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October 22, 2012

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
regs.comments@federalreserve.gov
Docket R-1430 and R-1442; RIN No. 7100-AD 87

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
regs.comments@occ.treas.gov
Docket ID OCC-2012-0008 and OCC-2012-0009; RIN 1557-AD46

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429
comments@fdic.gov
RIN 3064-AD95 and RIN 3064-AD96

Re: Basel III Capital Proposals

Dear Sirs and Madam:

I am the President & CEO of Avidia Bank in Hudson, Massachusetts which is a $1.1 billion state chartered savings bank and appreciate the opportunity to provide comments on the Basel III proposals.

General Comments

I strongly believe that the Proposals are far-reaching and needlessly complex and, if adopted, will have a wide range of negative implications on consumers, small businesses and the banking industry in general and specifically Avidia Bank. In addition to being extraordinarily complex and presenting numerous operational and compliance challenges to the industry, the Proposals remove regulatory discretion and expertise from the safety and soundness examination process. US banking regulators already have broad authority to impose bank-specific capital requirements on depository institutions through the existing prompt corrective action process and have far greater knowledge of local and regional economic conditions on which to base their regulatory decisions. I would recommend placing more emphasis on qualitative measures of risk as monitored by bank management and experienced regulators instead of a punitive, one-size-fits-all model that applies to both the largest, most complex institutions in the world as well as local community institutions with generally conservative balance sheets that pose little risk to the global economy.

Avidia Bank has a relatively simple and conservative balance sheet and did not engage in the risky lending and investment practices that caused the financial crisis. We have been serving Hudson and the surrounding communities since 1869. These institutions generally do not utilize complex derivatives or engage in substantial off-balance sheet transactions – we are a traditional residential and commercial lender regulated by both the Commonwealth of Massachusetts and the FDIC.

It appears that there is a needless urgency at the regulatory agencies to finalize and implement the Proposals as quickly as possible – without a comprehensive study of the broad impact they will have on the industry. For example, while the proposals have been available since July, an estimation tool was only recently made available. I believe the Proposals should be withdrawn in order to take more time to study the potential impact and that the regulatory agencies should then analyze those impacts under a variety of market circumstances, such as an increase in interest rates.

If the agencies decide to move forward with the Proposals, I would recommend that the final rules should exempt community and regional banks.This proposal will impose significant new regulatory and financial burdens on the small businesses and consumers these institutions serve in their local communities.

Basel III: Risk Based and Leveraged Capital Requirements

- **Increases in Regulatory Capital**

As stated above, I support a banking system with robust capital levels and recognizes that regulatory expectations for minimum capital levels have changed in the wake of the financial crisis. But I feel the complexity of the proposed risk-weighting rules, which will have a significant impact on my bank, precludes the regulators from obtaining accurate data on the industry through the current call reports. A more thorough data collection project should be undertaken in this area if policymakers are to truly understand the affect the proposed risk-weighting rules will have on the industry and the overall economy.

- **Inclusion of AOCI in Calculating Tier 1 Capital**

The proposed rule mandates that banks include Accumulated Other Comprehensive Income (AOCI) in calculating Tier 1 capital. The primary driver of AOCI (or loss) for most institutions is unrealized gains and losses in the available-for-sale securities portfolio. The inclusion of unrealized gains and losses on these securities in determining Tier 1 capital has the potential to substantially increase the volatility of Tier 1 capital and artificially distort the bank's regulatory capital ratios, particularly during periods of rising and falling interest rates. In the case of Avidia bank the impact to capital of a 400bp shock to rates would be approximately $20 million which would significantly hamper our on-going ability to grow and lend. And all of that impact would be from securities that we plan on holding until maturity and have an average life of less than five years.

Adoption of this provision would have several effects on institutions holding bond and equity portfolios, including forcing banks to avoid market changes by shortening the maturity of their portfolio, resulting in lower yields and earnings and reclassifying bonds and equities from "available for sale" to "held to maturity", lessening the ability of an institution to effectively manage their bond portfolio. In addition, the proposed risk rating of 300 percent on all equity securities is extraordinarily punitive, since losses on a security cannot exceed 100 percent of book value.

While larger institutions may hedge the impact of interest rate changes on AOCI, community banks are unable to do so and in a rising interest rate environment, including unrealized gains and losses in determining capital would negatively impact the ability of banks to contribute to economic recovery. The final rule should allow institutions to continue to exclude AOCI from capital measures as they are currently required to do today.

- **Limitation on Inclusion of Allowance for Loan and Lease Losses in Regulatory Capital**

There are various provisions in the Proposals that would force institutions to "double-count" risk elements on bank balance sheets. I believe that if these provisions are adopted, the final rule should also eliminate the current arbitrary regulatory limitation on the amount of an institution's Allowance for Loan and Lease Losses (ALLL) that is includable in its capital, which is currently set at the amount equal to 1.25% of total risk-weighted assets. Banks should be encouraged to build reserves during good economic times and removing this restriction would encourage institutions to fund their ALLL.

- **Limitation on Value of Mortgage Servicing Assets**

Under the proposed rule, institutions are required to deduct all mortgage servicing assets (net of deferred tax liabilities) that exceed 10% of its common equity Tier 1. In addition, the amount that is below the 10% threshold will receive a 100% risk weight, increasing to 250% beginning in 2018. Current rules already impose a 10% haircut on the fair market value of readily marketable mortgage servicing assets that are included in regulatory capital. Imposing this new requirement will even further impact U.S. banks beyond the current 10% requirement.

Avidia Bank sells mortgage loans they originate to third parties while retaining the right to service the loan. This practice is particularly prevalent in the current interest rate environment, where banks are unable to hold substantial amounts of fixed-rate mortgages on their balance sheets because of the inherent interest rate risk. Retaining the servicing of these loans provides the bank with a future income stream as well as a continued interface with the borrower.

The deduction of mortgage servicing assets combined with the punitive risk weight could severely impact some community banks, perhaps even lowering their capital levels below well capitalized status.Based on this proposed capital treatment, some banks may choose to exit the mortgage servicing business impacting long standing customer relationships and reducing fee income. In effect, this turns the mortgage business over to the very non-bank lenders that created the crisis and are not subject to these new capital standards.

I believe that the final rule should not include any deduction from capital for mortgage servicing rights. If the regulatory agencies decide to move forward with any changes to the capital rules in this area however, any existing mortgage servicing assets should at the very least be grandfathered. It is unfair to penalize banks with long standing mortgage servicing assets as a result of the Basel Committee's model which has few community banks and residential lenders. In addition, the agencies should allow banks to include 100% of the fair market value of readily marketable mortgage servicing assets to reduce the impact of the proposal.

<u>Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements</u>

- **Substantial Increase in the Risk Weighted Asset Amount for Residential Mortgages**

The regulators are proposing new methodologies for risk weighting mortgages that are heavily dependent on data and will likely result in a substantial increase in risk weights – in some cases up to 200 percent. These new risk-weight formulas apply to both new mortgages as well as existing loans that are currently in banks' portfolios that were underwritten to comply with existing capital standards. Since Massachusetts and New England are home to a large number of banks that specialize in residential lending, the proposed risk weights will have a disproportionate impact on a significant number of Community banks in New England.

The proposed rules rely heavily on loan-to-value (LTV) measures and appraisals in determining the risk-weighting for residential mortgage exposures. Under the proposal, only the highest quality mortgage loans with low loan-to-value ratios and strongest credit characteristics will qualify for the lowest risk weighting (Category I). Many other well-underwritten loans will now be subject to sometimes substantially higher risk-weightings, with loans in Category 2 with LTVs higher than 90 percent subject to a 200 percent risk-weighting – double the risk-weight for unsecured consumer loans.

It is unclear how the regulators can propose that any category of residential mortgage loan, which are secured by real property, could present twice as much risk to a bank than an unsecured consumer loan. I believe that the highest risk-weighting that should be applied to a residential mortgage exposure is 100%.

The proposal significantly increases capital costs for portfolio lenders, and disadvantages insured banks compared to non-bank mortgage lenders and credit unions that are not subject to these requirements. In particular, we believe these new capital requirements will have a chilling effect on the availability of credit to first-time homebuyers and low-and moderate-income borrowers with less than perfect credit histories. Banks that had previously placed loans to these populations that did not fit the secondary market guidelines in their portfolios will be forced to curtail this type of lending in the future or increase the costs of providing credit to these borrowers.

For example, for well underwritten, fully documented first mortgages, with no balloon payments, no negative amortization, and with prescribed interest rate caps if the loan is an ARM, the capital risk weight will increase from 50% to 75% if the LTV ratio is above 80% and the risk weight will increase to 100% if the LTV is above 90%. Therefore the current capital charge will double on a loan made to a first time home buyer who puts 5% down in cash and has mortgage insurance to cover the rest of the loan, since under the Proposal, mortgage insurance will no longer be considered when determining the loan-to-value ratio. This will also adversely affect minorities and other disadvantaged consumers who have difficulty making large down payments, particularly in a high-cost state such as Massachusetts.

For second liens, home equity lines of credit, and first mortgages that do not meet the requirements noted above (for example because the loan has a balloon feature), the risk weight for the loan will increase even more dramatically. For example, the risk weight for a home equity line would be 200% if the combined LTV (based on the amount of the first loan plus the total amount of the line, whether drawn or not) exceeds 90%.

With the ongoing rulemakings regarding the definition of Qualified Mortgage (QM) and Qualified Residential Mortgage (QRM), I would suggest that the agencies wait to finalize these provisions of the rule until final QM and QRM rules are issued. In addition, the Consumer Financial Protection Bureau (CFPB) has a number of open rulemaking proceedings that will have a significant impact on the mortgage process. Further study and coordination of rulemaking activities in this area is essential to ensuring that banks are not faced with conflicting requirements from the consumer protection and safety and soundness regulations.

As I have detailed above, the proposed risk-weighting of residential mortgage exposures is the most problematic change in the Proposal. I believe the proposed changes could have a tremendously negative impact on consumers and that the proposed risk weightings are inappropriate with their reliance on LTV ratios.

At a minimum, any final rule should grandfather all existing mortgage exposures by assigning them risk weights as required under the current general risk-based capital requirements. Grandfathering such mortgages is appropriate, since aggregating and analyzing the data to calculate the risk weights will be extremely burdensome, particularly for existing loans or in cases where the institution merged or purchased another bank.

Additionally, given the substantial increase in capital that would be required for such existing category 2 mortgages, which may constitute a substantial amount of assets on an institution's balance sheet, the retroactive impact of the proposed treatment would be especially punitive. Given that the Basel III NPR is already substantially increasing required minimum capital, the need for retroactive application of the new standards is significantly attenuated

Conclusion

As I have stated in the comments above, I believe that the Proposals have a variety of fundamental problems and that they should be withdrawn. The Proposals require substantial modification, and we believe additional studies are required in order to develop the most appropriate modifications to the capital framework.

I question whether the agencies fully understand the impact of the Proposals on the industry and the nation's economy. Many of the data points required to conduct a thorough analysis are not available on the current Call Reports and it does not appear the agencies conducted any data collection or industry-wide analysis prior to issuing the Proposals. Although many aspects of the Proposals are phased-in over a number of years, there is still a significant risk in finalizing sweeping changes to the way that institutions calculate their capital and risk-weighted assets and the capital ratios they are required to maintain. Once finalized, there will be little opportunity to revise the rules once their impact is more broadly understood.

Additionally, from a competitive standpoint, banks will be forced to comply with these new requirements while some of their largest competitors, the credit union industry, will be exempt. This exemption, in conjunction with the credit union industry's tax exemption, will further enhance their competitive advantage over the community banking industry. If finalized, the Proposals should apply to all depository institutions to ensure a level playing field.

Thank you again for the opportunity to comment on the Proposals. I respectfully ask that you consider our recommendations in developing final rules. If you have any questions or need additional information, please contact me at (978)567-3541 or m.oconnell@avidiabank.com

Sincerely,

Mark R. O'Connell
President & CEO