SALEM
CO-OPERATIVE BANK

October 12, 2012

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

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429 Office of the

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently published by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

Salem Co-operative Bank is a $400 million, state-chartered mutual savings bank celebrating 90 years of service to our communities. We have our main office in Salem, New Hampshire and one branch in Methuen, Massachusetts. Our primary business is residential lending and we began commercial lending in 2006. We are one of the 61 banks that were regulated by OTS and are now regulated by FDIC. The Bank has Tier 1 leverage ratio of 13.96%; Tier 1 risk-based capital ratio of 28.51%; and total risk- based capital ratio of 29.45% as of June 30, 2012.

Although regulatory capital requirements should be reviewed and modified to provide additional safety and soundness within the banking industry, the proposals currently do not take into consideration the composition and business structures of traditional community banks and the significance they play in the fabric of the communities in which they serve. This Bank had nothing to do with the economic problems, which were created by sub-prime lenders and the non-regulated players in the market including FNMA and FHLMC.

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Issue of concern: Risk Weighting changes of residential mortgages.
As a residential lender we are very concerned about the risk weights assigned to our mortgage portfolio, including but not limited to the excessive weighting of home equity loans. Some of our most successful products have been our first time home buyers mortgage program and our 90% LTV product for loans $250,000 and under. We do not require PMI insurance on these products, which allows the borrowers to save thousands of dollars they otherwise would have had to pay. With the new risk weightings we may be required to limit the availability of this product, which in turn would limit our availability to service this sector of our market. We offer these products as a way to promote home ownership and consider them as an appropriate offering for CRA purposes.

The weighting and record keeping for home equity loans would require banks to modify their lending requirements and add additional costs to the product in order to monitor the LTVs.

We have had few loans that we have taken losses on even through these difficult times. This Bank has had one foreclosure, one short sale, one deed in lieu of foreclosure and one home equity loan loss over the past 5 years. We pride ourselves in underwriting good quality loans, which is good for the bank as well as the consumer.

Additionally, any final rule should consider grandfathering all existing mortgage exposures by assigning them risk weights as required under the current general risk-based capital requirements (*i.e.* 50% risk weight).

Issue of Concern: Requiring Unrealized Gains and Losses Flowing Through Capital The Basel III NPR proposes that unrealized gains and losses on a banking organization's Available-For-Sale (AFS) securities to "flow through" to common equity Tier 1(CET1). Under the current risk-based capital rules, unrealized gains and losses that exist in accumulated other comprehensive income on AFS debt securities are not included in regulatory capital.

As of June 30, 2012, the Bank's unrealized gain on investments was $5.8 million on a $128 million portfolio comprised of US Government Agencies; Fixed and Variable GSE MBS products; Municipal bonds and SBA pools). If rates where to increase 300 basis points, the unrealized gain would become an unrealized loss estimated at $15.6 million, which would represent approximately a 4% decline in capital. Over the years we have used the investment portfolio as a vehicle in absorbing excess cash on our balance sheet. These new regulations may 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 would also lead to lower ROA at our institution as we would be required to purchase much shorter term investments in order not to have as much volatility in our capital computation.

The proposed rule should be revised so that unrealized gains and losses on AFS securities that reside in accumulated other comprehensive income do not flow through capital. This would allow unrealized losses due to credit impairment to be reflected in capital, but would exclude the interest rate impact. Many banks, including this Bank, have had to recognize other than temporarily impaired losses over the past few years including the write-off of FMMA and FHLMC preferred stocks. The changes in interest rates should not dictate the permanency of an adjustment to Tier1 capital, as interest rates can change on a day by day basis and we manage IRR on a day to day basis.

Issue of Concern: Treatment of Cash Flow Hedges Under the Basel III proposal, banks would be required to deduct any unrealized gain and add any unrealized loss on cash flow hedges included in accumulated other comprehensive income to CET1, net of applicable tax effects, which relate to the hedging of items that are not recognized at fair value on the balance sheet.

This proposed deduction would negatively impact a proven and reliable tool that banking organizations have used for years to manage interest rate risk in a safe and sound manner. In essence, it greatly diminishes the incentive to manage interest rate risk.

This Bank has used forward swaps to mitigate the impact of a rising rate environment on our liability sensitive balance sheet. These forward swaps help us manage the interest rate risk associated with holding longer term fixed rate mortgages on our books. The deduction of the cash flow hedging gains and losses are realized over the term of the instrument and therefore should be recognized over their life. Recognizing these gains and losses immediately into Tier1 capital would skew the actual cash flows of the instrument. Currently, the Bank has a $1.5 million net unrealized loss in derivatives that provides for a $30 million hedge against our fixed rate loan portfolio. If we were forced to discontinue these hedging vehicles due to the need to maintain capital requirements, we would be reducing the amount of safety and soundness-enhancing cash flow hedges, which could potentially lead to increased interest rate risk for the bank.

Cash flow hedges potentially subject to deduction present little or no economic risk to the bank – in fact, they are used to decrease economic risk to the bank. In light of the potential for increased risk and in light of the potential inconsistency with the safety and soundness-enhancing nature of the activity, the Agencies should eliminate this proposed deduction.

Although other provisions of the regulation do not affect the Bank at presently, the increased weighting on securitized assets is also an area of concern, as we currently are reviewing plans to possibly provide servicing of loans. At a time when borrowers are seeking the protection of community banks to provide with assistance in financing, the proposed regulations would diminish the means for banks to provide this valued service to consumers.

Taking all of these points into consideration, we strongly urge you to consider the unintended consequences that these regulations will impart on the traditional community banking framework that exists in this country. Basel III was designed to create a level playing field on an international basis and certainly there are distinctive differences between the international banks and the traditional community banks. Salem Co-operative Bank has always strived to serve our communities with financial care and volunteerism and have done so for 90 years.

Thank you for your consideration to these important matters,

Sincerely,

Ann R. Lally
President

Cc Senator Jeanne Shaheen
Senator Kelly Ayotte
Representative Frank Guinta