The Bank
OF ELK RIVER

October 19, 2012

Jenifer 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, SW
Mail Stop 2-3
Washington, D.C. 20219

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:

We are writing this letter to comment on the proposed Basel III capital rules being considered by the FDIC, OCC and Federal Reserve. We understand the fundamental logic behind the proposed Basel III rules requiring large, international banks to hold higher amounts of capital in order to insulate economies and commercial markets from being devastated in the event of future financial crises. We grapple with trying to comprehend the complexity of the calculation process to determine the amount of capital required based on the level of risk in our community bank's overall profile.

We are a $369MM community bank chartered in 1885 and have been owned by the same family since our inception. We are located in the northern suburbs of Minneapolis in what was a rapidly growing area. Our region was drastically affected by the Great Recession due to the unprecedented, extreme decline in real estate values. Our bank suffered significant financial losses depleting capital ratios to a level of being undercapitalized. Due to an earnest effort of shrinking the bank and successfully raising $4.5MM in capital from existing shareholders, the bank has returned to a level of adequately capitalized. As the bank continues to recover by returning to profitability and actively pursuing lending opportunities, our capital ratios are gradually improving. Access to capital markets is limited for closely held companies like ours and our shareholders have already increased their investment in the bank. Earnings are our principal solution to restoring our capital ratios to the regulatory requirements.

The table below provides The Bank of Elk River's June 30, 2012 capital and Total Risk Based Capital (RBC) position. The current position is being compared to the proposed Basel III and Standardized Approach to the Risk Weighting of assets. One of the major components to Basel III is the inclusion of Accumulated Other Comprehensive Income (AOCI) to capital. For most community banks this represents the gain/loss of their marketable securities available-for-sale within the investment portfolio.

630 Main Street, Elk River, MN 55330 | p) 763-441-1000 f) 763-441-0847 | www.thebankofelkriver.com | Member FDIC

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| | Total Capital ($000) | AOCI ($000) | RWA ($000) | RBC Ratio | Impact |
|---|---|---|---|---|---|
| Current Position | $22,605 | N/A | $ 264,116 | 8.56% | N/A |
| New Proposed | $22,605 | $ 794 | $ 289,609 | 8.08% | - .48% |
| + 100 | $22,605 | $ 14 | $ 289,609 | 7.81% | - .75% |
| + 200 | $22,605 | $-1,624 | $ 289,609 | 7.24% | -1.32% |
| + 300 | $22,605 | $-3,197 | $ 289,609 | 6.70% | -1.86% |
| +400 | $22,605 | $-4,756 | $ 289,609 | 6.16% | -2.40% |

As shown above, the potential of rising interest rates will impact the value of AOCI. Implementing bond analytics and affecting the investment portfolio with 100, 200, 300 and 400 basis point rate shocks, the impact on how the inclusion of AOCI as part of the capital calculation is illustrated. All four of these scenarios would negatively affect the Risk Based Capital position. It should be noted the bank's investment portfolio is strategically conservative and carries limited duration and interest rate risk.

In normal economic conditions, a rising rate environment would indicate growth in the national economy causing higher demand for credit. Including AOCI when rates are rising will potentially weaken the bank's capital position at a time when capital is needed most to support economic growth.

We agree with many of FDIC Director Thomas M. Hoenig's remarks to the American Banker Regulatory Symposium. In particular, we agree Basel III "will not improve the condition of small and medium sized banks and applying an international standard to a community bank is illogical."

Implementing a "one size fits all" capital solution for banks is ill-timed and poorly conceived. It makes sense to us for the regulatory agencies not to implement Basel III and explore a simpler capital solution for community banks that is supported by reasonable regulations that will promote economic growth and stability for small businesses and Main Street America.

Best Regards,

John E Babcock

John E Babcock
President/CEO/Chairman

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