

October 10, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

Re: **Docket No. R1430: RIN No. 7100-AD87**  
Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III,  
Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions,  
and Prompt Corrective Action  
**Docket No. R1430: RIN No. 7100-AD87**  
Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets,  
Market Discipline and Disclosure Requirements

Ladies and Gentlemen:

The following comments are submitted on the behalf of Highlands Union Bank in response to the requests for comments in the notices of proposed rulemaking for Basel III. Highlands Union Bank is a community bank servicing Southwest Virginia, Western North Carolina, and Upper East Tennessee. Highlands Union Bank is like many other community banks across the country in that it provides long term services to local towns and communities on a relationship based business model. This business model contributes to the success of all community banks across the country as it provides those community banks with a common sense approach to managing bank risk. It should be noted that community banks did not engage in the highly leveraged activities like that the largest banks, which not only depleted capital levels, but also caused widespread panic in financial markets.

Basel III appears to be a regulation that will be pushed down upon all banks, regardless of size, business model or understanding of community banking in general. As noted previously, community banks provided services to local towns and communities. Community banks not only provide services in the forms of financial services, but also jobs and investment in the communities which they serve. In other words, community banks help to provide long term economic success of the localities in which they are located. The proposal of Basel III threatens not only the existence of community banking but also that of the communities that we serve.

Highlands Union Bank fully understands the need for adequate capital levels and has a vested interest in a healthy banking system. However, Highlands Union Bank is concerned with Basel III completely revising the current risk weights used by community banks to calculate their regulatory capital, particularly for mortgages and the prompt corrective actions. With the proposed requirements many community banks will be forced to originate 15 or 30 year mortgages with durations that will make balance sheets

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more sensitive to long term interest rates. This has the potential to cause many community banks to exit the residential loan market completely. Also, second liens will either become more expensive or disappear from services as community banks may choose not to allocate additional capital to these balance sheet exposures. Community banks will also have to absorb the cost of additional operational cost to track mortgage loan to value ratios in order to determine the appropriate risk weight categories for mortgages. The proposed implementation guidelines are simply far too aggressive for community banks to meet the minimum capital requirements and do not consider future economic downturns, which many economists are forecasting.

Highlands Union Bank also objects to the proposed ten year phase out of tier one treatment of trust preferred securities. We believe that Collins Amendment permanently grandfathers the tier one treatment of trust preferred securities.

Highlands Union Bank also does not support the treatment of Allowance for Loan and Lease Losses. This should not be capped at 1.25% of assets in the inclusion of total capital as it is the bank's first line of defense pertaining to absorbing losses. Highlands Union Bank believes that most, if not all, of the allowance should be included in tier one capital for this very reason.

Based upon our analysis of Basel III and the Standardized approach for Risk Weighted Assets, Highlands Union Bank would have a significant reduction in ratios and calculations as noted below:

**As of 6/30/2012**

<u>Dollar Amount (000)</u>	<u>Current Rules</u>	<u>Basel III Rules Only</u>	<u>Basel III and Standardized</u>
Common Equity Tier 1 Capital	N/A	\$ 29,218	\$ 29,218
Tier 1 Capital	\$ 32,818	\$ 29,218	\$ 29,218
Tier 2 Capital	\$ 4,936	\$ 4,936	\$ 4,936
Total Capital	\$ 37,754	\$ 34,154	\$ 34,154
Risk-Weighted Assets	\$ 391,758	\$ 389,730	\$ 466,776
Average Assets	\$ 597,901	\$ 595,873	\$ 595,873

**Regulatory Ratios**

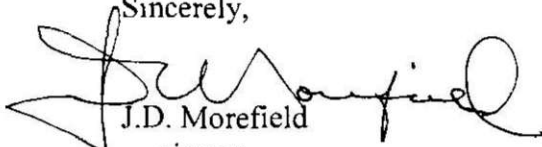
<u>Regulatory Ratios</u>	<u>Current Rules</u>	<u>Basel III Rules Only</u>	<u>Basel III and Standardized</u>
Leverage Ratio	5.49%	4.90%	4.90%
Common Equity Tier 1 Capital Ratio	N/A	7.50%	6.26%
Tier 1 Capital	8.38%	7.50%	6.26%
Total Capital Ratio	9.64%	8.76%	7.32%

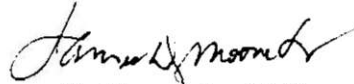
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As you can see the implementation of Basel III will have lasting damaging effects to not only Highlands Union Bank but the community banking industry in general. Basel III will not only reduce ratios and calculations, but negate the recoveries made by all community banks since the decline of the economy.


We appreciate your time in reading our comment letter and implore you to consider the exemption of all community banks with respect to Basel III.

Sincerely,

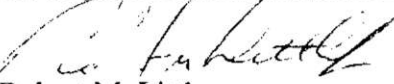
  
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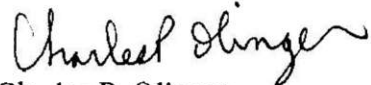
  
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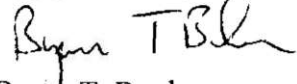
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