South Coastal Bank

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
Delivered via email: regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
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Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Delivered via email: regs.comments@occ.treas.gov

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").

South Coastal Bank is a Massachusetts state chartered savings bank founded in 1868 with our headquarters and main branch located in Rockland, MA; a suburban community south of Boston. We operate two other full service branches in Quincy and Scituate, MA and have residential loan production offices in Worcester and Danvers, MA. We also have a consumer loan operations center in Rockland, MA. As of September 30, 2012, we reported total assets of $288 million and we employ 62 people.

South Coastal Bank is a wholly-owned subsidiary of MountainOne Financial Partners, MHC (MountainOne). MountainOne is a mutual holding company headquartered in North Adams, MA and is the sole stockholder of South Coastal Bank and Hoosac Bank -

also located in North Adams, MA. Total assets of MountainOne as of September 30, 2012, were $827 million. MountainOne and its subsidiaries employ a total of 218 people.

We are supportive of strong capital requirements; however it appears to us that Basel III may be appropriate for large domestic and international banking companies. In our opinion it is not appropriate or necessary for community banks such as South Coastal Bank. As a community bank we provide credit to consumers, small businesses, and local real estate developers. During the credit crisis and liquidity crunch in 2008, community banks such as South Coastal Bank stepped up to the plate to provide financing to many small businesses and real estate developers that had been turned away from our big-bank competitors. We were able to fill this void because we have always maintained conservative and disciplined underwriting criteria along with knowing our customers.

Community banks, unlike the large, systemically important banks and international banks, have a relatively simple business model and non-complex products. We are not leveraged with material off-balance sheet liabilities. We support the need to strengthen the quality and loss absorption safeguards for large, complex financial institutions, but not at the expense of community banks.

We have serious concerns that if the Basel III proposals are enacted as proposed our ability to compete and provide credit to consumers and small businesses in the communities we serve will be severely diminished resulting in a reduced availability of credit.

In particular, our primary concerns with the Basel III proposals are summarized as follows:

I. Elimination of trust preferred securities

In order to support growth opportunities for its banks, our holding company, MountainOne, issued $20 million of trust preferred securities during 2007 under a set of rules that allowed us to include these trust preferred securities as a component of Tier 1 capital. The proceeds from the trust preferred securities have allowed us to grow our asset base, particularly our portfolio of residential mortgage loans and small business loans.

Given our mutual holding company structure, our avenues to raise Tier 1 capital are extremely limited, with retained earnings being the primary method of capital generation. The trust preferred securities have been an important, cost-effective source of capital for MountainOne and, in turn, South Coastal Bank and Hoosac Bank (the Banks). The elimination of the trust preferred securities as a component of Tier 1 capital will significantly reduce our consolidated capital ratios. In reaction to the proposed phase-out of the trust preferred securities from Tier 1 capital, we will likely be forced to significantly shrink the Banks' balance sheets (i.e. reduce lending and investing) and/or significantly alter our capital plans and overall organizational structure.

We respectfully ask that the propose rule be revised to permanently grandfather existing trust preferred securities for institutions between $500 million and $15 billion. We believe this is fully consistent with the intent of the Collins Amendment of Dodd-Frank Act.

II. Requirement that gains and losses on securities available for sale must be included as a component of regulatory capital

We are currently in an unprecedented period of low interest rates, with various forecasts calling for low interest rates to persist for several years to come. As interest rates eventually begin to rise, the value of our securities will decrease, leading to a decrease in our regulatory capital ratios. Depending on the severity of the increase in interest rates, our regulatory capital position could be significantly impacted by nothing more than a change in the interest rate environment.

As noted above, our avenues to raise capital are extremely limited. Therefore, in a rising interest rate environment, all other factors being equal, we would likely have to reduce our balance sheet to maintain comparable capital ratios. Extrapolated across the entire industry, this proposal could produce a significant amount of cyclicality and volatility into regulatory capital measures and could serve to stall an economic recovery as banks curtail lending in an effort to maintain their capital ratios. In this scenario, our customers, including consumers and small businesses, will be impacted by the reduced availability of credit.

It has been suggested that securities could be moved from the available for sale portfolio to the held to maturity portfolio to mitigate this issue. Although this would eliminate the cyclicality and volatility of having unrealized gains and losses flow through to regulatory capital, it would create other issues by limiting our ability to manage our investment portfolio through different interest rate and economic cycles, impacting our overall management of interest rate risk and liquidity risk.

We respectfully ask that this proposal be eliminated so that unrealized gains and losses on securities available for sale continue to be excluded from regulatory capital. At a minimum, we would ask that unrealized gains and losses on highly-liquid, low-risk securities, such as U.S. government, agency and GSE debt obligations (including mortgage-backed securities and collateralized mortgage obligations guaranteed by such entities), be excluded from regulatory capital.

III. Increased risk-weighting for residential mortgage loans, home equity loans and delinquent loans

In response to a changing landscape, namely the ability of community banks to regain market share in the residential lending business from previously unregulated mortgage companies and mortgage brokers, South Coastal Bank strategically reinforced its efforts in this business line. In 2012 we will originate over $200 million in residential loans within the communities we serve. We have also steadfastly maintained our market presence in the home equity lending business. Throughout the economic downturn our home equity lending portfolio has performed well with minimal delinquencies. To us, this is indicative of sound underwriting and a customer base that utilized the proceeds for appropriate reasons such as home improvement, educational financing, and debt consolidation. The Basel III proposals threaten to make these lines of business significantly less profitable, thereby requiring us to limit these lending activities or ultimately forcing us to abandon these critical lines of business.

As mentioned above, we have had a minimal level of loan losses on residential and home equity lending. Our underwriting has been very strong, as opposed to many of the non-bank lenders who were the real culprits in the housing crisis. By increasing the risk-weighting on residential and home equity loans, we will be force to hold additional capital on assets that historically have been very low risk for us and other community banks. These additional capital allocations will reduce the overall number of loans that we will be able to provide in our markets.

In addition to the issues noted above, the process of categorizing our portfolios based on the requirements in the proposal (i.e. determining and updating LTVs, determining past due status, determining which customers have both residential mortgages and home equity loans/lines, etc.) will be a significant administrative challenge, potentially forcing us to increase staffing to properly implement the regulations.

In order to provide financing to many first-time home buyers, as well as borrowers who lack a 20% down payment, we have historically used private mortgage insurance ("PMI") to mitigate the potential risk of loss of underwriting loans on LTVs greater than 80%. The proposed rules do not recognize PMI at all. Given our experience with PMI to support first-time home purchases and as an effective loss mitigation strategy, we strongly feel that PMI should be considered in determining the risk profile of individual loans.

For the period ending September 30, 2012, South Coastal Bank originated 35 loans totaling $7,835,000 in conjunction with the Massachusetts Housing Partnership (the "MHP") for borrowers that did not have the 20% down payment. The MHP supports affordable homeownership and its programs have helped thousands of low and moderate income first-time buyers become successful homeowners. Programs such as those offered by the MHP are a critical component of enabling South Coastal Bank to meet its Community Reinvestment Act requirement.

The proposals also call for increased risk-weightings on certain delinquent loans. Although loans that are delinquent have a higher inherent risk than nondelinquent loans, this risk is captured as part of our allowance for loan losses process. By increasing the amount of capital we must hold for delinquent loans, we are in essence being required to set aside capital in two different locations for the same risk. If the proposal regarding delinquent loans is adopted, South Coastal Bank would likely be more aggressive in attempting to reduce delinquencies. This could have a negative impact on our customers, as we might be less likely to pursue otherwise prudent loan workout strategies.

IV. Requirement to hold capital for credit enhancing representations and warranties on residential mortgage loans sold into the secondary market

We understand that the proposed rules require banks to hold capital for loans with credit enhancing representations and warranties, including for "pipeline" mortgages in the process of being sold. Under the existing capital rules, banks are not required to hold capital against loans with such representations and warranties. Our interpretation is that this new requirement would affect any mortgage sold with a representation or warranty that contains (1) an early default clause, and/or (2) certain premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. government or government-sponsored entity.

As discussed previously, South Coastal Bank has a meaningful residential mortgage banking operation whereby long-term fixed rate loans are provided to consumers and are then sold into the secondary market to limit the interest rate risk retained on our balance sheets. We are required to provide certain limited and temporary representations and warranties to the investors to whom we sell these loans should the loans default in the first month after sale. In the past three years we have never had a loan default within this time period and have had no losses associated with providing these limited representations and warranties.

Requiring South Coastal Bank and other community banks to hold capital against loans sold into the secondary market would be extremely punitive given the lack of loss history associated with this activity. We respectfully ask that the regulatory agencies retain the current 120 day safe harbor for providing these temporary representations and warranties.

V. Requirement to include unrealized gains and losses on cash flow hedges as a component of regulatory capital

Our holding company, MountainOne, has used plain vanilla cash flow hedges (i.e. interest rate swaps) to manage interest rate risk on its floating rate liabilities. The use of interest rate swaps is a proven, reliable and effective tool for managing interest rate risk, especially given the current interest rate environment.

The unrealized gains or losses on the interest rate swaps are currently excluded from regulatory capital. If we were forced to include the unrealized gains or losses as a component of regulatory capital, it would likely introduce significant volatility into our capital ratios should interest rates change, or the expectation for interest rates change. Should the proposal be enacted, we would have to consider other potentially less-effective methods for managing interest rate risk purely due to the impact the interest rate swaps could have on our capital position.

In conclusion, if the Basel III proposals are passed as drafted, South Coastal Bank, our holding company, our affiliate bank, and other community banks throughout the country will be significantly impacted. Each of the concerns noted above is likely to reduce our calculated capital ratios through a reduction in the instruments that are counted as capital, or through increased risk-weightings on various assets. The anticipated reduction in our capital ratios, combined with the proposed increase certain of the required capital ratios under the proposals, will likely force us to reduce our balance sheet and in turn curtail our lending activities. If we are forced to reduce our balance sheet and curtail our lending activities, we will also likely have to reduce staff. The combination of these results will have a negative impact on the consumers, small businesses and communities we serve, not to mention the ripple effect that will happen as most community banks across the country struggle with similar issues.

South Coastal Bank and its affiliates are committed to a strong capital position and the fulfillment of our mission to provide our customers with outstanding products and exceptional service in a profitable manner while supporting the growth of our employees and the communities we serve. Community banks like ours are the backbone of many communities in the United States and a key component in the local economies. We strongly urge you to consider the impact that the Basel III proposals will have on South Coastal Bank and other community banks and holding companies in this country and consider an exemption from these rules for these institutions.

Thank you for your consideration of our comments.

Very truly yours,

Robert J. Fraser

Robert J. Fraser
President & CEO

CC: Senator John Kerry
Senator Scott Brown
Representative William Keating
Representative Stephen Lynch