Dedham Savings
Your Bank.

October 9, 2012

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 comment on the Basel III proposals[1] recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. While these proposals will no doubt curb certain risk-taking by financial institutions of all sizes, the 'cure' will set in motion a new set of risks and endanger the viability of a large number of community banks in the process.

While I believe the proposal has many flaws, I want to specifically comment on two 2 aspects I believe will cause the greatest harm to community banks in general, including Dedham Institution for Savings, a $1.1B state-chartered mutual savings bank with 11 branch locations, headquartered just south of Boston in Dedham, Massachusetts.

Community banks are subject to BASEL III, credit unions are not.

BASEL III will unlevel (further) the playing field for community banks relative to credit unions despite the fact many community banks and credit unions operate a very similar business model. Setting higher capital standards and more punitive risk-weights to certain types of 1-4 family residential loans creates yet another significant competitive advantage for credit unions. It specifically favors bank-equivalent credit unions that already leverage their tax-exempt status and legislative clout to operate as banks absent the same oversight and regulatory controls that govern community bank operations. For instance, these credit unions will be poised to earn the financial rewards and political capital arising from certain types of high-LTV residential lending, such as first-time homebuyer programs that some community banks will no doubt be forced to curtail or abandon due to their higher capital costs under BASEL III.

[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.*

Incorporating AOCI as Part of Regulatory Capital

Including accumulated other comprehensive income (AOCI) in capital for community banks will increase volatility of regulatory capital levels and could rapidly deplete capital levels under certain economic conditions. AOCI for most community banks is comprised largely of unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates affect AOCI.

Nearly all bank assets and liabilities (investments, loans, deposits and wholesale funding) experience fair value fluctuations over time, yet BASEL III unfairly targets fluctuations on investment securities in the Tier I capital computation. Why should the fair value fluctuations on pass-thru mortgage securities be treated differently than those on a loan or pool of portfolio loans with virtually identical cash flow characteristics? Are the writers of BASEL III blind to asymmetric impact of having fair value fluctuations on (often a sizable) portion of the balance sheet affect regulatory capital while compensating fair value fluctuations on other on-balance sheet (and off-balance sheet) holdings get ignored?

With short-term and long-term interest rates at historic lows and credit spreads remarkably tight almost any rise in rates will cause the AOCI decline and likely turn negative. Any decline will have a direct, immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce capital balances. At my bank, for instance, if interest rates increased by 300 basis points, my bank's bond portfolio would show a paper loss of in excess of $11MM. This would mean that my bank's tier one ratio would drop by about 15% -an amount not sufficient to endanger the Bank's regulatory status of 'well-capitalized' but well enough to impact operating strategy. A 15% drop in capital would require upwards of 3 years of solid earnings to recoup – assuming there wasn't further paper losses due to rising rates during these 3 years!

Conclusion

The BASEL III proposal as written places community banks at a tremendous disadvantage to competitors. Also, under certain economic conditions regulatory capital will be destroyed during times when economic capital may be growing. If regulators and legislators are serious about dealing with risks posed by 'too big to fail' financial institutions, BASEL III is a step backward in that only the largest institutions are going to have financial and human resources necessary to deal with BASEL III purports banking system. Subjecting the community banking industry to proposals written solely with the TBTF institutions in mind is at best misguided and at worst indifferent to a segment of the industry that contributed very little to the financial problems that triggered the writing of these proposals in the first place.

Sincerely,

Mark Ingalls

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Dedham Institution for Savings