October 19, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

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

Dear Ladies and Gentlemen:

Thank you for the opportunity to allow Eagle Bank (the "Bank") the ability to 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 (the "agencies").

While the Bank is in favor of ensuring that banks are adequately capitalized and able to withstand future shocks to the economic system, the requirements of Basel III will have a major impact on community banks and the way community banks do business.

Eagle Bank is a state-chartered, mutual savings bank with approximately $435 million in assets, consisting of five branch locations in the greater-Boston area. The Bank was originally chartered in 1889 and serves as a traditional community bank, striving to serve both local businesses and the residents within the Bank's communities. The Bank wants to ensure that it will be able to effectively serve these communities in the future, as it has for over 120 years. However, the Bank, along with many other community banks, has several concerns with respect to Basel III, as it has the potential to change the way that community banks do business, and, ultimately, has the potential to affect the way that community banks are able to serve their customers and communities.

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The following are areas in which we have strong concerns, with respect to community banks, and are meant to be illustrative, not exhaustive:

1. **Requirement that unrealized gains and losses on AFS securities must flow through to regulatory capital.**

   Given the low interest rate environment, many banks have experienced increases in their investment portfolios. The proposed rule requires that all unrealized gains and losses on AFS securities must flow through to common tier 1 equity. Thus, if there is a change in the value of an AFS security, that change must immediately be accounted for in regulatory capital. Given normal market fluctuations, the regulatory capital levels of each bank would be extremely volatile. In order to hedge their risk, banks would be compelled to hold additional capital against the fluctuation of these securities, thereby lessening the amount of capital available for lending.

   As banks have the ability to hold these securities until maturity, unrealized gains and losses on a bank's AFS securities should not be required to flow through regulatory capital, potentially affecting a bank's regulatory capital levels on a daily basis. This requirement will ultimately force banks to limit investments in longer duration securities in order to account for potential market fluctuations. This could potentially cause banks to avoid longer term securities, such as 30 year Fannie Mae and Freddie Mac mortgage backed securities, US Treasuries, and municipal securities. Ultimately, this could potentially lead to a lower ROA at banks, as well as result in less funding for the housing market and national and local governments. Limiting a community bank's appetite to invest in longer term municipal and state bonds/securities will potentially result in municipalities and states losing an inexpensive source of funding from community banks. In addition, this practice could potentially cause banks to sacrifice earnings by avoiding longer term securities in order to combat market fluctuations.

   Also, this requirement will likely require many banks to enlarge their HTM portfolio, therefore, restricting banks' ability to manage interest rate risk and engage in routine activities used as an asset-liability management tool.

   Eagle Bank believes that the proposed rule should be revised so that unrealized gains and losses on AFS securities that reside in accumulated other comprehensive income do not flow through regulatory capital. This would allow unrealized losses due to credit impairment to be reflected in capital, but would exclude interest rate impact due to market volatility.

2. **Residential Mortgages**

   Basel III's increased risk-weighting, with respect to residential mortgage loans, will also serve to restrict lending by banks. The proposed Category II risk-weightings are extremely high in comparison to the Category I risk weightings. Also, PMI should be considered as a mitigating factor in the risk-weighting of loans, as it reduces the risk exposure of a particular loan. Most community banks are not able to hold 30 year fixed mortgages in portfolio due to inherent

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interest rate risk. Therefore, community banks generally will offer ARMs that they are able to keep on the books. However, the proposed risk-weighting requirements of Basel III will increase the level of capital required to be held against ARMs, increasing the cost of credit and restricting community bank's ability to lend in their communities.

In addition to the aforementioned potential effects of the proposed risk-weighting, the Basel III proposal would present an administrative challenge for community banks. The proposal would require community banks to risk-weight loans that were previously underwritten and priced in accordance with existing regulatory capital requirements. The proposal would require community banks to scour seasoned loans files in order to determine appraisal values and borrower characteristics in an effort to assign the appropriate risk-weighting. Community banks do not have the employee resources to review seasoned loans and, at the same time, effectively service the borrowing needs of the community at a period of time when the mortgage loan pipeline continues to expand due to historically low interest rates. Therefore, it would be necessary for community banks to hire additional employees or hire third-party consultants at a time when community banks are already challenged by rate induced margin compression and are attempting to rein in expenses. In a worst case scenario, should this proposal be enacted, it should be revised to grandfather loans that community banks currently have on the books. Grandfathering old loans would allow community banks to prospectively adjust their lending practices based upon the new risk-weightings.

Finally, the requirement to risk-weight delinquent loans over 90 days at 150% seems duplicitous. Currently, delinquent loans are contemplated in the loan loss reserve. Requiring banks to hold this additional capital against delinquent loans appears to be requiring a duplicate reserve for a delinquent loan. Again, this will only serve to lessen the amount of money that community banks are able to lend into the communities they serve. This additional reserve will also push community banks to become more aggressive in moving delinquent loans over 90 days off the balance sheet. Historically, community banks have been willing to work with delinquent borrowers in times of economic hardship, however, these proposed risk-weightings will only serve to reduce a community bank's willingness to work with a delinquent borrower.

While Eagle Bank recognizes the need for new capital requirements for certain larger financial institutions, it believes that applying these same requirements to community banks is punitive in nature and lessens the ability of community banks to compete with larger regional and national financial institutions. Community banks, for the most part, have remained well-capitalized and were not the driving force behind the economic crisis which has already led to considerable regulatory reform.

Raising capital levels at community banks is difficult at the current time, as capital increases are generally directly related to bank earnings. These earnings, at most community banks, have been shrinking due to margin compression in the current interest rate environment, the loss of fee income due to regulatory changes, and the cost of complying with the new regulatory burdens. The effect of the Basel III proposals will be to stymie the capital levels of community banks, in direct contrast of Basel III's goals. Therefore, Eagle Bank believes that the majority of community banks should be

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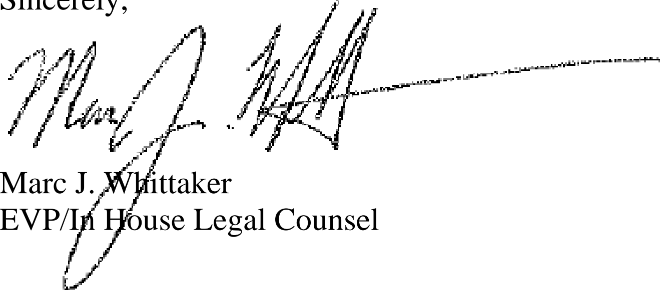
exempt from the proposed Basel III requirements. Community banks are the cornerstone of lending in most communities- applying the restrictive proposed Basel III requirements will only lessen the ability of community banks to serve their communities.

Sincerely,



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