB 114 addresses specific shortfalls in specific credits which, if managed appropriately, should suffice.

If Basel III is passed, a bank will have to make a specific reserve for a troubled 1-4 family asset, while also possibly having it risk weighted 2-3 times higher than current levels because of the loan being designated in category two. I would rather look at a minimum loan loss provision than use the Basel III.

It appears to me that the regulation is trying to compensate for what our government apparently perceives as poor bank management. Basel III is removing the bank's ability to manage the assets of the bank, meet the needs of its community and it further hinders community banks from being a competitive, viable entity.

I do not believe this is the correct regulation for our banks. I believe when a crisis happens to an organization, an industry or a country, you have to have time to stop the bleeding, understand the new landscape and allow recovery to occur. At that time, new regulation can be entertained to minimize a future crisis because businesses, industries and the country would be able to digest what the new regulation would do to them in normal times. As it is now, our industry has reduced the bleeding and we are trying to find the new normal, but a recovery has not yet taken place.

Tom, thank you for taking the time to truly "digest" the cause and effect of this regulation as proposed. The unintended consequences will have a material adverse impact on our industry without additional protection and/or benefit to the shareholder, client, or FDIC.

Sincerely,

John L. Lewis
CEO
Verity Bank

Cc: Joe Brannen, GBA