Saugusbank
a co-operative bank
412 Lynn Fells Parkway | P.O. Box 988 | Saugus, MA 01906

October 22, 2012

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

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comments on the Basel III proposals recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I am in complete agreement that required capital levels for the banks in this country must be robust and sufficient enough to maintain a safe and sound industry through the most extreme economic cycles or unforeseen circumstances. However, I do have concerns about the complexity of the proposals by the agencies and the negative impact these rules will likely have on a community bank such as Saugusbank.

Saugusbank is a $200 million, state chartered co-operative bank founded in 1911. Our three branch locations and loan center serve a community in which we are the only remaining "hometown" bank.

We are a typical community bank meeting the depository and lending needs of local consumers and serving small to medium size businesses with an array of products and services priced accordingly.

As of September 30, 2012, Saugusbank has Tier 1 leverage capital of 8.47% and Tier 1 Risk Based Capital of 13%. Saugusbank has consistently managed its growth and maintained sufficient capital levels to support that growth since, as a mutual institution in the current environment, our only way to increase capital is through the retention of earnings. It is this fact that gives me the greatest concern, and perhaps an unworkable scenario, relative to the proposed levels of capital and as well as proposed complex methodologies for calculating same.

In particular, following are several areas in which I have concerns:

A major area of concern is the requirement that unrealized gains and losses on available-for-sale (AFS) securities flow through the common equity Tier 1 computation. Our bank currently has a $52 million investment securities portfolio. While the majority of our issues are Held to Maturity, a significant amount are available-for-sale at certain points. This proposal would serve to increase regulatory capital in the near term; however, as interest rates begin to rise, the proposal will introduce a certain amount of volatility and distort our regulatory capital levels. This is likely to undermine our ability to take a long term perspective and inhibit our ability to manage our investment portfolio through different interest rate and economic cycles.

Residential mortgage lending and home loan financing is a significant part of our business, and we are a key lender in the primary market we serve. The proposed rules regarding risk rating 1-4 family residential mortgages will make mortgage loans more difficult to obtain for many who we serve. These new risk-weight formulas apply to both new mortgages as well as existing loans that are in our portfolio and where underwritten to comply with existing capital standards. Saugusbank generates mortgage loans for both our own portfolio and sale on the secondary market. Fixed rate and adjustable rate mortgages in one portfolio are used as a tool to manage interest rate risk. We do not generally hold fixed rate loans of greater than 15 years due to the interest rate risk, especially at this low rate level. Requiring higher risk rating of adjustable rate loans requires more capital, increases the cost of credit, and will consequently reduce the availability of credit. The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that are considered much riskier in our experience. For example, loans in Category 2 with loan-to-values higher than 90 percent subject to a 20 percent risk weighing is double the risk-weight for unsecured consumer loans.

In addition to the impact on our lending capability, the change from assigning "risk weightings to asset classes" to assigning "risk weightings to individual loans" will create an administrative problem for a bank our size. I believe this shift will do little to improve our "risk profile" but will do a great deal to increase the burden and expense of managing what is otherwise a safe and sound traditional community bank loan portfolio.

The proposal to increase risk weights as delinquent loans is redundant. Delinquent loans must be considered in the Allowance for Loan and Lease Loss Analysis. Accordingly, we already set aside reserves for loans that fall into a past-due status. By also increasing the amount of capital we hold based on past-due status, we are being required to set aside capital two times. I believe that the risk (and potential loss) related to problem loans should continue to be managed through loan loss reserve standards and not by duplicating capital requirements. We also question the limitation of 1.25% of risk based assets in ALLL since banks should build reserves with pre-tax dollars during good economic times.

In summary, Saugusbank believes that the cumulative effect of these proposals will have a significant impact on community banks like ours. We strongly urge you to consider the impact and to consider a possible exemption for community banks from the majority of these proposals.

Thank you again for allowing us to comment.

Sincerely,

Kevin M. Tierney, Sr.
President and CEO