NORTH AMERICAN BANKING COMPANY

October 17, 2012

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

Robert E Feldman
Executive Secretary
Attention: Comment/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street N W
Washington, D C 20429

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

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.

North American Banking Company is a four branch community bank serving the financial needs of citizens in and around the Twin Cities of Minneapolis and St. Paul, MN We received our banking charter from the State of Minnesota and our certificate of insurance from the FDIC in July, 1998. Since that time we have grown to an asset size of approximately $260 million We currently service over 5,200 accounts owned by our customers in the communities we serve, and we employ 59 Full-Time Equivalents

[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*

North American Banking Company strongly opposes the application of the new proposed "Basel III" and "Standardized Approach" rules to community banks for a number of reasons First among these is the fact that Basel III was designed to apply to the largest internationally active banks and not community banks Community banks like ours did not engage in the highly leveraged activities that severely depleted capital levels of the largest banks and created panic in the financial markets Community banks operate on a relationship-based business model that is specifically designed to serve customers in their respective communities on a long-term basis This model contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. Large, internationally active banks operate purely on transaction volume and pay little attention to the customer relationship. This difference in banking models demonstrates the need to place tougher capital standards exclusively on the largest banks to better manage the ability to absorb losses

Further, the application of the proposed rules to all banks (including "Main Street" community banks like ours), rather than just to the largest, internationally active banks for whom they were originally designed will create a number of negative consequences. These negative consequences will directly conflict with the objective of fostering the recovery of the economy of the United States, an objective that has been stated by the Chairman of the Federal Reserve Bank, the United States Congress, and the President of the United States

Examples of such unintended negative consequences include:

1. The increased capital requirements contained in the proposed rules will proportionately reduce the capacity of community banks to invest in their communities through lending and municipal securities activities For instance, in the case of North American Banking Company, under the proposed Tier I minimums the excess capacity of our institution to make loans within our community will be reduced by approximately $216 million (49%), all other things being equal

2. Inclusion of Accumulated Other Comprehensive Income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI for most community banks represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities Additionally, demand for both explicitly guaranteed government securities and implicitly guaranteed government securities has risen due to a "flight to safety" and due to government intervention in the capital markets This increased demand has caused credit spreads to tighten, further increasing bond valuations

   Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. This decline will have a direct, immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce capital balances At our bank, for instance, if interest rates increased by 300 basis points, our bank's bond portfolio would show a paper loss of $6 6 million This would mean that our bank's tier one ratio would drop by 24%

Large financial institutions have the ability to mitigate the risks of capital volatility They can enter into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Generally, community banks do not have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry Community banks should continue to exclude AOCI from capital measures as they do today.

Additionally, we believe the proposals could potentially force banks like ours to declare that future securities purchases be placed in the "held-to-maturity" category, rather than the more common and more flexible "available-for-sale" category thereby subjecting community banks to increased liquidity risks by taking away an important source of contingent liquidity: The sale of "available-for-sale" securities. Furthermore, the proposed rules unfairly penalize community banks by reflecting the fair value changes of a single balance sheet component in Tier 1 capital (e.g. AFS Securities), while excluding fair value changes of other balance sheet components (e g Time Deposits) which typically move in the opposite direction and would serve to offset or mitigate the effects of AFS Securities fair value changes

3. Under the proposals, mortgage servicing assets would be added together with deferred tax assets related to temporary timing differences and significant investments in other financial institutions' common stock and if, the individual amount exceeded 10% or if the aggregate amount exceeded 15%, would need to be deducted. In the case of our Bank, deferred taxes related to the temporary differences between the carrying value of ORE properties vs their tax bases are significant. As a result of these proposed rules, banks could be forced to prematurely dispose of OREO properties in depressed economic times simply to reverse the related deferred tax assets. As the pace and volume of ORE dumping increases, there is an exponential negative impact on ORE values and on the real estate market recovery in general Ultimately, this will compound the deposit insurance funds losses from banks that could fail due to lower capital ratios which might not otherwise occur under current regulations

4. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks offering these loan products, depriving their customers and potential customers of many financing options for residential property These higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset-liability management Community banks will be forced to originate only 15 or 30 year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates Many community banks like ours will either exit the residential loan market entirely or originate only those loans that can be sold to a GSE. Second liens will become either more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages Finally, second lien credit facilities are an important financial liquidity product currently available to prudent and credit-worthy consumers. Community banks should not have to police the prudence of consumers indirectly through the de facto elimination of financial products via regulatory capital regulations. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans.

5 The proposals would require higher risk weights for certain types of equity exposures, such as investments of common stock in an unconsolidated financial institution (unless already deducted), and investments in publicly traded companies and companies that are not publicly traded. Our bank provides capital to Small Business Investment Conduits (SBIC's) which provide SBA financing to small businesses. Higher risk-weighting requirements for these equity investments will reduce the ability of community banks like ours to support small business lending through these very effective vehicles. Again, this negative unintended consequence, limiting the financial resources of job-creating small businesses, is in direct conflict with the objective of fostering the recovery of the economy of the United States. An objective stated by the Chairman of the Federal Reserve Bank, the United States Congress, and the President of the United States

In addition to citing the inevitable unintended consequences of the proposals discussed above, we have the following comments:

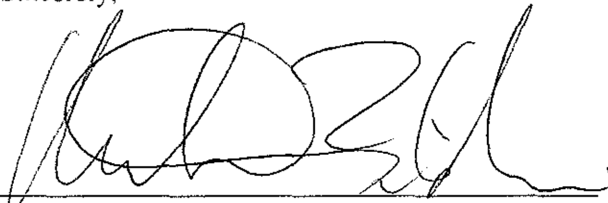
Regarding proposed capital conservation buffers:

Implementation of the proposed capital conservation buffers for community banks will be difficult to achieve under the proposal and therefore should not be implemented. Compensation models within community banks are far less dependent on variable components (bonuses etc.) than the investment banks on Wall Street that created the financial crisis. The volatile earnings histories and outlandish compensation payouts present in the Wall Street banks do not exist in community banks. Therefore, these proposed new rules should not be imposed on community banks. Community banks have done a very good job in managing their capital under current regulations, as evidenced by the relatively small costs charged to the FDIC Insurance Fund during this crisis from failures of traditional community banks vs. failures of larger banks (like WAMU). These failures disproportionately depleted the FDIC Insurance fund which is created from premiums paid by member banks, NOT consumers or taxpayers. If these new buffers are implemented, many community banks will be forced to build additional capital balances to meet the minimum capital requirements. Community banks simply do not have access to the capital markets that larger banks have. The only way for community banks to increase capital is through the accumulation of retained earnings over time. Due to the current ultra low interest rate environment, community banks' profitability has diminished, further hampering their ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) to allow those banks that need additional capital to retain and accumulate earnings accordingly.

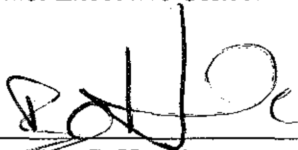
Conclusion:

The universal application of these proposed regulations to all banks is not only financially and ethically unsound, it is dangerous If the regulations are meant to remedy the ills perpetrated by the largest, most short-term-transaction-dependent, short-term-profit-minded, too-big-to-fail, overly-complex Wall Street Banks that caused the most recent financial crisis (with the help of FNMA and FHLMC), then they should only be applied to them

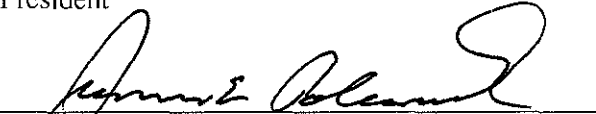
Sincerely,



Michael A Bilski,
Chief Executive Officer



Bradley G Huckle
President



Joseph E. Polaczyk,
Executive Vice President & Chief Financial Officer