



October 19, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve  
20<sup>th</sup> Street and Constitution Ave. NW  
Washington, DC 20551

Thomas Curry  
Office of the Comptroller of the Currency  
250 E. Street, SW Mail Stop 2-3  
Washington, DC 20219

Robert E. Feldman, Executive Secretary  
Att: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> St. NW  
Washington, DC 20429

Submitted to all listed above via:  
Federal eRulemaking Portal and Email

RE: Basel III Capital Proposals

Ladies and Gentlemen:

We appreciate the opportunity to provide comment on the proposed rulemaking regarding the Basel III capital standards recently approved by your agencies.

The strength and stability of the banking system is essential for our nation, states, regions, counties, and cities if they are going to prosper, and weather business cycles. We understand your desire to increase minimum capital standards; however, we have serious concerns about the proposals you have submitted for comment.

First Federal Community Bank, National Association (OCC Charter 25025; FDIC Certificate 29787) was founded in 1898 as the Dover Building and Loan Company in Dover, Ohio. We have had several name changes and a charter change, however we have served our primary market area, Tuscarawas and Holmes counties in east central Ohio for over 114 years, presently with five banking offices. Our total assets are \$240 million, and we service an additional \$97 million in residential mortgage loans that we have originated and sold to FHLMC (Freddie Mac). We have a strong lending operation targeting small businesses and residential mortgage loan customers. We also meet many of our customer's borrowing requests including automobiles, boats, home improvements, etc.

First Federal, as one of the area's premier community banks, has been a leader in our communities, not only in our ability to meet the credit needs of the community, but in our civic involvement as well. During the most recent five year business cycle, we have consistently grown our loans and assets, managed our credit quality appropriately, and been profitable every quarter. We have had significantly below average net charge-offs and few foreclosures. We did not use TARP funds and have remained well-capitalized throughout the Credit Crisis.

We have a vested interest in the success of our communities, because they are the only markets we have, unlike large multi-state banking organizations. Because of that, we want to continue being a community leader and continue to provide for the credit needs of our market. We believe the proposed rules may hinder or limit that ability. We would like to express the following concerns:

**I. Increased Risk Weighting for Mortgage Loans**

A significant portion of our lending activity is providing residential mortgage loans to our customers. The proposal, as written, may result in us being forced to reduce the volume of mortgage loans we can originate. The increase in risk weightings of residential mortgages to a higher level than certain other types of loans that we believe historically have presented greater risk is unjustified for small community banks. Our loss experience on our residential mortgage loan portfolio has been minimal.

Additionally, the movement to risk weight individual loans rather than classes of loans will create a significant cost and administrative challenge for our bank. We believe that existing regulatory and accounting rules already provide a framework to ensure ALLL adequacy for our loan portfolio, including residential mortgage loans. The increase in risk weighting on such loans may result in additional capital requirements that are unnecessary as our ALLL methodology adequately addresses weaknesses in our residential loan portfolio.

We also believe the rules will cause residential mortgage loan interest rates to rise as banks will need to evaluate the capital carrying cost in pricing models.

**II. Representations and Warranties on 1-4 Family Residential Loans which have been sold into the Secondary Market**

We are concerned about existing representations and warranties on sold loans that will cause our bank to have to set aside capital. As previously referenced, over the past 14 years we have originated and continue to service a significant portion of residential mortgage loans that we have sold to Freddie Mac (\$97 million as referenced above). We have remained one of the top market share residential lenders in our market area providing for the dream of homeownership and affordable financing. Our track record on required repurchase demands from Freddie Mac has been stellar, and we desire to continue residential lending with resale to the secondary market as a core part of our business. This proposed rule may drive us out or limit this business activity and remove a

key tool we use to manage interest rate and liquidity risk and will reduce the availability of credit in our market.

**III. Proposal to Increase Risk Weights on Delinquent Loans**

Current regulatory and accounting guidance related to the valuation and classification of impaired loans is already very specific. We believe the proposal has the effect of setting aside capital twice for problem credits. The unintended consequence that may naturally follow is that banks like ours may be forced to move delinquent loans off the balance sheet more rapidly, reducing the efforts to work with borrowers as we have been encouraged to do in a safe, sound, responsible, and respectful manner.

**IV. The requirement that gains and losses on securities must flow through regulatory capital**

We presently have significant unrealized gains in our investment portfolio. If this proposal becomes final, it would serve to immediately increase our regulatory capital. When rates rise, the reverse would be true and we would experience a reduction of our regulatory capital. This pendulum swing would occur even though there has been no other corresponding change to the risk profile of our balance sheet.

This volatility could present a circumstance where we would have to reduce our balance sheet (most likely through reduced lending) in order to maintain appropriate regulatory capital levels. It's also possible and likely that this timing would occur at a time when the economy is expanding, precisely the time that small businesses and consumers would be counting on the bank to provide credit. Limiting or reducing our capital during this scenario would be a threat to any recovery.

This proposed change could also have the effect of encouraging banks our size to sell our existing Available for Sale securities or converting to Hold to Maturity securities. This would limit our ability to use securities as a tool to manage liquidity and use the securities portfolio as a source of profitability.

**V. The fact the Federal Credit Unions are not subject to Basel III Rules**

Credit Unions were granted a special tax subsidy and exemption in the 1930's to serve customers with a 'common-bond' of small and modest means. At the present date, some aggressive Federal Credit Unions have flaunted the 'common-bond' ruling and have become, and advertise as, 'bank-like' providers of financial services. Unfortunately, we have such a competitor in Tuscarawas County that enjoys a near 40% tax and pricing advantage to our company. They already have an additional advantage in that they are not subject to the Community Reinvestment Act and the costs of complying with it. Now, based upon these new proposed rules, you seek to further provide credit unions a strengthened competitive advantage by raising our required capital and furthering the gulf between our pricing structures.

**VI. The 'Discretionary' ability given to supervisory authorities to require even more capital than these new proposed rules require**

We believe the discretionary portion of the proposed rules further damages the proposed transparency and stated intention of requiring significantly enhanced capital. This potential arbitrary application could result in different requirements at similarly sized community banks without demonstrated necessity. This authority is already available to bank regulators for troubled banks. If as an industry, we are going to propose higher minimum capital standards and a significant and sustained effort to granularly define the elements of that capital, this provision appears to be over-kill.

Our company has demonstrated (as almost all the community banks in our region have) that we did not contribute to, or participate in, the 'silly-season' of lending that occurred pre-2007. These rules being applied to small community banks will only further damage the viability of this important segment of needed credit in our rural communities.

To summarize, the proposed rules as currently written will have a significant negative impact on our bank in the following ways:

1. The proposal may significantly increase the amount of capital that we are required to hold. This could happen without any change in our corresponding risk profile and despite the fact that we have experienced no significant loan losses and have more than adequate ALLL.
2. The proposal is so complex that compliance will require significant investment in new software and manpower. In fact the current software we use to manage capital is useless in complying with the proposal. We would have to go back and manually review every residential mortgage loan on our balance sheet, and this is a monumental task.
3. The proposed rules are isolating one component of risk of the bank to the detriment of a number of other risk areas and will limit our ability to manage those risk areas. None of these risks are singular, and the bank cannot effectively be managed by concentrating on only one area of risk.

While we understand the desire to increase the level of capitalization of the banking industry, the rule is likely to have a significant negative impact, particularly on community banks. We would ask that you consider withdrawing the proposed rule and start over. Should you deem that request impossible, we would recommend that you consider granting an exemption to small community banks from these rules, similar to the exemption granted to 7,500+ credit unions.

Sincerely,



Trent B. Troyer  
President & CEO



E.L. Loader  
Chairman of the Board



Richard A. Brinkman, Jr.  
Director, First Federal Community Bank  
& Area President, AAA East Central Ohio



Steve Clinton  
Director, First Federal Community Bank  
& President, Capital Market Securities, Inc.



Leonard L. Gundy  
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& President, Dover Hydraulics, Inc.

cc: U.S. Representative Bob Gibbs  
U.S. Representative Bill Johnson  
Senator Sherrod Brown  
Senator Rob Portman  
Michael Van Buskirk, Ohio Bankers League