UNITED BANKERS' BANK
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October 18, 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 Application to Community Banks

Ladies and Gentlemen:

I am writing to you today to express our strong concern regarding the implementation of the proposed Basel III capital requirements on community banks. While there are many facets of regulation where "one size does fit all" that is not the case in this circumstance. If Basel III is implemented as currently proposed, it will have a significant and potentially debilitating impact on the nation's community banks.

Our organization, United Bankers' Bank is headquartered in Bloomington, Minnesota and provides a comprehensive suite of correspondent banking services to community banks in a 13 state market area primarily located in the Upper Midwest. We were chartered in 1975 as the nation's first bankers' bank.

Outlined below are our concerns with Basel III's impact on community banking:

- **Basel III is well designed for "too big to fail" megabanks but not for community banks**.

  Many of the megabanks (perhaps most) have an investment banking facility due to the repeal of the Glass-Steagall Act of 1933 by Gramm-Leach-Bliley Act of 1999 (GLBA). The combination of investment banking permitted under GLBA with a traditional commercial banking model can increase the level of risk (exotic financial products/derivatives) that an institution may incur. This additional risk can lead to increasing levels of volatility and excessive risk taking, exemplified by the 2008 financial crises. Complex capital models have a legitimate place in the megabank world where exotic financial products can have significant impact on bank balance sheets and capital levels. In contrast, community banks are not engaged in investment banking activities.

- **Risk can be identified more simply in community banks than "too big to fail" banks.**

  The community banking model puts a premium on knowing your customer and understanding the scope of their business. This is "typical" community banking, where the borrowers are local and well-known to the lender. As a result, while risk is never eliminated it is minimized significantly and is relatively straight-forward to identify and manage. Thus, the complicated capital models in Basel III only add overhead burden to community banks and potentially increased volatility to their capital accounts.

- **Inclusion of AOCI in regulatory capital will increase volatility**.

  If the goal of Basel III is to better manage capital risk, we are perplexed as to how the addition of "accumulated other comprehensive income" (AOCI) as part of the regulatory capital calculation will be helpful to any community bank. In fact, we see increased "volatility" under certain economic conditions potentially depleting a community bank's capital. Today, interest rates are at historic lows. When interest rates rise, securities held as available for sale or at "fair value" will fall causing the balance of AOCI to decline and become negative. This decline will have an immediate impact on common equity, tier 1 and total capital as the unrealized losses will reduce capital balances.

  Another fundamental problem with inclusion of AOCI in regulatory capital calculations is that only one part of the balance sheet is being "marked to market." We previously discussed the negative impact rising market interest rates have on the AOCI (depreciation in the securities portfolio) reflected in the capital calculation. However, while interest rates are rising, that same bank's deposits are appreciating, due to management's ability to maintain or significantly slow their deposit rates increases compared to the national markets. This is just one simple example of how "marking to market" only one part of the balance sheet unnecessarily and unfairly impacts capital; it's an incomplete picture of the true changes in the economic value of capital.

- **Basel III, if neither amended or modified, will in all likelihood contribute to the consolidation of community banks**.

The overhead burden created through Basel III combined with the potential capital volatility created by AOCI will create a scenario where smaller community banks may find it simply too difficult to manage in a post-Basel III world. The thousands of smaller community banks' whose mission is serving so many rural and regional communities throughout our nation make a real difference. If these banks disappear, so does local representation and the razor sharp economic impact that the bank may have had on its community.

- **Capital Conservation Buffers will be challenging for many community banks to reach.**

  Most community banks within the Upper Midwest are privately held and do not have access to public capital markets. As the Fed has indicated, interest rates are likely to remain low through mid-2015. Most community banks report low loan demand and retention of existing loans has become challenging with the price of retention at ever lower interest rates. As a result, earnings are likely to remain challenging until the economic recovery becomes more robust. If the capital conservation buffers remain in place, community banks may need more time to improve their profitability, build capital, and comply with the increased requirements.

- **New risk weights will weigh disproportionately on community banks who have traditionally been a stable provider of home financing in their communities.**

  The determination of risk weights for mortgage lending is complicated and requires sophisticated monitoring systems that will add to overhead burden. In addition, community banks generally face increased capital allocations to their traditional mortgage lending activities. Since most community banks have approximately half or more of their loans tied to real estate, the outcome of the Basel III risk weighting will in all likelihood reduce lending. We believe it is important to note that the vast majority of community banks did not play any kind of role in the "toxic" mortgage debacle of the last decade. Rather, they have done what they have always done support the growth of their communities in a conservative manner.

- **Trust Preferred Securities (TRUPS) phase-out for community banks between $500 million and $15 billion will have serious consequences for the continued viability of many of these banks**.

  TRUPS were approved by regulatory authorities and formed a key part of many banks' capital structure. If these banks cannot replace these securities according to the Basel III guidelines they will in all likelihood need to look for merger partners which may be a difficult task depending on market circumstances. In addition, our understanding of the Collins Amendment to the Dodd-Frank Act is that it conflicts with Basel III. This is another example of Basel III injecting volatility into the banking system where it does not need to do so.

- **Basel III's distribution prohibitions on community banks with a Subchapter S corporate structure conflicts with the requirement that shareholders pay income taxes on earned income**.

  Since approximately two thirds of the community banks in the Upper Midwest are Subchapter S, this provision of Basel III presents a very difficult problem. We recommend that the capital conservation buffers be suspended during those periods where the bank generates taxable income for the shareholder.

There is a world of difference between "too big to fail banks" and community banks. Community banks did not create the financial debacle that our country is recovering from, nor should community banks have to pay the price for burdensome regulation. We respectfully ask that community banks be given special consideration in the implementation of Basel III for the reasons outlined above. We thank you for the opportunity to provide feedback...

Sincerely,

William C. Rosacker
President & CEO
United Bankers' Bank