The Bank
OF ELK RIVER

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 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.

The Bank of Elk River is a community bank that has served the financial needs of our area for 127 years. I have been an employee and minority owner of the bank for 41 years.

Our bank was greatly affected by the financial mess caused by Wall Street and the resulting regulatory over-reaction aimed at community banks. Our region was drastically affected by the Great Recession due to the unprecedented, extreme decline in real estate values. Our bank suffered significant financial losses depleting capital ratios to a level of being undercapitalized. Due to an earnest effort of shrinking the bank and successfully raising $4.5MM in capital from existing shareholders, the bank has returned to a level of adequately capitalized. As the bank recovers by returning to profitability, our capital ratios are gradually improving. Access to capital markets is limited for closely held companies like ours and our shareholders have already increased their investment in the bank. Earnings are our principal solution to restoring our capital ratios to the regulatory requirements.

The table below provides The Bank of Elk River's June 30, 2012 capital and Total Risk Based Capital (RBC) position. The current position is being compared to the proposed Basel III and Standardized Approach to the Risk Weighting of assets. One of the major components to Basel III is the inclusion of Accumulated Other Comprehensive Income (AOCI) to capital. For most community banks this represents the gain/loss of their marketable securities available-for-sale within the investment portfolio.

	Total Capital ($000)	AOCI ($000)	RWA ($000)	RBC Ratio	Impact
Current Position	$22,605	N/A	$ 264,116	8.56%	N/A
New Proposed	$22,605	$ 794	$ 289,609	8.08%	- .48%
+ 100	$22,605	$ 14	$ 289,609	7.81%	- .75%
+ 200	$22,605	$-1,624	$ 289,609	7.24%	-1.32%
+ 300	$22,605	$-3,197	$ 289,609	6.70%	-1.86%
+400	$22,605	$-4,756	$ 289,609	6.16%	-2.40%

As shown above, the potential of rising interest rates will impact the value of AOCI. Implementing bond analytics and affecting the investment portfolio with 100, 200, 300 and 400 basis point rate shocks, the impact on how the inclusion of AOCI as part of the capital calculation is illustrated. All four of these scenarios would negatively affect the Risk Based Capital position. It should be noted the bank's investment portfolio is strategically conservative and carries limited duration and interest rate risk.

In normal economic conditions, a rising rate environment would indicate growth in the national economy causing higher demand for credit. Including AOCI when rates are rising will potentially weaken the bank's capital position at a time when capital is needed most to support economic growth.

I agree with many of FDIC Director Thomas M. Hoenig's remarks to the American Banker Regulatory Symposium. In particular, we agree Basel III "will not improve the condition of small and medium sized banks and applying an international standard to a community bank is illogical."

I used Wikipedia to research the number of banks in Europe and found that almost all European countries have fewer banks than are chartered in the Minneapolis area. The United States should not impose capital requirements that are designed to apply to countries that don't have a community banking system. Community banking in the USA has helped to make our country the richest country on earth and we should not be forced to adopt a failed European model.

Implementing a "one size fits all" capital solution for banks is ill-timed and poorly conceived. It makes sense to us for the regulatory agencies not to implement Basel III and explore a simpler capital solution for community banks that is supported by reasonable regulations that will promote economic growth and stability for small businesses and Main Street America.

BASEL III, when combined with "mark to market" accounting will whipsaw earnings and capital of community banks and will promote future boom and bust cycles. Our country has put into place a lot of policy to prevent reoccurrence of the financial panics of the late 19th and early 20th centuries. As a student of history, I believe that BASEL III and mark-to-market accounting will take us straight back to those times as financial markets swing wildly because of capital swings in the banking industry. BASEL III and mark-to market accounting are the Smoot Hawley Tariff Act of our time.

Sincerely,

Patrick H. Dwyer
President (Ret)