Franklin Savings Bank

October 9, 2012

Jennifer 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, DC 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:

Thank you for the opportunity to provide comment on the Basel III Proposals[1] (hereinafter referred to as Proposal) 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").

Franklin Savings Bank is a $375 million state chartered mutual savings bank serving central New Hampshire. The Bank operates seven full service offices, and has been successfully serving our customers and communities since 1869. Franklin Savings offers traditional loan and deposit products; as well as investment, insurance and brokerage services through a wholly-owned subsidiary. Our balance sheet is consistent with that of a "traditional community bank", with 66% of assets representing loans made to consumers and small businesses. We serve a rural area and are critically important to the economic health and vitality of our communities.

<u>I am writing in strong opposition to the Basel III Capital Proposal.</u> There are a number of troubling components contained in the Proposal; some of which I will specifically address in this letter. Generally speaking however this Proposal, if implemented in its current form, will lead to a reduction in product choice and higher prices for consumers.

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[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.*

The first specific component I will address in the Proposal is the requirement that all unrealized gains and losses on available for sale securities flow through to common equity tier 1 capital. I expect this creates a problem for all banks, but as a small mutual savings bank this will have a significant impact on our ability to manage our asset/liability position – especially in the area of interest rate and liquidity risk.

The most obvious opening statement to make is that unrealized gains and losses are, as the title suggests, unrealized. The gains and losses on the underlying securities of an investment portfolio are inevitable, and primarily result from the current level of interest rates relative to the rate of each individual security held. Even for a small community bank like ours, the unrealized gain/loss position can easily change by a few million dollars simply due to a change in interest rates of a few percentage points. With rates being at all-time historic lows there is no doubt they will rise again at some point in the future. The ultimate increase in interest rates, and corresponding impact on capital, could both be significant.

Franklin Savings Bank accounts for all investment securities as "available for sale". Under this designation, the Bank has the option to sell securities for a variety of permissible activities related to prudent management of the balance sheet. At our bank we generally sell securities to: generate liquidity to fund loan growth, reduce and/or manage credit risk, balance the repricing frequency of assets and liabilities (so as to reduce interest rate risk), and to augment earnings when opportunities arise (i.e. to execute bond swaps that provide positive total returns). Having to classify our investment securities as "held to maturity" would greatly impact our ability to effectively manage our balance sheet and associated risks. With this said, a reclassification is inevitable if unrealized gains and losses are required to flow through regulatory capital.

The next specific component I would like to comment upon is the risk-weighting of residential mortgage loans. There are a number of concerns that arise based upon the Proposal:

- ✓ Assignment of loans based upon original loan-to-value (LTV) ratios: Although our bank does track original LTV ratios, I question what value, if any, the original LTV ratio has in a dynamic economy where real estate values can fluctuate greatly. Using the original LTV ratio also does not take into consideration the regular monthly payment of principal made by the borrower which reduces LTV exposure. Just based on these two facts alone, a 95% LTV mortgage made in 1993 would be 100% risk-weighted, even though market appreciation and principal paydowns would likely show a current LTV under 50%.
    - Not allowing for credit enhancement such as private mortgage insurance (PMI) to reduce the risk-weighting will surely have the unintended consequence of limiting credit availability for many borrowers including first time home buyers. PMI has been used effectively by Franklin Savings to assist credit worthy borrowers who have had limited funds for down payment.
- ✓ Assigning 100% risk-weighting to junior liens including home equity loans: I believe it is a mistake to risk-weight home equity loans at 100%. For years consumers have used the equity in their homes to meet myriad credit needs including: making improvements

to their homes, providing education for their children, paying for unexpected expenses, and even planning for family vacations. Regardless of the credit need, home equity loans provide a flexible and convenient source of credit for American families. By assigning a 100% risk-weighting to this asset, community banks (especially those that are mutual) like ours will be forced to limit access and availability to home equity lines so as to preserve capital.

- ✓ Assigning higher risk weights to past due loans: This provision in the Proposal really makes no sense given that every financial institution in the country maintains an Allowance for Loan and Lease Loss (ALLL) account for the very purpose of providing for troubled credits. Furthermore, both regulators and accountants are required to review the adequacy of the ALLL held by banks and to recommend adjustments should the ALLL be deemed inadequate. So if banks are forced to hold additional capital to provide for past due loans, then efforts should be taken to eliminate the ALLL.
  - An unintended consequence that will result if this provision remains is that banks will be discouraged from working with borrowers who are experiencing financial difficulties. In fact, banks will likely move to foreclosure more quickly rather than work with borrowers simply in an attempt to preserve their capital. As a community bank, we pride ourselves on finding solutions that keep families in their homes. These solutions may include troubled debt restructures, loan modifications or payment plans. Often these solutions involve the customer remaining past due for an extended period of time until they "catch up". Our ability to work with our customers in this way will be greatly diminished as a result of the impact on capital that will result.

Another component of the Proposal that will lead to unintended consequences relates to the treatment of mortgage servicing assets (MSA's). To the extent that MSA's become a higher risk-weighted asset, or contribute less toward common equity tier 1 capital, community banks will be forced to reconsider servicing loans. Most community banks have never purchased MSA'a, rather they made a strategic decision to retain servicing on loans they originated and sold to the secondary market. This Proposal will force servicing back into the hands of large national banks; those that many will argue quite convincingly caused problems for consumers with practices that included "robo signing" etc. More and more consumers are asking that their community bank service their loan; this Proposal will likely eliminate that option.

There are other components of the Proposal that I believe will have unfavorable and unfortunate consequences on community banks, our customers and our communities. Although I have commented in some detail on those that are most troubling, I have concern with the capital volatility resulting from pension plan liabilities, treatment of Trust Preferred Securities, requirement to hold capital against loans sold with an early default clause and the capital treatment of certain deferred tax assets (as they could potentially impact participation in tax credit investments).

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In summary, this Proposal threatens community banks and the traditional community banking model. It is especially troubling to mutual institution like Franklin Savings Bank; again as our only access to capital comes from our ability to generate net income. However this Proposal also threatens to harm consumers by increasing the cost of bank products and services, while at the same time eliminating product choice and availability. This truly is a lose, lose situation.

Given the onslaught of regulatory burden that has fallen squarely on the shoulders of community banks/bankers across the country (those who weren't "part of the problem" that led to the financial crisis), serious consideration should be given to exempt community banks from BASEL III, or any other similarly crafted Proposal. Our country has done exceedingly well having a banking system with thousands of community based institutions. I can assure you rural communities across central New Hampshire benefit from the presence of a community bank like ours. I encourage you to seriously consider the impact and possible unintended consequences of this Proposal, and of any future banking proposal.

Sincerely,

Ronald L. Magoon

Ronald L. Magoon
EVP, COO, CFO & Treasurer