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October 2, 2012

Robert E. Feldman Executive Secretary
Attention: Comments/Legal ESS Federal Deposit Insurance Corporation, 550 17th Street N.W.
Washington, D.C. 20429

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

Ladies and Gentlemen:

This letter is in regard to the request for comment on the proposed capital rules, collectively referred to as "Basel III," released by federal banking regulatory agencies in June 2012. United Community Bank is a $230 million bank located in West central Minnesota. We have 2 branches and engage totally in community banking type functions. Basel III will impact us negatively in a significant way as I will outline later in my letter.

It is my understanding that the original purpose of the regulation was intended for large international institutions and that somehow in the process it was decided that the regulations should be applied to banks of all size.

Based on my understanding of the regulation we will be impacted negatively by the following provisions.

1. We currently have an unrealized gain in our AFS investment portfolio of approximately two million dollars. The proposal in Basel III would have changes in investment values run through the income statement providing for wide swings in net income and capital which will distort the true performance of the bank. The implementation of Basel III during the current record low interest rate environment will result in our unrealized gain ultimately being a charge against earnings in future years as interest rates rise. This is clearly an unintended consequence that will have a very serious impact on our bank as the amount is close to the annual profits of the bank.

2. Real Estate lending at our bank will be severely impacted by Basel III. We have originated over 20 million in loans that we have sold into the secondary market in 2011 and 2012. We also have a strong portfolio of residential loans that we hold, with most of them being loans that have a balloon payment to provide for an interest rate adjustment at periodic intervals as a hedge against interest rate risk. We have not suffered a loss on one of these loans for years and to have to hold additional capital against these types of loans is ludicrous. I'm concerned that our consumers are going to suffer if our access to the secondary market for loans is impaired in addition to having to hold additional capital against 1 to 4 family loans that have been traditionally a low risk asset.

   The regulation requires the establishment of Loan to Values for all real estate loans, those definitions must be clarified and consequences considered in determining the value of the regulation to community banks such as ours.

   While loan-to-value (LTV) ratios are an element of determining credit quality, they are only one piece of the puzzle. In addition, they are very difficult to effectively monitor over time. The Basel III proposed rules require risk weighting of every residential real estate loan based on LTV. However, the rules do not provide what value is to be used. If banks are required to hold additional capital based on initial LTV, banks will become over-capitalized as the loan amount is paid down (as the vast majority of loans do). This will also result in a very time consuming endeavor on the part of banks and I'm sure the valuations used by the bank will be subject to differing opinions by regulators over time.

3. The 10% annual phasing out of Trust Preferred securities is a very serious issue with banks that have relied on those instruments for capital. Our bank holding company has never issued those but do not feel that the community banking community can withstand an annual 10% phasing out of this important component of capital. This issue was debated extensively in Dodd-Frank with the result that it was left status quo.

   All bankers understand the importance of capital but the phasing out of Trust Preferred securities will just exacerbate the problem of capital. It is no secret that the raising of capital for community banks is already difficult with owners and directors net worth being the most likely source of capital. Phasing out the capital based on Trust Preferred securities while requiring more capital based on other requirements of Basel III is totally counter intuitive. This situation will work to the detriment of consumers in smaller markets as their community banks struggle to have the capital to serve them with larger banks and their business models hesitant to enter the small markets now served by community banks similar to ours.

In review I would make the following general observations on Basel III in addition to the more specific examples that I have cited previously:

- The diverse make-up and business models of our nation's banks do not fit the complex, standardized Basel III approach which will lead to several banks exiting the targeted areas and ultimately leaving consumers with less competitive options.

- Basel III is duplicative and unnecessarily burdensome as regulators already have mechanisms to protect the financial system from high risk and delinquent loans.

- Realizing of unrealized gains and losses of available-for-sale (AFS) securities will create dramatic changes in bank capital requirements based on economic cycles with little actual change to most banks' risk profiles as bond portfolios are generally comprised of low-risk issues managed for interest rate and liquidity risk purposes.

- Harsh treatment of residential real estate will further limit supply of products available to consumers with little impact on the businesses and practices that led to the recent financial crisis.

- Elimination of certain capital elements like trust preferred securities and deferred tax assets will negatively impact smaller institutions' ability to raise funds in the marketplace, resulting in lesser funds available for consumer and small business lending during times of economic improvement.

I greatly appreciate the opportunity to comment on Basel III and truly hope that a more common sense approach to the capital issue can be reached.

Yours truly,

C.L. Cavanagh

Charles L. Cavanagh
President

Cc: Senator Amy Klobuchar
Senator Al Franken