Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Office of the Comptroller of the Currency
250 E Street, S.W.
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, DC 20429

Re: Basel III Capital Proposals

Ladies & Gentlemen:

Liberty Bank sincerely appreciates the opportunity to express our comments on the recently approved Basel III proposals.

Liberty Bank was chartered in 1825. It is Connecticut's oldest bank and the 8th oldest bank in the United States. We remain a mutually owned institution with assets in excess of $3.5 billion. As a community bank, our forty-four offices provide personal service to consumers and businesses throughout much of Connecticut and several surrounding states.

Like most of our community bank brethren, our earnings and asset quality have been stable and strong for a long period. For example, during the 20 year period from 1992 to present, Liberty Bank posted a median ROA of 1.15%. We did not promote, underwrite or purchase sub-prime or Alt A loans.

While we are in favor of strengthening safeguards in the financial institutions sector and it is our intention to maintain capital at or above the minimum capital requirements, there are several components of the Basel III proposal that we feel may significantly affect our capital structure, our earnings and therefore our ability to provide credit and other services to our customers. These components are listed below.

Residential Mortgage Lending

Liberty Bank is the #9 residential mortgage lender in the state of Connecticut. The Bank originates home equity lines, second mortgage loans and first mortgage loans. These loans may be adjustable or fixed.

The Bank holds adjustable rate loans while it sells the fixed rate loans it originates to Fannie Mae and Freddie Mac in order to provide interest rate risk protection for the Bank's balance sheet. Imposing higher capital standards on specific types of residential mortgage lending may serve to restrict the overall volume of residential mortgage lending to the Bank's customers while at the same time negatively affect the Bank's interest rate risk position.

Gains and Losses on AFS Securities

Liberty Bank has nearly $700 million in high-quality debt securities which are comprised almost entirely of instruments issued by government sponsored enterprises. These high-quality securities represent 20% of the Bank's total assets. The Bank does not invest in corporate bonds or any speculative debt securities.

The Basel III proposal to include gains and losses on available for sale securities in the capital ratio will create tremendous volatility to the Bank's capital even under yield curve fluctuations resulting from normal business cycles. The current yield environment is the lowest it has been since before World War II. The Federal Open Market Committee's actions have and are expected to keep interest rates low for the foreseeable future. Accordingly, a significant negative impact will occur to the Bank's capital when interest rates rise sometime in the next few years if this proposal becomes regulation. Additionally, an unintended consequence of this proposal might be to encourage the Bank to either classify securities as Held to Maturity or maintain a short duration portfolio. In either case, this will impede the Bank's ability to effectively mange its investment portfolio in a manner necessary to address interest rate, liquidity and earnings risk.

Other Items Affecting Other Comprehensive Income

Liberty Bank maintains a defined benefit pension plan for its 600 employees, which has a funded status of 115% under recently enacted MAP21 guidelines. However, the accounting treatment of the Bank's pension plan has resulted in an unfunded pension liability of $32 million which is recorded in Other Comprehensive Income. This unfunded pension liability has been created mostly by the long-lasting, artificially maintained low interest rate environment. These liabilities, and their proposed impact on capital, are subject to significant fluctuations as a result of changes in the yield curve.

Equity Portfolio

The Bank has held a common stock portfolio for decades. This portfolio has been maintained for several reasons. The asset appreciation created by long-term investing in common stocks provides a significant cushion for both tactical and strategic initiatives. For example, Liberty Bank created a private foundation, with no impact to the Bank's earnings, because it was funded with $5.2 million of appreciated common stock. Even more critical, the loan loss expense of $33 million provided from operations during the three years 1990-1992, was funded by roughly the same amount of realized gains from the common stock portfolio during the previous decade.

The number of banks which were grandfathered under FDICIA to hold equity securities is relatively small. It is fair to state that bank failures have occurred due to loan losses and liquidity, not common stock portfolios. Accordingly, we strongly urge you to reconsider the 300% risk-based factor for these investments and keep the previously approved 100% factor.

Summary

The following table summaries our current capital ratios and the estimated affect based on the Basel III and Standardized approaches currently under consideration.

	Current Ratio	Basel III Ratio	Standardized Ratio
Leverage Ratio	14.55%	14.02%	14.02%
Common Equity Tier 1 Capital Ratio	n/a	17.47%	15.31%
Tier 1 Capital Ratio	17.96%	17.47%	15.31%
Total Capital Ratio	19.44%	18.73%	16.41%

To best illustrate the impact on Liberty Bank's capital, the decline of a net 300 basis points between the Current and Standardized Total Capital Ratios is essentially driven by two components of the Basel III proposal. By raising the capital requirement for equity investments, the cost to the Total Capital Ratio is 127 basis points. By including the unfunded pension liability in capital, the cost to the Total Capital Ratio is 95 basis points. Combined, these two items represent 222 basis points, or over 70% of the net capital lost by these proposals.

Liberty Bank is well managed and well capitalized with low non-performing assets. To eliminate 300 basis points of Total Capital from a community bank based upon proposed rules best suited for multi-national, money-center banking conglomerates is unwarranted.

Accordingly, we strongly urge you to reconsider your position on these proposed rules and instead, maintain the current rules, enhance your quarterly trend monitoring and enforce the safety and soundness regulations currently implemented.

Thank you for providing this forum for comment.

Sincerely,

Thomas J. Pastorello
Executive Vice President & Chief Financial Officer