



Kevin M. McCarthy

President & CEO
October 19, 2012

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

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals¹ 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").

As President and CEO of NewportFed, a traditional thrift institution in Newport, RI with \$485 million in total assets, I am writing to express my concern about the proposals. We are a 6 branch federally chartered thrift providing both retail and commercial mortgages to the residents and small businesses of RI and contiguous markets in southeastern MA and CT. Our institution was founded in 1888. We are proud of our 124 year record serving Rhode Island communities. We provide solid paying jobs and we employ 90 people, mostly Rhode Island residents. In recent years we have donated nearly \$250,000 annually to non-profit, civic and community organizations. In the past year donation requests have been the highest we have ever experienced. We make every effort to accommodate as many requests as possible, from sponsoring little league teams to providing home heating assistance for distribution through social service agencies, as the reliance of our communities on this assistance continues to grow. The difficult economy makes our ability to continue this level of support an on-going challenge. The proposed capital reform will add to our costs and to our regulatory burden, requiring that we redirect our financial resources away from our local communities.

Compliance with the proposed rules will affect our Bank as follows:

- 1) The proposal assigns risk weights to residential mortgages based on whether the mortgage is a "traditional" category 1 mortgage or a "riskier" category 2 mortgage; and the loan-to-value (LTV) ratio of the mortgage. The proposed category 2 risk

¹ The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions; Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

- 1) weights are high relative to category 1 risk weights (35 to 100 percent), delinquent loans (150 percent), and general unsecured credit (100 percent). Furthermore 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.

We are a major provider of mortgages in our markets. Our underwriting has been consistently strong...our performance exemplary, unlike the non-bank lenders who were the root cause of the housing crisis. It's what we do. The risk weightings as proposed would be higher in most cases than other riskier loan types and the effect on capital may limit our lending capacity, to the detriment of the bank's earnings and to the communities we serve. Likewise assigning risk weightings to individual credits rather than asset classes will create an administrative nightmare which can only be solved by incurring additional hardware, software, and personnel costs. The look back requirement alone is an expense burden that is can only be recovered by pricing up new originations of mortgage products and other bank services, perhaps putting these products out of the reach of low-middle income consumers.

Furthermore, in the matter of risk weightings, assigning a higher rating to loans that fall delinquent is both redundant and unnecessary. Delinquent loans are incorporated into the evaluation of the Allowance for Loan and Lease Loss and capital is held to mitigate exposure. Although we traditionally experience few delinquencies, if another capital requirement is imposed on delinquent borrowers, our willingness to work with borrowers to remediate issues will end. If our response is typical, in difficult economies, the wholesale abandonment of the consumer by banks, will multiply the effect of the downturn, perhaps elevating conditions to systemic levels, not unlike those we experienced in 2008.

- 2) The proposal will require us to collect and report new and in many cases, very granular information in order to calculate the risk weights of assets. Banks will be required to obtain, maintain and report new information about underwriting features and LTV ratios of credit exposures, and sufficient information to satisfy due diligence requirements. As indicated above, existing loans are not grandfathered and therefore the new information will need to be collected on the

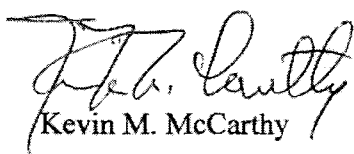
bank's existing portfolio. Existing information may also need to be maintained and reported on in different ways and forms and with greater frequency. It is likely that our bank will need to change our internal reporting systems, provide additional employee training and/or hire additional personnel. At first blush it appears we may have to go so far as install new systems, modify existing systems, and/or hire a third party to assist with meeting the new requirements. A complete analysis of our products and services will be required to determine whether the benefit to the bank and to the customer warrants taking on the costs and complexity associated with meeting the requirements. We believe there is a strong likelihood that one or more services or products will be eliminated to lessen the burden of compliance on the bank. None of this benefits the bank or the consumer.

- 3) The proposal classifies all junior liens, such as home equity loans and lines of credit, as category 2 exposures with risk weights ranging from 100 to 200 percent. In addition, a bank that holds two or more mortgages on the same property would be required to treat all the mortgages on the property, even the first lien mortgages as category 2 exposures. Thus, if the bank that made the first lien also makes the junior lien, then the junior lien may "taint" the first lien into a category 2 mortgage, which results in a higher risk weight for the first lien mortgage. By contrast, if one bank makes the first lien and a separate bank makes the junior lien, then the junior lien does not change the risk weight of the first lien. The proposal provides one exception to these general rules: the first and junior lien may be combined into one category 1 mortgage exposure only if the bank holds both the first and junior lien on the same property, no party holds an intervening lien, and the combined exposure meets all the requirements of a category 1 mortgage. This exception is very narrow, and most junior lien mortgages likely will be deemed category 2 mortgages.

We have provided home equity products to our customers for decades with great success. Home equity loans are one of the only remaining consumer products that have not been pirated by non-banks. Our history of losses in the last 15 years is almost nonexistent in all types of economies. Consumers value the product for its simplicity and flexibility. We underwrite to standards that are virtually identical to those for conforming first mortgage product. This product satisfies a market need, provides a reliable earnings stream to the bank, and its variable rate pricing helps mitigate interest rate exposure. The punitive risk weights of up to 200% will increase the cost of credit to the consumer and restrict credit. The proposal, if adopted, will further limit our capacity to meet market demand, and eliminate a class of consumers who utilize the product to effectively manage major expenses (education, medical, etc.) or unforeseen expenses. In a worse case, we may have to remove the product from our menu.

The concerns we've expressed are just the tip of the iceberg. Perhaps the most relevant impact of Basel III to the nation's community banks is its sheer size and complexity. Over 750 pages of regulation and legalese added to the on-going burden of Dodd-Frank and the rule changes promulgated by the CFPB. Quite frankly it's become overwhelmingly unmanageable. In drafting this letter, it is apparent that we cannot do justice to evaluating the impact of these proposals on our bank because of the volume of work necessary to understand the rules, apply them to our circumstances, and develop a true assessment of their implications. If the intent is to accelerate the inevitable consolidation of banks in this country, and eliminate the financial institutions that constitute the backbone of our economy and the lifeblood of small town America, we could not think of a better way.

Sincerely,



Kevin M. McCarthy