INNOVATIVE BANKING, TAILORED FOR YOU

October 5, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

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

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

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I am the CEO and 4th generation owner of a small rural community bank in Minnesota. We have served our community for 93 years with small business and personal loans and home mortgages. I have reviewed the Basel III proposals and have serious concerns about its affects on our ability to continue to profitably serve our communities financial needs. In conjunction with existing and proposed regulations (like CFPB mortgage regs), it jeopardizes the very viability of the community bank model. In my 38 years in banking, I have never been so concerned about our ability to earn a reasonable return with the limiting of products we can offer and the growing regulatory burden. It is becoming overwhelming.

Basel III appears to have been written for large international banks, is very complicated, and I am amazed that it is being applied to community banks like mine. With our limited staff and resources, it will be very burdensome just to evaluate and measure and comply. It creates a very real regulatory burden for a small bank like ours. At the very least, the proposal should be tiered and should exempt banks such as mine that have simplified balance sheets and traditional lending activities.

My major concerns with the proposal are as follows:

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions; Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

Although we currently have high levels of both core and risk capital, the proposed inclusion of AOCI introduces volatility in capital, driven by interest rates, which will make it difficult for us to implement a capital planning program. We will be forced to hold additional capital to compensate for this volatility. With low loan demand, we have a large investment portfolio. When interest rates move higher, we will see significant capital reductions. We will also have to alter our investment strategies to reduce the risk to capital of this volatility. This will have a negative effect on earnings as well as return on invested capital, again jeopardizing the financial viability of the community bank model.

Residential mortgage loans are the bread and butter of our bank lending. The proposal adds a complexity to mortgage lending that will create a regulatory burden and may well require us to exit certain types of mortgage lending that are important to our rural community.

Raising the risk weights for balloon mortgages penalizes community banks that use this product to mitigate interest rate risk on our portfolio loans. This is the majority of our mortgage portfolio! The proposal will force us to abandon balloon mortgages and increase our interest risk. The net result will be higher rates and less availability of mortgages to borrowers.

Penalizing high LTV loans will also curb future lending as it removes our ability to work with customers we know to provide them with affordable mortgages. Higher risk weights for non performing loans only duplicates the purpose of the allowance for loan losses and further complicates lending decisions.

In evaluating the effects of the proposal on our lending portfolio, I can only conclude that it will impair our home financing by raising borrowing rates and limiting borrower access to financing as we manage our capital risk.

The cumulative effects of the Basel III proposal and proposed CFPB regulations concerning home lending may very well drive us out of the residential mortgage lending business or, at the very least; require us to be very selective in what products we offer and to whom. The detrimental effect on our community and our bank will be great.

The allowance for loan losses inclusion in capital should not be capped at 1.25% of assets. All of the allowance should be included in capital since it represents the first line of defense against capital absorbing losses. Don't discourage the building of reserves!

In summary, I have concluded that this Basel III capital proposal and its application to community banks is probably one of the most detrimental regulatory proposals I have seen in my 38 years of banking. It will totally alter the loan products and investments for our portfolio, it will reduce the profitability our bank as well as our future viability and it will reduce the availability of competitive mortgage loans in our rural market. If implemented as proposed, I would anticipate a reduction in the number of community banks and a further concentration of money center banks.

Please reconsider the adoption of the proposal or exclude community banks.

Sincerely,

Mark Hewitt, CEO
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