UNITED BANK

September 26, 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
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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 (the NPR) 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").

We represent the views of a privately held community bank with 11 offices in the west Michigan area headquartered in Grand Rapids. Our company, with just less than $500 million in assets, focuses on retail, commercial and mortgage banking. We are fortunate to be celebrating our 125th year in business during 2012. United Bank of Michigan is a traditional community bank, with local staffers serving neighboring individuals and businesses, and with a strong personal involvement in and commitment to those same communities. Our parent entity, United Community Financial Corporation, is a single-bank financial holding company.

To not just survive but to thrive for so many years as an organization, we have benefited from a strong commitment to keeping our company fiscally sound with a strong capital position. We

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welcome continuing efforts on the part of the banking agencies to assist all banks in strengthening the quantity and quality of their capital when appropriate and sensible to do so. We pay particularly close attention to any guidance or proposal that would attempt to clarify or alter capital rules because of the potentially dramatic impact they can have on our operations. Our strong sentiment is that any such regulatory position, this NPR for example, needs to deftly balance the needs of banks and their customers with the safety and soundness of the banking system, to minimize risk without hampering the industry. Banking is essentially a risk management business, rules that attempt to overly limit or eliminate risk can be especially damaging to the industry. While we find some elements of the Basel III Capital Proposals to be beneficial and well-intentioned there are other aspects which we feel compelled to comment upon. Indeed, we feel that some facets of the proposal would be especially detrimental to our business, and hence have a negative impact on our ability to fully serve our customers and our communities. We would like the banking agencies to be aware of some general comments we have regarding the proposal, then we will address a few specifics that have the most bearing on our situation.

It has become immediately apparent that the scope of the proposals will require institutions to collect and report new and in many cases, very granular information. In order to calculate qualifying capital and associated risk weights of earning assets, we will be required to obtain, maintain and report a variety of new information about underwriting features and LTV ratios of credit exposures. Along with that we will need to generate sufficient information to satisfy due diligence requirements and our own internal controls. It will need to be maintained and reported in many different ways and forms and with greater frequency. As a bank we are accustomed to dealing with the process of capturing and reporting data, that's nothing new, but it is the complexity and sheer volume of new requirements that has us so concerned. External and internal reporting systems will need to be modified to handle a variety of new processes, and at this point we are not at all sure our IT vendors can handle the task in a timely manner. As a smaller institution we do not have the resources to build new systems. Eventually, as is generally the case, expensive new software programs will become available but there is no guarantee as to how long that will take or to what extent it will need to be supplemented with manual inputs. This information gathering process could well usher in very labor-intensive methods requiring additional staff with an immediate need for extensive retraining. For community banks in particular, the cost-benefit equation for this NPR is woefully out of balance.

We estimate major increases in our audit and compliance costs as we add several layers of internal controls to deal with the new documentary requirements. And when all is said and done we will have done nothing but negatively impact our ability to grow our business and profits and ultimately our internal generation of capital. That seems rather ironic as well as being counter- productive. There is a very real cost in having excess capital and incremental, forced levels of capital accompanied by onerous and arcane formulas is the costliest of all.

Even worse, we fear that our company and hundreds of others like us will find that the only feasible alternative is to shrink our operation as well as our ability to service our existing and potential customers. The result is fewer mortgages, fewer commercial loans and less flexibility in reasonably pricing our deposit and loan products to our customers.

For all of these reasons we feel that the added costs, perhaps as much as several hundred thousand dollars per year will greatly outweigh any benefits to us, our customers or our communities or the banking system in general. And we do not feel when all is considered that this outcome leads to a "safer and sounder" banking system. Greatly increased operating costs, higher capital ratios, steeper risk- weightings, complex added reporting requirements, invalidated capital instruments for community banks - seems like an unhealthy recipe for sure.

In our view, the many, many moving parts in the proposed rules are not only highly complex but unnecessary. We have taken prudent measures over the past few years in response to a variety of other recent regulations and sensibly expanded guidance to lower our risk profile, control credit costs, and to expand and enhance our quantitative risk models. All with the objective to improve decision making, enhance profitability and ultimately boost home-grown capital, the preferred means to beefing up equity. A number of elements of the proposal would be directly counter to that notion. And, our own analysis of the FDIC's most recent Quarterly Banking Profile (2Q12) from which we note that the industry's ratio of tangible common equity to tangible assets (the TCE ratio) ended the quarter at 8.9%, which is the strongest capital level observed in any quarter dating back at least 28 years (to 1Q84, the earliest period included in the 2Q12 QBP). In fact, the 2Q12 TCE ratio is the highest/strongest year-end TCE ratio for the banking industry since the Great Depression. Notably, our company's regulatory capital position reached an all-time high at mid-year 2012, with no outside capital injections of any kind. In fact, our internally generated earnings alone resulted in increased capital ratios every year from 2007 through 2012, encompassing the entire financial crises period.

As to the proposed rules being deficient or ill-advised with regard to community banks we would only point to the recent well publicized comments of Ben Bernanke, Federal Reserve Chairman and Thomas Hoenig, FDIC Director, well known regulatory officials, who have come down of the side of rationality and simplicity when considering proposals for community banks that are based on big bank problems and a vague notion of international convergence that does not particularly suit the circumstances in our country. In general we object to the complexity and the complicated, unworkable and one-size fits all rules that are derived from this international compromise. These proposed rules are harsh and punitive to healthy banks. Requiring excess capital, especially when it is most difficult to come by, benefits no one in the real world, not a bank, not its shareholders, not its customers and not the communities it serves.

We would like to present a few specifics to illustrate our general arguments.

Phase out of Trust Preferred Securities as Capital Instruments

A few years ago our company issued a $12 million Trust Preferred (TruPS) security. The arrangement, which we entered into in good faith, fully expecting to utilize for its full 30 year maturity, has indeed served us very well (as well too for the investors who ultimately purchased the investment). This issuance was a decision that we made in careful consideration of, and with respect to, full compliance with the very clear capital rules that existed at that time. As a true capital instrument it allowed us to expand for the long-term and leverage our growth internally, exactly as planned.

Now we see a proposed rule that, inconsistent with the intent of the Collins Amendment to the recent Dodd-Frank legislation, does not grandfather TruPS for institutions between $500 million and $15 billion in consolidated assets. Instead, Basel III requires the phase-out of these instruments from Tier 1 capital treatment for bank holding companies in that size range as of December 31, 2009, permitting only the inclusion of 90% of the carrying value of such instruments in 2013, with annual 10% decreases in the includible amount through 2021, until the instruments are fully phased-out on January 1, 2022.

We are puzzled as to why that very sensible treatment of TruPS should be tossed out now when the concept of hybrid subordinated debt has worked so well for the community banks that used it as intended. To invalidate usage now would be a very significant burden to our capital plans if the rule were allowed to go forward as written. It would force us into considering very expensive alternatives to replace what is now working quite well. The banking agencies should be aware that In light of the considerable costs of Dodd-Frank and potentially this NPR, privately held companies such as ours are facing greatly reduced alternatives in raising capital. With limited liquidity for shares and with limited options for obtaining replacement capital we would be especially hard pressed to come up with suitable alternatives at anywhere near a reasonable cost. Our $12 million TruPS that faces being phased out for capital treatment, if not replaced, means over $10 million in asset shrinkage for each of the ten years of the phase out period. Those are dollars that would be sapped out of our local economy, and just for our company, in the form of fewer business and consumer loans of all types, including residential mortgages.

We fail to see how the benefits of this proposed rule could be anywhere near the ultimate cost to banks, their customers and the local economies in which they operate. Also to be considered is the double impact at work here, greatly increased costs in complying with the proposed rules while seeking new and costly sources of replacement capital. Bank investors are looking at

growth opportunities, not for regulation-hindered institutions with immediately lower growth prospects due to constraints brought on by much higher capital requirements.
We respectfully suggest that the banking agencies consider alternatives to this drastic measure. We would strongly propose that the rule be revised to fully recognize the intent of the Collins Amendment in grandfathering treatment for smaller organizations that urgently need regulatory relief. In the alternative, if the agencies elect not to follow the intent of the Amendment then in the least, we would propose that the phase out of TruPS qualification as capital be limited to companies over $1 billion in asset size, so that hundreds of smaller organizations would receive grandfathered treatment, exactly as contemplated by Dodd-Frank. That legislation never intended for this type of instrument to be phased-out for community banks. It needs to be resurrected.

Comments Regarding Unrealized Gains and Losses Flowing Through Capital

We are also quite concerned with the proposed rule that would require unrealized gains and losses on available for sale (AFS) securities to flow through capital for regulatory purposes. This is a complete reversal of existing risk-based rules that reflect the unrealized gains and losses in accumulated Other Comprehensive Income (OCI), and are not included for regulatory capital purposes. If the rule were to be implemented as proposed, changes in the value of an AFS security (which can occur daily in some cases) must immediately be accounted for in regulatory capital. Generally, unrealized gains and losses occur in AFS portfolios primarily as a result of movements in interest rates as opposed to changes resulting from credit risk. Interest rates, particularly on debt securities, can fluctuate frequently, and therefore the proposed rules will introduce significant volatility into capital calculations.

Permitting this provision of the proposal to be enacted as written would have immediate consequences related to our company's ability to freely hold securities as a source of liquidity and interest income in all rate environments. It would clearly promote volatility in earnings, capital and in realized gains and losses, not to mention the impact on our ability to purchase and hold securities issued by our local communities, school districts and other civic infrastructure improvement or equipment projects. We feel that interest rate risk in holding securities is adequately addressed in our analytical models and to introduce this further element of capital volatility is neither advisable nor desirable. Indeed, routine securities activities are an important asset-liability management tool in their own right. The proposed rule would limit options related to this function as well as to our liquidity and contingency funding plans.

Further, allowing unrealized gains and losses to flow through capital would negatively impact the ability of our bank and certainly many other banking organizations to contribute to economic activity in a rising interest rate environment. With the inclusion of unrealized losses of AFS securities in the proposed CET1 and total Tier 1 capital, rising interest rates would put downward pressure on banking organizations' capital levels, potentially causing banks to reduce the growth of, or even shrink their securities portfolios to maintain capital ratios at desired or required levels. The proposed concept would introduce substantial volatility into the proposed CET1 and total Tier 1 capital; it would force banks to maintain ratios of these measures to risk-weighted assets substantially above the levels that would otherwise apply in order to avoid the sanctions applicable to banks that fall into the proposed capital conservation buffer. Additionally, the provision would certainly lead to our institution limiting investments in longer duration assets, including 30-year Fannie Mae and Freddie Mac mortgage-backed securities and debentures, U.S. Treasuries, and municipal securities. This could lead to lower returns on assets and equity at our bank and less funding for the housing markets as well as for national and local governments.

In summary, the benefit of this portion of the proposal is far exceeded by the costs associated with a shrinking portfolio in order to avoid the potential gyrations in required capital. Particularly, as is certainly the case with most community banks, we frequently purchase the securities of local issuers, such as municipalities and school districts as well as for Community Reinvestment Act purposes. All of these are frequently for longer durations, those most susceptible to swings in value with changing rates. Effectively the proposed rule amounts to a capital penalty for doing so. We would not want to restrict or curtail this activity in any manner as our company, our customers and our communities and in many cases the housing sector would all suffer negative consequences.

We would strongly encourage the banking agencies to revise this rule such that unrealized gains and losses on AFS securities that currently reside in OCI do not flow through capital. This would still allow losses to be reflected for credit impairment impact but not for those resulting from interest rate swings. This would allow unrealized losses due to credit impairment to be reflected in capital, but would exclude the interest rate impact.

If the banking agencies are determined to require all unrealized gains and losses to flow through capital, we would then strongly suggest that unrealized gains and losses that predominantly result from changes in interest rate risk should be carved out. In other words, the agencies should consider filtering unrealized gains and losses for securities that do not have credit risk. This approach would exclude from regulatory capital unrealized gains and losses resulting from such low-risk securities as U.S. government and agency debt obligations and U.S. GSE debt obligations.

Comments Regarding Residential Mortgages and Assigned Risk Weights

The proposed rule that assigns risk weights to residential mortgages based on (1) whether the mortgage is a "traditional" category 1 mortgage or a "riskier" category 2 mortgage; and (2) the loan-to-value (LTV) ratio of the mortgage has the distinct potential to be very problematic for banks such as ours. We noted in our own study of the proposed schedule of risk weights that the proposed category 2 risk weights are quite high relative to category 1 risk weights (35 to 100 percent), delinquent loans (150 percent), and general unsecured credit (100 percent). These are unrealistic and unnecessary.

The proposed rule, if enacted as is, would require considerably more complex tracking and control systems and processes as we evaluate continuing loan to value calculations for risk weighting purposes. Then there is the inevitable and addition to audit and compliance costs associated with all this new activity. Incremental expenses will be appreciable, both initially and ongoing and would again have a negative impact on our bank and our ability to fully serve our customer base.

The proposed residential mortgage rules raise several other additional issues. Under the NPR, a bank is required to re-assess a mortgage after a loan restructuring or modification, unless the modification is made under the federal Home Affordable Mortgage Program (HAMP). Thus, a category 1 mortgage might become a category 2 mortgage after modification if the bank does not modify the loan under HAMP. In addition, the proposed rules do not recognize private mortgage insurance (PMI) at all. Mortgages are therefore subject to high risk weights even if PMI reduces the risk of loss on such loans. Finally, the proposed rules do not include any type of grandfather provision, so all mortgage loans currently on bank books will be subject to the new capital requirements. As a result, banks would be required to examine old mortgage underwriting files to determine the appropriate category and LTV ratio for each mortgage.

Frankly, this proposed rule would be very harsh for community banks such as ours with growing mortgage loan businesses. If enacted as proposed, the rule would ultimately result in diminished ability to make mortgages, particularly some less traditional types. And of course the impact would again be felt by our customers, who would find it harder to obtain mortgage loans that meet their needs and by our communities at a time when this type of market hindrance is not at all welcome.

Comments Regarding Assigned Risk Weightings on Delinquent Loans

There is one final comment we would like to make for the banking agencies consideration. We are very concerned that increased risk weights on delinquent loans will impact our ability to work with our customers at a time when they are experiencing difficulty in servicing their debt. Under existing rules, the risk-weight of a loan does not change when the loan becomes delinquent. Instead, the additional risk is addressed through the Allowance for Loan and Lease Losses. The proposal would change this approach significantly assigning nonresidential loans over 90 days past due a risk-weight of 150%, a fifty-percent increase.

While the immediate impact of the proposal on our existing loan portfolio, if enacted as written, would be considerable, our concern is that it would likely and unfortunately affect how we approach negotiations with delinquent customers going forward. Specifically, we could well be less inclined to pursue loan workout strategies and instead proceed directly to foreclosure or loan sale. We presently take a measure of satisfaction in our ability to work with customers who are having problems. We would not want such a proposal to come between us and that ability when we would much prefer an alternate solution to foreclosure or another negative outcome for our customers. We suggest that this proposed rule be dropped in its entirety.

Again, we thank you for the opportunity to express our views on the Basel III proposals. We believe strongly in our positions as stated here and believe they represent a real world approach where the benefits truly outweigh the costs. We hope we have adequately expressed our view that smaller organizations, especially those under $1 billion in consolidated assets, be relieved from the most onerous of the all-encompassing proposed rules, particularly those that were originally directed at large international institutions. We trust that the agencies will give our comments and suggestions the consideration they deserve. Please call or email if you have any questions or if you need additional information.

Sincerely,

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