First Federal
MEMBER FDIC

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

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] 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").

First Federal (a mutual thrift, does not have shareholders) was founded in 1922 to provide a secure, locally-owned financial institution for Yamhill County residents... a place to build savings and borrow money to purchase a home. This initial philosophy continues to guide our decision-making and strengthen our dedication to our customers and our community. Presently we hold $290 million of local area deposits and have $211 million of loans, primarily single family residential mortgage loans. We do not sell the loans we originate; we keep them in our portfolio. We are also a strong supporter of our communities. Since 1999, we have donated more than $1.5 million to Yamhill County organizations with 501(c)(3) nonprofit status.

We are very concerned about the impact the Basel III proposed residential mortgages rules will have on our bank and community. We currently have over $20 million in balloon mortgage loans on our books, nearly all of which are at a fixed rate. This type of loan reduces our interest rate risk and can save the borrowers money with a lower interest rate. I don't believe Basel III considers the long term risk imposed on thrifts like ours when the government started manipulating long term interest rates with the quantative easing by the Federal Reserve. A balloon loan can be one of the safest kinds of

[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.*

mortgage loans and it works well for many of our borrowers. The proposed changes will double the amount of capital we have to hold for these loans. As a mutual thrift, we do not have access to the capital markets to increase our capital so we will be forced to either sell the loans or to not make the loans at all. How does this help our community? It certainly doesn't reduce our risk. The real losers are our customers, who can no longer borrower from a local financial institution.

The residential mortgage rules also require a bank to re-assess a mortgage after a loan restructuring or modification. If we restructure a borrower's home loan to assist them in time of need, we will be required to hold double the amount of risk based capital unless the loan is modified under the Federal Home Affordable Mortgage Program (HAMP). Since we do not participate in the HAMP program, we are penalized if we accommodate a borrower with a modification. This part of the regulation would have a disparate impact on our bank when we try to work directly with our troubled borrowers. How does it help our borrowers and our community if we are required to hold less capital if we refuse to modify the loans for troubled borrowers?

In addition, the rules no longer recognize the utilization of Private Mortgage Insurance (PMI) to reduce the risk exposure to the bank, again doubling the amount of capital required for every loan with PMI. Most people buying their home do not have 20 percent or more equity to put down on their loan. This provision will significantly reduce the number and amount of home loans that can be made to borrowers without a substantial down payment. As long as the PMI provider is a viable company, and the financial institution follows the PMI requirements, why is a higher amount of capital required? It appears the only beneficiaries to these provisions are the financial institutions that originate and sell all their loans to the huge financial intuitions that have no relationship with the borrowers and have no incentive to work with the borrower.

We are also troubled by the proposal regarding home equity lending. This proposal increases the risk weighting of junior liens from 100 percent to 200 percent. In addition, if we have the first mortgage, the entire balances of both loans are now subject to the 200 percent capital requirement (unless we can prove no other party has an intervening lien and the total exposure meets other category 1 mortgage rules). This will be both time consuming and difficult to prove and may require additional staffing. If a different bank has the first mortgage, they are not required to hold additional capital. This, once again, seems to benefit the banks that originate and sell all their loans. Why is there a penalty imposed if the borrower's bank provides both the first mortgage loan and an equity loan?

The proposal does not currently have a significant effect on our Tier 1 or our Risk Based Capital because we have had significant decay in loan balances over the past five years. Our remaining loans have low loan to value ratios, we have relatively no construction loans, almost no PMI loans, and minimal commercial real estate activity. When the economy eventually turns around, this proposal will significantly curtail our ability to lend in our community because of all the new higher capital requirements, specifically for loans with PMI or for those people wanting shorter term balloon loans. We will be required to reduce available funds for people hoping to buy their new homes and will not be able to support the growth of local businesses wishing to expand.

In closing, we respectfully urge you to carefully examine the effects of the new capital standards on mutual thrifts that originate and keep the mortgage loans. These are the banks that provide financing for housing in our communities and work with borrowers without government intervention. This proposal will make it more costly for us to assist borrowers in need and will prevent others from purchasing homes. Please consider amending these standards as necessary to ensure that our concerns are resolved.

Sincerely,

Jon Johnson
EVP & COO