COUGHLIN & COMPANY INC.
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140 East 19th Avenue, Suite 700
Denver, CO 80203-1035
303-863-1900
303-863-7100 FAX

October 18, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1430; RIN No. 7100-AD87; Docket No. R-1442; RIN No. 7100-AD87

Dear Regulator:

I am writing in response to the Basel III proposed rules as published on June 7, 2012. In particular I am writing to express concern and also share what I believe are unintended consequences that will affect Community Banks and small-to-medium size municipalities as a result of the proposed rule to incorporate unrealized gains and losses from investment securities as a component of risk based capital. Over 40 years experience as an Investment Banking Professional working closely with municipalities, non-profit organizations, affordable housing developers, and private corporations, as well as participating in Community Banking as a Director and Shareholder, provides me a well informed basis for my position.

As you are aware, longstanding regulatory policies and banking statutes address investment portfolio administration for Community Banks. These longstanding policies incorporate expectations of credit risk and interest-rate risk avoidance, earnings augmentation, and investments in local communities. Generally Accepted Accounting Principles and risk-based capital rules presently require inclusion of unrealized gains and loss as Other Comprehensive Income, where the gain or loss results from a change in market interest rates, which is a component of equity capital. Gains and losses are subsequently included in Retained Earnings upon the realization of the gain or loss at disposition. Further, current rules and GAAP require a direct charge to earnings and adjustment to equity capital for investments where a change in market value is other than temporary. Accordingly, existing risk based capital rules address unrealized investment gains and losses for Banks that do not have the ability to maintain their respective positions in those securities, or where loss of principal or interest is expected. Inclusion of the unrealized gains and losses in the calculation of risk based capital ratios would create an incentive for Banks to forego certain investments, in particular investments in longer-term securities due to the financial reporting volatility associated with changes in market interest rates. Longer term securities often serve to reduce interest rate risk which enhances capital adequacy, well as provide for increased yield that is accretive to internal capital formation. Accordingly, the proposed Basel III rules create redundancy and additional potential risk, as well as conflict with existing Regulatory Policy regarding prudent investment portfolio management.

In non-metropolitan areas, Community Banks are a primary purchaser of bonds issued by the local municipalities. Debt offerings issued by smaller municipalities that are purchased by Community Banks are well-secured and supported by the financial capacity of the issuer, and are often issued without an investment rating due to the significant increased expense that would be incurred to obtain a rating from a recognized agency. Due to their proximity and involvement in local affairs, Community Banks are in favorable position to evaluate the risks and returns of such issues and serve as a primary market. Community Banks may be dissuaded from the purchase of municipal bonds in an effort to avoid the volatility and affect on capital ratios created by changes in market interest rates. As a consequence, small municipalities may be forced to increase interest rates as well as incur expense to obtain investment grade rating resulting in higher financing costs and potentially delaying or causing the cancellation of improvement projects and diminishing quality of life and economic activity. The Federal Government has long maintained its recognition of the importance of assisting the fiscal financing efforts of small-to-medium sized municipalities through the Community Banking industry as indicated by the "Bank Qualified Status" provided in the Internal Revenue Code. Further, the importance of the Banking industry to municipal bond finance was recently emphasized through Federal Economic stimulus initiatives that provided IRC Bank Qualification Status to all municipalities.

The maintenance of a sound banking system including sufficient capital is of critical importance to all citizens. The unnecessary redundancy and potential adverse consequences resulting from the change in treatment of unrealized gains and loss on AFS investment securities warrants further review and revision. Your consideration of these comments is appreciated. Please contact me with any questions at (303) 863-1900.

Regards,

Dennis Coughlin
President