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October 22, 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 that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the “banking agencies”).

Donegal Mutual Insurance Company is a regional mutual property and casualty insurance company that is also the top-tier holding company for Union Community Bank, a small unitary thrift in Lancaster County, Pennsylvania, where we are headquartered. Union Community Bank, with assets just over \$500 million, provides tailored products and services to individual and small business customers in Lancaster County and actively participates in supporting our local community. Both Donegal Mutual and Union Community Bank trace their roots to the late 1800’s and have been continuously serving their customers since that time.

We are very concerned about the “one-size-fits-all” approach the Basel III proposals take in relation to savings and loan holding companies and community banks under the supervision of the banking agencies. We share many of the concerns that have been raised by banking organizations, industry advocates, and, recently, members of the U. S. Senate. We are specifically concerned about the following issues as they relate directly to our company:

1. All savings and loan holding companies, regardless of size, are required to comply with Basel III. The Federal Reserve has a long standing policy statement excluding bank holding companies under certain thresholds from the capital rules. However, Dodd-Frank did not make a similar exception for savings and loan holding companies that own small community banks. The application of the proposed capital rules to our savings and loan holding company would result in increased costs and put us at a competitive disadvantage, thereby reducing our ability to serve our community. Due to the complexity and scope of the proposed rules, we request that the rules

be revised to include an exemption for savings and loan holding companies for community banks with less than \$1 billion in assets.

2. The proposed application of bank-centric capital rules to insurance companies is unreasonably burdensome and duplicative of the effective supervision by state regulators currently in place. The insurance industry has proven throughout the most difficult of economic and financial market disruption that the current regulatory framework is effective. This is especially true for institutions of modest size and lesser complexity than the very large carriers that have garnered significant regulatory attention. Forcing insurance companies that currently prepare statutory financial statements only to prepare audited consolidated GAAP financial statements would be unduly burdensome and would subject smaller savings and loan holding companies, such as ours, to significantly increased compliance costs. We request that the capital rules for insurance companies be revised so that they are based on current statutory insurance accounting methodology promulgated by the National Association of Insurance Commissioners.
3. We are concerned about the proposed phase-out of trust preferred securities as capital instruments. Small community banks have limited means to increase their capital. Phasing out trust preferred securities would be especially burdensome to community banks that have relied on this source of funding in the past. We request that all existing trust preferred securities be grandfathered and allowed to remain in a community bank's capital base. This position would be consistent with our interpretation that Dodd-Frank never intended for this type of instrument to be phased out for community banks.
4. The Basel III proposal that unrealized gains and losses on a banking organization's Available-For-Sale (AFS) securities to "flow through" to common equity Tier 1 (CET1) would negatively impact the ability of banking organizations to contribute to economic recovery in a rising interest rate environment. With the inclusion of unrealized losses of AFS securities in CET1, rising interest rates would put downward pressure on banking organizations' capital levels, potentially causing banking organizations to reduce the growth of or shrink their securities portfolios considerably to maintain capital ratios at desired or required levels. We request that the proposed rule be revised so that unrealized gains and losses on AFS securities do not flow through capital, especially unrealized gains and losses related to the impact of interest rate changes.

While we support adequate capitalization of our nation's financial institutions, we also recognize that smaller businesses can be disproportionately impacted by regulations that are designed with larger entities in mind. We respectfully request that you give serious consideration to the impact of the proposed rules to banks with less than \$1 billion in assets and their related holding companies. We ask you to modify those rules so that community banks may continue to fulfill their vital role in local communities all across our nation.

Thank you for your consideration of our concerns.

Sincerely,

A handwritten signature in black ink, appearing to read "Donald H. Nikolaus". The signature is fluid and cursive, with a large initial "D" and "N".

Donald H. Nikolaus
President and Chief Executive Officer