MASCOMA
SAVINGS
BANK
Incorporated in and mutually owned since 1899.

October 22, 2012

THE HONORABLE THOMAS CURRY
COMPTROLLER OF THE CURRENCY
OFFICE OF THE COMPTROLLER OF THE CURRENCY
250 E STREET, S.W.
MAIL STOP 2-3
WASHINGTON DC 20219

Re: Basel III Capital Proposals

Dear Comptroller Curry:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently announced by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

Mascoma Savings Bank (Mascoma) is a 113 year old, $1 billion community bank headquartered in Lebanon, New Hampshire, with 250 employees in 18 offices located in west central New Hampshire and east central Vermont. Currently our bank is considered above the well capitalized requirement with a Tier 1 capital ratio approaching 10 percent. Mascoma offers a full range of services to customers of all economic means by offering many types of loan and deposit products suited to their needs.

I would like to make a couple of general comments regarding the pending Basel III proposal. First, it goes without saying that the financial services industry has experienced heavy turbulence during the past five years. In addition to trying to recover financially from this most recent calamity the industry is now dealing with thousands of pages of regulation emanating from Dodd-Frank. To add Basel III into this mix at this time is placing an additional huge regulatory burden on smaller community banks such as Mascoma.

Second, the complexity of the Basel III proposal is enormous. The proposal itself is approximately 800 pages. Reading it is enough to give a rattlesnake a headache! Trying to interpret it is a whole different matter. We have been studying it for a couple of months now and we still don't know in a number of instances if we have made the correct interpretation. After reading it and understanding it (which I doubt is possible and is setting the table for conflicts between the regulators and the banks going forward) a bank will have to be able to access the correct information within its systems. Certain of the information required to properly allocate assets is not easily accessible. It is not because we DON'T have the information; it simply cannot be EASILY ACCESSED.

These two factors are placing extraordinary stress on already overtaxed community banks.

Now to the specific issues concerning Mascoma. As a mutually owned bank Mascoma only has one source of capital and that is the retained earnings of the bank. For this reason, generally speaking, mutuals carry more capital than their publicly owned sister banks. Because of their limited access to capital mutuals need to control their growth so as not to outstrip their earning capacity. The earning capacity and the capital that earnings generate, then, serve as a governor on the growth and risk appetite for a mutual bank.

Like most community banks across the country, our intent is to continue serving our customers and our communities. The introduction of revised capital rules, though commendable for its intent, will alter the way Mascoma conducts business and will have an adverse impact on the customers and the communities that it serves. The imposition of these additional capital requirements could have a significant negative impact on our local economy.

Following are some of our specific concerns with the most recent Basel III proposal:

1. **The revision to the calculation of regulatory capital requiring gains and losses on available for sale securities to flow through regulatory capital.**

   Current regulatory capital measurements exclude the impact of after-tax unrealized gains and losses on available for sale securities. The BASEL III capital proposal would require all after-tax unrealized gains and losses to be recognized in regulatory capital.

   Currently, our bank has a \$195 million AFS investments portfolio with approximately \$3.3 million in after-tax unrealized gains in capital. The purpose of this portfolio is partially to manage liquidity, to generate some income on these funds, and to provide collateral for our sweep account customers, which are a significant funding source for us. In a shocked interest rate environment of "up 300 basis points" the pre-shock unrealized gain of \$3.3 million would become an unrealized after-tax loss of \$8.8 million. This represents a net change in capital of \$12.1 million effectively negating our current earnings stream by 2 full years. Extreme volatility of capital would be the consequence of this proposal in a changing rate environment. Although in the short term in an interest rate environment similar to today, this proposal would serve to increase regulatory capital, this capital position could be reversed very quickly introducing significant volatility to regulatory capital.

   In order to eliminate this capital volatility our bank would most likely:

   - Alter our investment holdings such that lower duration would be the overriding factor in holding an investment. Shortening duration by its very nature provides a much lower yield and thus lower earnings.
   - Significantly change the overall mix of the investment portfolio. Each type of investment class will need to be reviewed to determine their respective reactions to various interest rate swings. A longer term investment would be much more

susceptible to volatile swings in value due to its relationship to longer term rates. It is very likely no long term investments will be considered for the investment portfolio. This would impact earnings as short term investments yield far less than long term investments.

- It is very likely the bank will consider designating all investments in the future as held to maturity. This measure would remove the capital volatility but would have a negative impact on our ability to manage liquidity and interest rate risk.

As a consequence of the adoption of this proposal and a rise in interest rates, our bank may not be in a position to contribute to economic growth. In a rising interest rate environment Mascoma will likely try to improve its declining capital ratios by reducing the size of the balance sheet. The most likely fallout will be the reduction in loan originations thus slowing down economic growth in our market area. All of the bank's business and consumer customers will be affected by reduced access to credit.

It should also be noted that fluctuations in our capital will also affect our lending in that it will alter our legal lending limit. These fluctuations may impact our ability to lend on certain projects, both positively and negatively.

In response to this proposal it is strongly recommended unrealized gains and losses be excluded from the calculation of Common Equity Tier 1 Capital. The impact of interest rates in which the bank has little or no control over would severely penalize the bank's capital position particularly as interest rates rise.

2. **The Risk-Weight revisions to residential mortgage loans in which risk weights for various residential mortgage exposures rise to as high as 200 percent.**

Current regulatory requirements for residential mortgage exposures provide for a 50 percent risk weight for most residential loans. The Basel III proposal is quite complex and includes a number of revisions in an attempt to reflect varying degrees of risk in residential real estate. Under this new proposal the risk weights carry a range of 35 percent up to 200 percent. Loans would need to be classified as either Category 1 or Category 2 loans and would have varying risk weights primarily dependent on loan to value ratios.

Our bank is a leading provider of residential mortgages in our market area. The imposition of higher risk weights for loans carrying higher than 80 percent loan to value ratios would have the unintended consequence of reducing available financing to a number of potential borrowers. As an example for those homebuyers who have less than 20% equity, it will become more expensive for them to obtain a mortgage even though private mortgage insurance is available. The bank would need to seriously reconsider offering this type of financing to its local customers. This may be particularly detrimental to first time homebuyers in our market seeking to obtain credit.

Besides the relative value changes in the risk weightings of individual loans, the assignment of risk weightings to individual loans will create an administrative burden. The proposal requires creating multiple pools of loans based on loan to value ratios and in some cases aggregating secondary or junior liens with existing first lien mortgages. The proposal will require continued re-evaluation of the risk weightings as collateral values change.

This proposal also changes the risk weights of second mortgages or "junior liens". Currently the bank has a portfolio of junior liens identified typically as home equity loans or lines of credit. The current risk weight of 100 percent could in some cases carry a revised risk weight as high as 200 percent dependent on loan to value ratios. Mascoma Savings Bank has provided loans identified as junior liens for many years and has had minimal losses. This proposal could have a significant impact on Mascoma's decision to continue offering this type of financing due to both capital cost and administrative burden.

The residential mortgage provisions within this proposal have the impact of increasing the cost of capital and the overall cost of administering the proposal requirements. Overall, it is likely loan customers will be negatively impacted by higher rates or the inability of not obtaining the loan due to the administrative burden placed on the bank.

3. **The risk weights on certain commercial real estate loans determined as "High Volatility Commercial Real Estate Exposures" being revised from 100 percent to 150 percent.**

Under Basel III certain newly identified loans determined to be "high volatility commercial real estate loans" will be required to carry a higher risk weighting. Each commercial real estate loan will need to be specifically reviewed to determine if it falls within this newly defined pool of loans. This will create a significant administrative burden and most certainly will cost more to originate these loans.

Our bank has originated a large number of commercial real estate loans in our market area. The bank has always followed prudent underwriting guidelines and has been very successful in providing needed financing to our commercial real estate customers. In addition, although there have been minimal losses in the form of charge offs, the bank maintains a loan loss reserve balance and increasing the capital cost seems unnecessary.

The proposal has the likely possibility of curtailing this type of loan financing in our market area. The combination of increased capital cost and administrative burden would cause the bank to seriously consider withdrawal from this type of financing.

4. **The proposal to increase the risk weight on delinquent loans from 100 percent to 150 percent.**

   All of our loans considered delinquent are managed very closely and an appropriate reserve for losses is provided. Imposing higher capital requirements on such loans has an unintended consequence of reducing the incentive to work with borrowers. The proposal will create the incentive to remove such loans from the balance sheet if they reach the 90 day past due period. These particular borrowers would be harmed by this proposal.

   As a result of numbers three and four Mascoma's risk weighted assets will rise by approximately $70 million as our balance sheet stands today. This will have the effect of reducing our Tier 1 capital by 130 basis points and our Total Capital by 140 basis points. Again this will have a negative effect on Mascoma's ability to lend going forward which in turn will have a negative impact on our local economy.

The cumulative impact of the items identified above will have a significant impact on our bank and to most community banks in the country. We strongly urge you to reevaluate the significant impact this proposal will have on community banks throughout the country and consider withdrawing it in its entirety.

Thank you for the opportunity to provide comments and for your consideration.

Sincerely,

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