BRAINERD
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October 17, 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, S.W.
Mail Stop 2-3
Washington, D.C. 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").

I am Chief Financial Officer of a $64 million Savings & Loan located in the center of Minnesota. We are a traditional community financial institution that is owned by our customers (mutual) that cares deeply about our customers and our employees. I would describe our financial institution as "plain vanilla". We work hard to maintain high marks in safety and soundness, compliance, and the related regulatory requirements. The 22 employees of our Association are committed to helping our community grow. Without our Association providing home loans, small business loans, and consumer loans to our area, our community would suffer. I am highly concerned about the effects Basel III will have on our ability to continue supporting the economic development opportunities in our area.

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My main areas of concern are:

I. **Requirement that gains and losses on available for sale securities must flow through to regulatory capital.**

Our country is in an unprecedented period of low interest rates. Most banks have significant gains in their investment portfolios. This proposal would serve to increase regulatory capital in the short term. As interest rates begin to rise, this inflated capital would be quickly reversed and could move very dramatically in the other direction. While nothing will have changed in a bank's equity, their regulatory capital ratios could change very dramatically. **This proposal will introduce a significant amount of cyclicality and volatility into the system which is opposite of what I believe the goal should be.**

Our bank and others could be forced to reduce the size of our balance sheets as the economy begins to improve, simply because interest rates begin to rise. This could serve to undermine an economic recovery as banks reduce lending and concentrate on pulling back to maintain capital ratios. Our small business customers and consumer customers will be impacted by the reduced availability of credit under this scenario.

Our bank's reaction to this will probably be to sell all of our AFS securities and to place all future purchases in Hold to Maturity. This will eliminate the cyclicality and volatility of the proposal, but it will also eliminate our ability to manage our investment portfolio through different interest rate and economic cycles, a core tool to offset liquidity risk of our Association.

II. **Increased risk weighting for residential mortgage loans**

Our association provides a significant number of mortgages to people living in the market we serve. We are one of the largest providers of mortgages in these markets. This proposal, along with some of the proposals being considered by the Consumer Financial Protection Bureau threaten to significantly reduce our Savings Association away from this very important business segment.

Since the inception of our association, losses on residential home loans have been minimal. Our underwriting has been very strong as opposed to many of the **non-regulated mortgage lenders who were the real culprit in the housing crisis**. However, the community banks are being forced to pay dearly for the sins of others. The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that would be considered much riskier in our experience. This one section of the proposal will definitely reduce the number of loans that we are able to provide in our markets.

In addition to the effect on our ability to lend, the change from assigning "risk weightings to asset classes" to assigning "risk weightings to individual loans" will create an administrative nightmare. You will not be able to just assign a risk weighting when you book the loan, you will have to continually re-evaluate the risk weightings based on changes in collateral values, past due status and other risk factors.

I question the ability to truly examine a bank's performance in properly assigning risk weightings under this rule due to the amount of people and time it will take to review the data.

I question the comments I have heard from some recently that the new proposal will have a small effect on most community banks. Much of the information needed to evaluate the effect is not available. Each bank will be different and most community banks, if any, have not yet performed the massive exercise necessary to evaluate and assign the risk weightings to every loan in their portfolio.

III. Change in risk weighting for home equity and second lien loans.

We presently hold about $12 million (20% of Assets) in second lien loans to customers in our markets. We have provided this program for over 30 years and have experienced minimal losses on loans in this segment of our portfolio. In fact, we almost never have any past due loans in this segment of our portfolio. These loans are priced higher to compensate for the added risk and since we have experienced minimal losses, it has been a very profitable segment of our business. To rate these loans as having a higher risk than Commercial loans makes no sense. The risk rates of up to 200 percent are punitive and will restrict availability of credit and increase the cost of that credit.

Additionally, **The part about moving a Tier 1 1st mortgage loan and because you have the second now both loans are risk rated as Tier 2 with higher capital requirements has no basis in reality. Second mortgages would almost always be more risky if you did not have the first mortgage. Many banks are walking away from full seconds because they don't own the first and therefore may forgo partial recoveries on the seconds that they would have foreclosed because they owned the first.** Today's Risk weightings treat this situation by allowing the second to join the first to reflect this lesser risk position.

This program has been used by the bank to supplement the bank's secondary mortgage program. It has allowed our customers to achieve the best pricing they could achieve on their mortgage loan. This proposal will cause our bank to curtail this program and only make home equity loans to people we do not already have the first mortgage.

IV. Limitation on ALLL as Capital to 1.25%.

We also question the limitation of 1.25% of risk-based assets in the loan loss reserve. Why would limitations be placed on an allocation of capital that serves as a "capital preservation buffer"? Institutions should be encouraged to build reserves with pre-tax dollars during good times. Additions to the loan loss allowance should be encouraged, not discouraged.

V. **Delinquent Loan proposal.**

My next concern deals with the increased risk weighting on delinquent loans. During times when commercial lending became tough, our bank, like many, had situations whereby we had to hold loans in past due status for some time. In our association's case, we minimized our risk of loss by carrying a larger balance in our loan loss reserve. The proposal of increasing the risk weighting on past due loans has the double effect for most banks of decreasing capital while at the same time we are holding large amounts in our loan loss reserve. I feel that managing the loan loss reserve is a more prudent and effective way of handling this situation.

Finally, Brainerd Savings and Loan believes that the cumulative effect of each of the items discussed above will have a significant impact on most of the community banks in this country. No risk system will totally eliminate bank failures during the extreme economic stress we have felt over the past 4 years. Brainerd Savings and Loan has weathered 16 recessions and the Great Depression with 7-8 percent Tier 1 Capital over the past 90 years. Sometimes a simplistic requirement such as just increasing the Tier 1 and 2 Capital requirements by 1 to 2 percent would be sufficient to further protect the community banking industry without increasing the regulatory burden on small banks.

We strongly urge you to consider the impact the Basel III system proposal would have and to consider a possible exemption for most of the country's community banks from the bulk of these rules. If because of regulatory burden our association is not allowed to continue these activities, our community suffers. This is the story across all of America. This is the unintended consequence of additional regulation. We do not shirk away from the need to have a safe and secure banking system, but I also refuse to turn my back on our community and the other rural communities in our country.

Sincerely,

Bruce A. Boland

Bruce Boland
CFO
Brainerd Savings and Loan Association

CC: Senator Amy Klobuchar
Senator Al Franken
Representative Chip Cravaack