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October 17, 2012

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

Re: **FDIC RIN 3064–AD95**
Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III

Ladies and Gentlemen:

The following comments are submitted on behalf of Unity Bancorp, Inc. ("Unity") in response to the requests for comments in the notices of proposed rulemaking ("NPR") on minimum regulatory capital and the standardized approach for risk-weighted assets. Unity is a bank holding company incorporated in New Jersey and registered under the Bank Holding Company Act of 1956, with approximately $800 million in assets and $650 million in deposits. Its wholly-owned subsidiary, Unity Bank, ("The Bank') is chartered by the New Jersey Department of Banking and Insurance. The Bank has been in operation since 1991, is considered a small business and provides a full range of commercial and retail banking services through the internet and its fifteen branch locations located in Hunterdon, Middlesex, Somerset, Union and Warren counties in New Jersey and Northampton County in Pennsylvania.

General Observations – Basel III should not apply to Community Banks

Basel III should not be a "one size fits all" proposal. In our assessment, the Basel III proposals were intended for large, sophisticated financial institutions competing with others of a similar scale across the globe. It is apparent the writers of this proposal have no understanding of the unique characteristics of a community bank. We are troubled that our U.S. regulatory authorities would include community banking in this complex capital standard. The American banking system is unique, primarily due to its large number of community banks. Community banks are focused on the long-term, economic well-being of the towns and cities across America that they serve and have contributed significantly to the creation of jobs and economic activity in this country for decades. Forcing these new capital proposals on this sector epitomizes unnecessary and costly regulatory burden and will result in what are sure to be damaging, unintended consequences.

Community bankers in New Jersey understand and appreciate the need for adequate capital. According to FDIC data, the median Tier 1 Leverage ratio at June 30, 2012 for New Jersey-domiciled banks was a healthy 9.81%. We all have a vested interest in a healthy banking system. Our concern is not based on maintaining adequate levels of capital but rather the process and unintended consequences of instituting this complex set of new rules. Unity is upset, and justifiably so, over what we believe to be totally unnecessary and inappropriate proposals to redefine what constitutes Tier 1 capital and capital adequacy for all banks, regardless of size or risk profile. Members of management at Unity can't remember a regulatory proposal that will do more harm. The capital structure for community banks is not broken so why are you trying to fix it? This is Washington overreacting to a problem they created.

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We believe this complex and cumbersome proposal threatens the very existence of community banks and our plea is for common sense to prevail by exempting community banks from these draconian proposals. Let us continue to measure capital according to present methodology.

Concerns

Members of management and the Board of Directors of Unity believe there are a number of problematic areas contained in the proposed rules. Please consider our thoughts on the exclusion of TruPs and preferred stock and accumulated other comprehensive income:

Trust Preferred Securities (TruPs) and Cumulative Perpetual Preferred Stock

Raising or replacing capital today, whether in the public or private markets, is challenging for most community banks. Potential investors are scarce. Community banks are also finding it difficult to issue long-term debt, as institutional investors conduct risk-return trade-offs. Through the 2000's, trust preferred securities proved to be an easily accessible source of capital for community banks. In 1996, the Federal Reserve Board approved the inclusion of minority interest in the form of trust preferred securities in a bank holding company's tier 1 capital. Bank holding companies could raise capital in the market and downstream the capital to the bank. This provided needed capital for organic growth or acquisition, while not diluting the interest of stockholders. One of the victories in the Dodd-Frank debate was the ability to count TruPs as Tier 1 capital for entities under $15 billion in assets. Unity currently has $88 million in Tier 1 capital of which $15 million is outstanding TruPs. Unity Bancorp's Tier 1 capital ratio was 11.08% at June 30, 2012; excluding TruPs Unity Bancorp's Tier 1 capital ratio would decline 1.88% to 9.20%. This proposal not only phases out TruPs capital, it appears to directly contradict Congress. Taking away a form of capital that was regulator approved in a time when it is difficult to raise capital for community banks, is ludicrous. We strongly encourage you to follow Federal law on this issue, and allow those entities with TruPs to continue to include that capital in the Tier 1 category.

Cumulative perpetual preferred stock was another source of equity capital for community banks. It is another way for community banks to efficiently raise capital in a cost effective manner. There is an investor demand for preferred stock more so than common equity. We believe that not allowing preferred stock to count as Tier 1 capital is not appropriate. In addition, having the U.S. Treasury Capital Purchase Program ("TARP") program continue to count as a form of capital seems self serving.

Accumulated Other Comprehensive Income

Unity has concerns over various aspects of the proposal. We believe it is inappropriate to include unrealized gains and losses in the available for sale portion of the securities portfolio in Tier 1 common equity capital.

Currently, Unity has a $125 million securities portfolio. The historically low interest rate environment has created issues for all banks. The Federal Reserve is suppressing rates through Quantitative Easing I, II and III, in addition to buying longer-dated U.S. Treasury securities and selling shorter-dated U.S. Treasury securities ("Operation Twist"). These programs will not last forever and as we all are aware, interest rates will move upward. Unity, as well as other banks, will be faced with potentially significant unrealized losses in our securities portfolio. If interest rates increase 300 basis points, Unity's portfolio would experience a $6.4 million valuation loss, which would negatively impact capital under this proposal. Unity has a well structured securities portfolio that serves as a source of liquidity and earnings. Including unrealized losses in capital will not only introduce significant volatility into capital, but could easily create scenarios in which a formerly well-capitalized bank could face severe sanctions due solely to market rate movements. Further, the "mark-to-market" requirement will require banks to hold more capital to compensate for inevitable swings in interest rates, thus hindering growth and lending opportunities. The "mark-to-market" push is going to create massive volatility in financial statements.

Unity has invested in issuances of their local governmental entities with approximately $20-25 million municipal securities in our portfolio with maturities out to 2028. The cost of borrowing for these municipalities will likely increase, as Unity and other New Jersey community banks will no longer hold longer maturity securities for fear of rate-driven capital degradation. Thus, there is likely to be a significant negative impact on infrastructure development at the state and local level, as well as harm to projects that create jobs locally.

Unity and other community banks are long term investors, and we do not actively trade our securities portfolio. In our opinion, inclusion of unrealized securities gains or losses capital is only meaningful in a liquidation scenario. The proposed changes to incorporate market rate swings into Common Equity Tier 1 capital will result in Unity moving to shorter maturities, giving up earnings opportunities, and sacrificing liquidity by moving securities to the "Held to Maturity" bucket. This one provision has the potential to have a devastating impact not only on banks across the country, but also on the communities and customers they serve.

Conclusion

Unity is concerned about the damaging effects of this proposal on an already overwhelmed community banking industry. The ultimate losers in this draconian change are consumers, small businesses, and local government entities who will face higher borrowing costs and diminished availability of both credit and bank services.

We, in the strongest possible manner, implore you to exempt all community banks from these burdensome, complex and counterproductive capital rules.

Thank you for your consideration of our thoughts and comments on this critical issue.

Sincerely,

Mark S. Brody/lbm

Mark S. Brody
Director
Unity Bank and Bancorp