NEW HAMPSHIRE
THRIFT BANCSHARES, INC.

LAKE SUNAPEE BANK fsb
the advantage of leadership

October 18, 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 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").

We are writing on behalf of Lake Sunapee Bank, fsb, (the Bank) and New Hampshire Thrift Bancshares, Inc., (NHTB) to respectfully express our concerns related to several elements of the proposed Basel III capital requirements. We fully support the need to reassess and revise the minimum capital requirements to safeguard the industry as a whole; however, we believe that these proposals as defined would significantly harm our business and ability to continue to effectively assist the communities that we serve.

NHTB is the holding company of the Bank, a federally-chartered stock savings bank, which was formed in 1868 and which provides a wide range of banking and financial services, as well as McCrillis & Eldredge Insurance, Inc., a full-line independent insurance agency which offers a complete range of commercial insurance services and consumer products. At September 30, 2012, the Bank had total assets of $1.1 billion, investments of $183.3 million, loans of $810.3 million (representing balances in over 12 thousand customer accounts), and deposits of $830.7 million (representing balances in over 63 thousand customer accounts.) Lake Sunapee Bank also owns 50 percent of Charter Holding Company, which is headquartered in Concord, New Hampshire and provides trust and investment services from seven offices across New Hampshire with approximately $1.6 billion of assets under management.

As a smaller institution, we have limited access to the capital markets, unlike larger financial institutions. Community banks, like ours, had little to do with the economic crisis that was largely a result of activities outside of the banking system that were securitized by large investments banks and brokers. We know our customers, we stay connected to them, and we understand the inherent risk of lending to them.

The following points highlight those areas of most concern to us:

Incorporating AOCI as Part of Regulatory Capital

The inclusion of accumulated other comprehensive income (AOCI) in capital for community banks will result in increased volatility in regulatory capital balances and could rapidly deplete capital levels in certain economic conditions unrelated to the credit quality of relevant instruments. AOCI, for most community banks like ours, represents unrealized gains and losses on investment securities held as available-for-sale. As these securities are carried at fair value, any gains or losses due to change in market interest rates are captured in this valuation. Recently, both short-term and long-term interest rates have fallen to historic lows resulting in unprecedented unrealized gains for most investment securities. Additionally, demand for many government guaranteed securities, both implicit and explicit, has risen due to a flight to safety as well as government intervention in the capital markets. This has caused credit spreads to further tighten increasing bond valuations as interest rates have fallen to levels that are not sustainable long-term once an economic recovery ensues.

As interest rates rise, fair values will fall causing the balance of AOCI to decline and become Accumulated Other Comprehensive Loss. This decline will have a direct and immediate impact on common equity, Tier 1 and total capital. At our Bank, for instance, if interest rates increased by 300 basis points, the Bank's portfolio, which is comprised mostly of mortgage-backed securities issued by GSEs, would show an unrealized loss of in excess of $10 million. This would mean our Tier I ratio would drop by 10% under the proposed Basel III requirements even though the inherent credit risk never changed.

Large financial institutions have the ability to mitigate the risks of capital volatility of this nature by entering into qualifying hedge accounting relationships for the financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. Community banks, like ours, do not have the knowledge or expertise to enter into these highly complex transactions and manage the associated risks, costs and barriers to entry. We respectfully request that community banks under $10 billion in assets should be allowed to continue to exclude AOCI from capital measures as they are today.

New Risk Weights

The proposed risk weight framework under Basel III is excessively complicated and will be an onerous regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks who offer these products to customers and deprive consumers of many financing options currently available for residential property. Community banks will find their hands tied and only able to originate 15- to 30-year mortgages with durations that will make our balance sheets more sensitive to changes in long-term interest rates. Many banks will either exit the residential loan market entirely or only originate those loans that can be sold to a GSE. Second liens will become more expensive for borrowers, if they don't disappear altogether, as banks elect to move from allocating additional capital to the balance sheet exposures of higher-weighted residential products. Additionally, community banks will be required to invest significant capital in software upgrades and incur additional operational costs to track mortgage loan-to-value ratios in order to comply with the stratified risk-weight matrix developed under Basel III for mortgages.

Mortgage Servicing Rights

Following the same lines of impact that mortgage risk-weight changes will have on originations, the increased risk-weight on mortgage servicing assets (MSA) will result in lower volumes of loans sold into the secondary markets, including GSEs. As the MSA increases through origination and sale, the value of MSA and the risk-weight exposure increase disproportionately, once again penalizing community banks for serving their communities. Community banks, like ours, should be allowed to continue to follow the current risk-weight and deduction methodologies. We carry a competitive advantage because our customers enjoy dealing with a local servicer. We retain servicing on over 99% of the loans we sell. As we grow, our servicing portfolio will continue to grow and the related MSA will grow as a result. Under the proposed risk-weighting changes, this would result in a disproportionate increase to risk-weighted assets increasing capital requirements and limit our ability to extend long-term fixed-rate products to residential customers.

Lake Sunapee Bank and other community banks operate on a relationship-based business model that is specifically designed to serve customers in our respective communities across the country through practical, common sense, and safe & sound approaches to managing risk. The largest banks operate on transaction volume and pay little attention to individual risk or customer relationships. The Bank and other community banks did not engage in the highly leverage activities that severely depleted capital levels of the largest banks and created panic in the financial markets. The difference in banking models further illustrates the need to place tougher capital standards exclusively on the largest banks to better manage the ability to absorb losses.

Thank you for this opportunity to comment on the proposals. We share your desire to increase the underlying strength of our financial system and prevent another financial crisis of this nature in the future. The proposed rules go beyond the original intent of the Basel II accords and will hinder community banks from continuing to effectively serve our customers, and we respectfully request you carefully consider the unintended consequences and far-reaching impacts of these proposals on the community banking system, the communities we serve, and the citizens that rely on their relationships with community banks.

Respectfully Submitted,

Stephen W. Ensign
Executive Chairman
New Hampshire Thrift Bancshares, Inc.
Lake Sunapee Bank, fsb

Stephen R. Theroux
President and Chief Executive Officer
New Hampshire Bancshares, Inc.
Lake Sunapee Bank, fsb

Laura Jacobi
Senior Vice President and Chief Financial Officer
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