Highland Bank

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

October 3, 2012

Ladies and Gentlemen:

This letter is in response to 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.

Highland Bank is a $450 million community bank providing services to the greater Minneapolis/ St. Paul Minnesota market since 1945. Our organization is closely held and owned by my family, since 1976. Since its inception, Highland has helped small business and individuals with their financial services needs. Through its service to the community Highland has helped our community grow and prosper.

The recent financial crisis has seriously tarnished banking's good name. It is a shame that community banks have been lumped in with those players that caused the crisis because traditional banks and community banks, like Highland, did not create most of the problems that caused the crisis. However since so many other organizations have become banks, call themselves banks or imply that they are banks, community banks are being unnecessarily burdened with many of the corrective actions. Many corrective actions are needed but they should be focused those that primarily caused the crisis, no community banks. When making policy in the future, please recognize that the majority of small banks are the stalwart supporters of their local economy and have modest risk profiles, know their customers, comply with banking regulations and provide an immeasurable service to the community. Do not lump us in with those that contributed to the crisis, the investment houses, the mortgage brokers, the large mortgage banks. Please don't burden community banks with unnecessary regulations in an effort to fix the problems of the past. After all community banks largely didn't create the problems, but we can be part of the solution in fixing the economy.

Highland Bank expresses concern over two areas of the Basel III proposals. Our concerns are listed in order of importance:

1. Area of Concern: Phase out of Trust Preferred Securities (TRUPS) as Capital Instruments -
    a. Please exempt community banks or
    b. Grandfather their exiting TRUPS

Highland Bank has taken advantage of the opportunity to issue long term obligations (TRUPS) to help meet its funding and capital needs. Unfortunately, we do not have access to the public markets for additional capital should the phase out of TRUPS take place as suggested in the proposed rule making. Highland's TRUPS have an existing life that will cause us to naturally retire them. However the truncated time period for allowing a smaller portion of them to count as capital in the proposed rule will significantly impact Highland's ability to continue to provide lending to primarily the small business market. We will be forced to reduce our loan portfolio to comply with the new rules. Even the Dodd-Frank Act, allowed for the continued use of TRUPS for smaller banks. We ask that you maintain these capital resources for banks under $1 billion including Highland. While we'd like the opportunity to continue to use TRUPS as currently allowed, we'd agree with the Collins amendment which grandfathers TRUPS for institutions between $500 million and $15 billion. Instead, your proposed rule making requires the phase-out of these instruments for bank holding companies having between $500 million and $15 billion in total consolidated assets as of December 31, 2009 with reductions planned in the future. In Highland's case, the issuance of TRUPS was helpful during the latest crisis. The TRUPS issued by our holding company, Highland Bancshares, functioned as essentially equity and added cash and capital for the combined organization to weather the worst financial crisis in 70 years.

2. Changing Unrealized Gains and Losses on Available-For-Sale (AFS) Securities to flow into capital.
    a. Drop this change
    b. Exempt Community banks

Our organization has traditionally operated its securities portfolio as a buy and hold organization. However, on occasion we have had to make changes to all parts of our balance sheet, including our securities portfolio, given certain changes in the market. By changing the AFS portfolio to mark to market rules, we will have to choose between limiting our liquidity and potentially suffering big fluctuations in our capital accounts. Over the last 4 years Highland would have seen a one third reduction in its capital should it have been required to mark to market its securities portfolio. That reduction would have put further restraints on our ability to lend and on our ability to weather the financial crisis. Lastly over the last 20 years, Highland has held all of its securities as AFS, yet has sold, on average, fewer than 10% of its portfolio annually.

The Basel III proposals regarding changes to the treatment of unrealized gains and losses on AFS securities will significantly impair Highland's ability to appropriately measure and monitor interest rate and liquidity risk. We have typically held Agency backed CMO issues as well as local municipal securities. The municipal securities support our local communities. The proposed rules will limit the opportunity Highland and banks like Highland to purchase and hold these bonds. This will negatively impact numerous Minnesota communities that rely on their local banks for support. Please eliminate entirely or exempt banks with under $15 billion in assets from this rule.

Thank you for your time and attention.

Rick Wall
CEO
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St. Michael, MN
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