David W. Nurnberger

October 22, 2012

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

Office of the Comptroller of the Currency
250 E Street, SW
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, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

I am writing to you as a concerned member of the Board of Directors of Naugatuck Savings Bank (NSB) located in Naugatuck, Connecticut.

Thank you for the opportunity to provide comments on the Basel III proposals[1] 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").

Naugatuck Savings Bank (NSB) is a state chartered stock savings bank wholly owned by Nutmeg Financial MHC, a non-stock mutual bank holding company. A 142 year old community bank, NSB has approximately $950 million in assets, 80% of which are comprised of local mortgages and loans. Our assets are funded primarily with local deposit dollars of which today we hold about $760 million. The bank serves approximately 30,000 households and small businesses in Connecticut through the operation of its eighteen banking offices in New Haven

[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.*

and Litchfield counties. The bank has never been a threat to the insurance fund. The Board and current management can attest to the fact that for over 50 years the bank has been profitable each and every year. In all that time the consistently profitable operations of NSB have enabled the bank to build capital through retained earnings. This capital growth has allowed the bank to grow assets at 6 to 8 percent each year while remaining well capitalized through many economic cycles and interest rate environments, a fact further documented by the consistently good CAMELS ratings it has achieved in each and every safety and soundness examination.

Basel III as proposed will significantly reduce our regulatory capital, as the following chart illustrates. This will force management and our board to make many difficult strategic decisions regarding long range growth plans, investment portfolio asset mix and portfolio duration, contributions to our foundation, and the level of employee benefits. All of these decisions will have a negative long-term impact on our customers, employees and the economic well-being of the communities we serve.

Summary Estimates for Fully Phased-in Proposals (as of 2022) - Comparisons			
Dollar Amount (000)	**Current Rules**	**Basel III Rules Only**	**Basel III and Standardized**
Common Equity Tier 1 Capital	n/a	$81,907	$81,907
Tier 1 Capital	$96,287	$81,907	$81,907
Tier 2 Capital	$9,559	$8,778	$8,778
Total Capital	$105,846	$90,685	$90,685
Risk-Weighted Assets	$701,199	$685,099	$738,071
Average Assets	$942,742	$951,427	$951,427
Regulatory Ratios	**Current Rules**	**Basel III Rules Only**	**Basel III & Standardized**
Leverage Ratio	10.21%	8.61%	8.61%
Common Equity Tier 1 Capital Ratio	n/a	11.96%	11.10%
Tier 1 Capital Ratio	13.73%	11.96%	11.10%
Total Capital Ratio	15.10%	13.24%	12.29%

Our bank has three particular areas of immediate concern as a result of the implementation of Basel III as proposed. They are the following:

1.) The effect on capital due to the fact that we have made excess contributions beyond the minimum required into our defined benefit pension plan.

2.) As a mutual bank, the conversion issue aside, our limited ability to raise capital other than through additions to retained earnings.

3.) The negative effect on the bank's risk weighted capital ratio due to the proposed increased risk weighting on investments in equities.

With these concerns in mind, there are three recommendations that we would like to make:

1-Eliminate from Basel III the inclusion of the Pension and Retiree Health Benefit Accumulated Other Comprehensive Income (AOCI) in CET1.

Two arguments can be made to eliminate this provision from Basel III, first is that the Pension AOCI is truly just a prepaid asset recorded as a debit in capital. Based on correspondence with the bank's public accounting firm FASB's intent in issuing Accounting Standards Codification (ASC) 715, *Compensation Retirement Benefits* was to reduce income statement volatility caused by the considerable discretion an employer can exercise in funding pension plans and the explicit assumptions that go into the calculation of the projected benefit obligation. The FASB's concern about volatility resulted in delayed recognition or "smoothing" of amounts recognized over time in the income statement. Recording these amounts in AOCI is very similar to the recording of a prepaid asset – only the "asset" is recorded as a negative equity amount, not an asset. Similar to a prepaid asset, these unrecognized dollars are amortized out of AOCI over a period of many years. Clearly, prepaid expenses should never be deducted from regulatory capital.

The second argument is based on the FDIC's concern that the pension assets are not available to the agency in a receivership. In discussions with our investment bankers this is not true. Their opinion is that in a receivership the claims of the FDIC would be senior to those of the beneficiaries of underfunded defined benefit pension plans, who would have the status of unsecured general creditors of a bank sponsor. In short, the inclusion in regulatory capital of pension assets and liabilities of U.S. banks recognized in AOCI would achieve nothing but the introduction of unnecessary and counterproductive capital volatility that would in no way further protect the insurance fund or taxpayers in the event of a receivership.

2-Provide mutual savings institutions with the ability to raise capital without converting to a publicly traded company by eliminating from Basel III the phasing out of Trust Preferred Securities as Capital Instruments. An alternative is outlined in a bill sponsored by Representative Grimm, H.R. 4217 the Mutual Community Bank Competitive Equality Act, which provides for, among other things authorizing mutual institutions to issue mutual investment certificates which would be eligible for inclusion as Tier 1 capital.

The bank is a member of America's Mutual Banks (AMB) and we support their comment letter sent by Chairman Martin Neat. Their letter provides a detailed recommendation of why the agencies should consider the issuance of capital certificates for mutual savings banks. Please consider all the recommendations outlined in AMB's comment letter.

3-Maintain the 100% risk rating on all equity investments.

In Connecticut, mutual savings banks have the ability to invest in equities. The Bank has had this investment option for decades and has used it effectively to enhance earnings through the benefit of the "dividend received deduction". Much of this investment has been in preferred stocks or preferred ETF's.

We have also, through prudent investment over time been able to donate appreciated equities to the Naugatuck Savings Bank Foundation. As a result, the Naugatuck Savings Bank Foundation has a value today of nearly $7 million supporting significant charitable giving in our local community. Basel III, as it stands for banks like ours, will require a 300% risk weighting for such investments in excess of 10% of capital, even higher than that required for construction and development loans and junk bonds. In our opinion this makes these investments virtually unreasonable to hold and removes a tool we have used to efficiently fund our foundation.

The implementation of Basel III as proposed would significantly and negatively alter the way Naugatuck Savings Bank operates. For the sake of our customers, employees and community, we ask that you consider these recommendations seriously. Thank you for your time and consideration.

Sincerely,

David W. Nurnberger
Director
Naugatuck Savings Bank

cc: M. Yanarella, Chairman & CEO
C. Boulier, President