William J. Smigiel
Chairman & CEO

LIBERTY BANK for savings
Trust & Integrity
Since 1898

October 15, 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 comments on the Basel III proposals 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").

Our Bank, Liberty Bank for Savings is an 800 million dollar bank with more than 20 percent capital located in Chicago. IL. We have been in business for 114 years, and our capital levels are the result of retained earnings through conservative practices from those many years. We operate like a traditional mutual thrift, our roots. That is, that we are owned by our depositors in the event of liquidation; however, we have no means to raise capital in any other way than by retained earnings, which is true of all 600 plus mutual institutions in the country. Liberty is more than adequately capitalized by a good margin and while the regulations as proposed do not create a direct challenge to us because of a lack of capital, they do certainly impact us in very negative terms from some very practical point of views that I discuss in the body of this letter.

We are a thrift that has served a community of blue-collar people throughout our history. Our neighborhoods and history of the association has been to service people on the lower end of the economic scale. While it is true that today we are seeing some revitalization near our main office, we are by no means out of the woods. Some of our branch offices in other areas of the city are of modest means as well, people whom major institutions have often overlooked. One of our reasons for continuing in business is to continue to help our community with many kinds of benefits, such as in leadership, quality of life and banking services, like passbook accounts, mortgages, CD's, insurance and so forth. We want to be able to continue to serve our neighbors.

We think we understand many of the risks in mortgages, thought changes in the economy have certainly impacted us harder in some respects because we are farther down in the economic ladder. Our people tend to be the ones laid off first.

Consider the source of the problems that were caused in the mortgage mess and address them first:
Community banks did not cause this mess and we are certainly just as much the victims. Capital levels do not change what has occurred but they do make us less competitive in an already overly competitive market. There are many calculations that must take place in the new regulations to determine what the appropriate capital levels might be that change depending on the shape of the new loans that come on our books in any given quarter. Further, there is no way to adjust loan values down as loans pay down without expensive appraisals to adjust for lower capital levels that would be justifiable to regulators either. Stated a different way, the regs are just more complex, with little positive benefit and much negative impact.

We believe that at the primary level, more should be done to encourage banks to be bigger players in the mortgage market where you can control activity rather than regs that just puts more power in the hands of those that do not have skin in the game, those outside the banking network of regulation. Nothing has been addressed to limit the profiteers within the mortgage brokerage industry, Wall Street, and the conduits into the Federal housing agencies that only profit from mortgage business yet control most aspects of the mortgage markets.

Credits for excess capital as alternative:
We think the entire concept of capital should be revisited. We know outside investors, particularly public investors will always aim for minimum capital from which to calculate return, yet capital is never at risk until there is a problem and capital can too easily run away under this and the current system.

From our perch, we view the idea that no matter what capital levels are required, levels set at 5 percent or even at 50 percent, the "bottom" is still "zero", cross the line and you are done. Can't a cushion be built into the system, a reward, if you will, for more capital at the table, rather than an absolute drop-dead capital level? I think it needs to be considered that "what is the relevance of either 5 percent or for that matter 50 percent, to anything other than as the backstop of governmental intervention?" No one ever intends to go over it, but when the markets fall away, the "reward" could be re- captured by regulators to strengthen that backstop.

Inherent to this type of a system, it also needs to be said the regulatory agencies need to be more accountable too. Regulatory agencies need to begin an evaluation process that is forward looking rather than always looking in the rear view mirror. The regulators always look at things after the horse has left the barn. We all knew the subprime, low doc, no doc, creative financings, were the problem yet no one made any effort to stop it beforehand. It is very hard to understand the tolerance regulators had for such shenanigans as they were going on, and did not make efforts to stop them. Creativity is one thing, but no skin in the game is just plain wrong.

Negative Impact on CRA and community loans:
As bankers, we are very troubled with the message and effects of these regulations with our missions. The regulations as they stand, adds yet another hurdle, with little benefit, as to why we should and if we should stay in business, which is ever harder as a small company. We have always felt that you wanted us to participate as partners in our communities, to do the work of our communities that struggle and yet here you are chasing us out by red tape and complexity.

We are more than willing to do our fair share, but doubling the level of capital forces us to believe that you as regulators are talking out of both sides of your mouth. The regs hurt our ability to support our local communities. In our case it is not the capital amount, per se, other than to say that the cost of capital is high enough for a standard mortgage, but clearly the new regulations discourage anything other than a standard mortgage. Yet we are mandated to provide creative financing, i.e. "special" mortgages on the compliance side of our regulatory burden. This approach only makes it that much harder in communities where "creative loans" are a way of life.

Service to our clients instead of focused placement to giant servicers:
The regulations also encourage banks to sell their servicing of loans to minimize capital requirements. Community banks focus on relationships and often use the secondary market to minimize interest rate risk, create mortgages in their community, but retain their relationship with customers. The regulations encourage just the opposite.

We can certainly see that the giant servicers have done a poor job of servicing loans in an adverse market. It would be our belief that the financial system benefits from competition and the spreading of risk by servicing loans through many players rather than a handful.

Over burdensome and expensive methodology for small banks:
The proposals as written, to determine capital levels is overly burdensome requiring some information that would be difficult to pull from accounting systems as they stand now. New systems and people to run them require new significant costs, perhaps as much as a half a person per month. Getting such data to make adjustments quarter to quarter to find out what we might need for capital purposes is a great deal of extra work for a small shop. And while in a stable interest cycle the accounting might stay a bit more stable, but it is no less work.

More significantly, as we have seen with wave after wave of refinance activity the need for capital could change dramatically and for a mutual, there is no way to raise capital. It can only restrict growth, which at times like this is the opposite of what is desired; especially in a neighborhood that needs revitalization.

The system does not seem to provide for changes, and if it did, it would be costly. The classification of where a mortgage might fit would not change without an appraisal, an expensive proposition at 300 to 350, per property in portfolio. Without a formal appraisal, it is very hard to provide for accuracy. Yes, there are indexes but none are completely right, which would permit shopping for values to fit the needs of a particular company which in turns negates the positives of the proposal.

Finally, from a public accounting perspective, the complexity does not provide for any more real guidance as to the risks that a potential investor might have when evaluating ones balance sheet. The accounting might bring more capital, but how does one expose the detail of the calculations that might be involved. We need a less burdensome alternative and one that is less costly to administer.

Deduction of Mortgage Servicing Assets that Exceed 10% of an Institution's Common Equity Tier 1:
Liberty Bank is generally a direct investor into the loans that we made, however from time to time, particularly in times of high refinance activity, Liberty gets swamped with mortgage applications, more than is prudent for us to hold and, accordingly we sell excess volume of mortgages to the secondary market. However, we are not the type of player in the marketplace that commands serious attention in a market like Chicago; therefore, in serving customers, we service the loans ourselves so as to keep a relationship with our customer. On some level, generally, our loan customers "know" us and is the reason they come to us, therefore maintaining a relationship with the customer is very important. In some cases, again depending on the course of rates, the value of the servicing can be significant, perhaps more than the 10%. Nevertheless, as a practical matter, we almost never count this benefit as a "core" to income, but rather a "bonus" to income until the servicing rolls off.

Under the proposal then the rules might cause, from time to time, rather exaggerated accounting treatment, as we move from period to period when there is higher servicing income and lower servicing income, which of course would require significant participation with our outside accountants to determine where we are from month to month. This of course would be costly to account for properly.

Since we do not "live" by the servicing income, the 100% treatment seems rather extravagant, and certainly the 250% punitive to maintain a relationship. We think of it as a core of our business, that is, more important to serve clients than to determine whether we can serve a client based on capital treatment. It is quite unfair and unreasonable to ask that a company focused on relationships to be forced to turn away a client that wants to have a relationship with us, but we cannot "afford" it. The makeup of our balance sheet seeks to avoid risk.

Nearly two thirds of our portfolio is government guaranteed, or at least implied. To force me into a capital issue based on interest rate changes (refinance activity) is beyond my ability to control with sudden changes to interest rates and at the same time turn away a prospective customer from the Bank.

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What we think is fair, based on our operations, that there be no deduction from capital for mortgage servicing rights, but we would suppose compromise is a part of the picture. At a minimum existing mortgage servicing assets should be grandfathered, it is highly unfair to penalize a bank with long standing servicing right to suddenly have to change position because of the Basel accord.

While we would certainly support the need for better capital considerations in the banking industry, we fail to see how the Basel Committee's recommendations truly accomplish their task when it comes to the services provided by community banks. We strongly encourage "credits" for having more capital at the table, as stated above. The lack of appreciation for what a community bank does for its local customer is clearly evident in what has been proposed, not to mention the extreme cost to comply. It would cost thousands of dollars for the quarterly adjustments to determine what the capital levels need to be because of the need to focus on hours of staff time and hours of independent accountant time to verify the calculation, all for little benefit, if any. We would much rather serve our community and we think that is what you would like us to do too.

I strongly encourage you to consider this impact and perhaps offer an exemption to community banks altogether. Our communities need support more than ever and that is what we want to do. Please let us help our communities.

Sincerely,

William J. Smigiel
Chairman & CEO

WJS/jez

cc: Senator Mark Kirk
Senator Richard Durbin
Congressman Luis Gutierrez
Congressman Robert Dold
Mr. Robert Davis, American Bankers Association
Mr. Jay Stevenson, Illinois League