October 11, 2012

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

Dear Sirs:

I am writing to express my dismay over the proposed new capital standards known as Basel III, and to urge the nation's financial regulators to withdraw the current version of this proposed regulation until a number of issues have been addressed. Basel III was drafted utilizing the European banking model for large, multi-national banks. This model has no applicability to the vast majority of banks and savings institutions operating in Ohio and across the United States.

Liberty Savings Bank is a federally charted community savings bank with approximately $600 million in assets. It is headquartered in southwestern Ohio, with branch offices in Colorado serving the metropolitan Denver area, and in Florida serving the Sarasota-Bradenton market. At the end of August, 2012, Liberty's loan portfolio totaled $339 million. As of June 30, 2012, Liberty had a Tier 1 capital ratio of 14.13% and total risk based capital of 25.15%. Liberty already has strong capital levels in place, and if implemented Basel III would impose undue hardships and costs without providing any additional assurance of our company's safety and soundness.

I take exception to a number of issues with the current proposal of Basel III, and have discussed these issues further below.

Issue 1: The standards as proposed are unnecessarily complex and expensive to implement.

The Federal Reserve and other federal regulators have gone on record stating that almost all Ohio banks will meet the new capital standards. Generally, that is Tier 1 capital to risk weighted assets of 6% (up from 4%), a new standard of common equity Tier 1 capital to risk weighted assets of 4.5%, and a capital "buffer" of 2.5% in order to make cash distributions such as dividends and bonuses. If most banks already meet this standard, why force the industry to go to extraordinary expense to validate the new capital levels?

The real burden of implementing Basel III as currently proposed would be in the cost of compliance. The proposal is so complex that ensuring compliance would require significant investment in time and personnel. In fact, the software that we currently use to calculate risk-weighted assets is useless in understanding the impact of the proposed capital regulations, making it difficult to even get thoughtful input from an important sector of banking.

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This proposal is data driven down to the level of individual loans and existing loans are not grandfathered. Since the information required to comply with this proposed regulation was not required or captured at the inception of the loans, Liberty would have to go back, manually, to analyze our portfolio to properly assign risk weighting to each loan. This would be a monumental task, requiring hundreds of hours and great expense.

The proposed regulation would undoubtedly be more difficult and expensive to implement than initially realized by policy makers, but the additional level of safety and soundness would be illusory and simply not worth the additional cost.

As a fallback position, Liberty would request that the new standards apply prospectively only. We can adjust lending practices and pricing in the future to avoid the impact of the punitive risk weights, but we cannot amend loans already made.

Issue 2: Requiring unrealized gains and losses from a bank's available-for-sale investment portfolio will not increase safety and soundness and will in fact introduce increased volatility to bank capital levels.

The Basel III proposal would require unrealized gains and losses from the available-for-sale (AFS) portfolio to flow through to common equity Tier 1. While current standards require unrealized gains and losses to be shown as a part of "accumulated other comprehensive income," it is not included in regulatory capital. This proposal would include those unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate, as opposed to changes in credit risk. Undoubtedly, this requirement would add a significant amount of volatility to capital ratios.

Several consequences emerge as a result of attempting to strategically manage the capital positions assuming this rule is adopted. Liberty would likely trend towards greater use of the held to maturity (HTM) designation. However, this action would limit Liberty's ability to hold a cushion of marketable liquid assets, thereby possibly hindering our liquidity our position. Additionally, the investment portfolio is used heavily as a mechanism to manage Liberty's overall interest rate risk sensitivity, shortening or lengthening duration/cash flows when necessary to affect the balance sheet's global sensitivity. A reclassification into the HTM account would constrain Liberty's ability to influence the interest rate risk position efficiently. Also, if Liberty were to maintain an allocation within the AFS portfolio, we would likely target much shorter durations in order to mute any ancillary effects the portfolio may have on the capital position. This would not only compress the yield naturally achievable by longer duration products (in a steep yield curve environment) but also exacerbate our balance sheets' rate risk sensitivity if we were asset sensitive. One could argue that each of these results is counter-productive to the ultimate goal of creating and preserving capital. Finally, the ancillary effects of this declining demand from all financial institutions for longer duration products, such as municipal bonds, could prove detrimental to small municipalities' ability to efficiently fund themselves.

It can be argued that inclusion of the AFS adjustment within capital is unnecessary. Given the GAAP requirements relating to other then temporary impairment, the capital position should reflect investments in which the initial investment is not expected to

be recovered by way of the permanent impairment recognition process. Apart from that, any residual unrealized gains and losses are transitory by nature. With the passage of time, these instruments will return par given the intent and ability to hold to recovery.

Issue 3: Punitive capital charges on all but standardized "plain vanilla" loans strike at the heart of the community banking model. This would have unintended adverse consequences for the economy and for banking.

The proposals currently create a set of criteria differentiating between Category 1 and 2 loans (with their respective LTV risk weight buckets). One potential capital penalty relates to the following requisite characteristic of a category 1 loan:

"The terms of the mortgage loan provide for regular periodic payments that do not:

a. Result in an increase of the principal balance
b. Allow the borrower to defer repayment of principal of the residential mortgage exposure
c. Result in a balloon payment"

This last item is particularly troublesome as Liberty holds residential mortgage loans that were originated with balloon payment features. However, these loan contracts did not have the other contractual terms listed in items a or b above. We question the applicability, in isolation, of this clause. It seems clear that the intent of this paragraph was to apply a more capital intensive charge to loans commonly referred to as option loans (e.g., Option ARMs). However, these loans exhibit most frequently all three of the characteristics cited above (or at least two of the three). Commonplace within the industry, residential loans exist that only exhibit the balloon payment portion and which are otherwise underwritten with standard loan terms. We would argue that the default/loss profile of these loans has been much lower over the crisis than the loans such as Option ARMs that appear to be the intent of this section.

As such, we would request a more explicit ruling that requires satisfaction of all three of the criteria, or two of the three, listed simultaneously in order to be disqualified as a Category 1 loan. However, if the agencies' conclusion is to leave this portion of the proposal unchanged, we ask for existing loans to be grandfathered as Category 1 and all new originations of balloon loans after the implementation date to be held to this new standard. This will allow for the industry to adjust structure or pricing effectively in light of the higher capital requirement.

Finally, the removal of the exception relating to the 120 day recourse programs on sold 1-4 family loans (liquidating into GSE programs) will have damaging effects on Liberty due to its larger mortgage banking department that routinely sells into secondary markets. We would ask the agencies to consider maintaining the current 120 day grace period exception so as to not disturb the pipeline of residential mortgage credit and the corresponding ancillary effects that would be felt in the housing market.

Issue 4: The proposed regulation would deduct mortgage servicing assets that exceed 10% of an institution's common Tier 1 equity.

The proposal would exclude mortgage servicing assets in excess of 10% of Common Equity Tier 1 (CET 1). Also, deferred tax liabilities, mortgage servicing rights, and investment in the stock of an unconsolidated financial entity could not exceed 15% of CET 1. Worse, the amount of mortgage servicing assets below 10% of CET 1 would be assigned a risk weighting of 100%, but would be phased up to 250% by 2018, adversely impacting capital twice. There is simply no evidence that mortgage servicing rights or deferred tax assets have the inherent risk that would justify this punitive treatment.

As an alternative, we would ask the regulators to consider either 1) grandfathering existing servicing assets, or 2) allowing a greater percentage (for instance 30%) to be included in capital.

Issue 5: A penalty for piling on. Banks would be penalized for working with troubled borrowers.

Currently, when a loan is past due, the additional risk is addressed through ALLL. Under the proposed regulation, these assets would take on a new 150% risk weighting. In essence, this would require a double charge to capital for delinquent loans, which would further undermine workouts and encourage fire sales of troubled assets for less than reasonable market value.

Conclusion

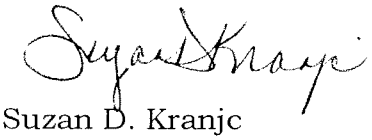
In order to completely appreciate the risk these proposed capital standards pose to community banks, they need to be considered in the context of other costs imposed on banking through new regulations. According to the House Financial Services Committee, there are already 7,365 pages of new regulations that have to be read, understood, and incorporated into day-to-day operations. Together with the Basel III proposal, these requirements could very well make community banking a losing business model and unnecessarily encourage further consolidations of financial institutions.

The current proposal should be withdrawn and resubmitted after recognizing the reality that most banks are operating with risk profiles that do not justify either the additional capital or the large additional expense of tracking assets to the degree required by the proposed standards.

Alternatively, regulators should consider carving out banks that either present very small risk to the financial system, or that have a traditional, straight forward, low risk balance sheet. At the very least, a simplified capital requirement should be developed for such institutions that will not require the extensive and expensive data required under the current proposal. Banks such as Liberty that are not "too big to fail" should be given additional time to phase in any new proposed minimum capital levels due to our restricted access to capital markets.

I would be happy to answer any questions you may have regarding the above, or to discuss the matter further with you. I may be reached at 937-382-1000, ext. 3475.

Sincerely,



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