19 October 2012

Jennifer J. Johnson, Secretary,
Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue, N.W.,
Washington, D.C. 20551
Delivered via email: regs.comments@federalreserve.gov
Docket No. R–1430; RIN No. 7100–AD87
Docket No. R–1442; RIN No. 7100–AD87

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219
Delivered via email: regs.comments@occ.treas.gov
Docket ID OCC-2012-0008
Docket ID OCC-2012-0009

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Delivered via email: comments@fdic.gov

Ladies and Gentlemen:

Thank you for the opportunity to provide comments on the Basel III proposals that were recently approved by the agencies. First Federal of Lakewood is a $1.35 billion, federally chartered mutual thrift established in 1935. We currently have eighteen branches in Northeast Ohio and seven loan production offices throughout the state. As of June 30, 2012, First Federal had Tier 1 Leverage Capital of 10.56% and Total Risk Based Capital of 17.45%. First Federal of Lakewood has long been a leading provider of prudent, affordable residential mortgages in Northeast Ohio. First Federal services over 12,000 mortgages, and, since the onset of the credit crisis, has experienced less than 175 foreclosures while effecting over 300 successful workouts. Our customers turn to us for safe lending terms and fairly priced deposit products. They also know that we will work with them patiently should they experience a disrupting life event such as job loss, death of a family member, or divorce.

We are in favor of the concept of strong capital and loss absorption safeguards throughout the entire financial sector, applied equally to all institutions engaged in banking or bank-like activities, including credit unions. First Federal has historically held capital well in excess of minimum required amounts and its business plans call for the same into the future.

First Federal agrees with the positions and analysis that the American Bankers Association and other community banks have taken on the impact and costs associated with implementing these rules. In addition to those positions, the Basel III framework is troubling for mutual thrifts like First Federal of Lakewood. Our primary source of capital is from retained earnings. We control our capital ratios through prudent balance sheet management. Mutual institutions, as a whole, had little to do with recent banking problems which were, in fact, driven by the misuse of subprime loans made outside of the banking system and securitized by large investment and commercial banks and their subsidiary lenders. First Federal, on the other hand, originates and services loans to customers in its local communities and understands directly the risks associated to lending to them. The direct impact to community-based mutuals like First Federal is outlined below.

A major area of concern is that the proposed rules will provide extreme short-term volatility in the calculation of capital ratios, which First Federal manages precisely over a long-term planning horizon. For example:

- First Federal currently has $180MM in AFS (available for sale) securities with gains and losses that can vary widely as interest rates change. Under the proposed Basel III scheme as it applies to AFS calculation as a part of Accumulated other Comprehensive Income, a 300bp change in rates could impact our Tier I capital by 20 to 100bps in either direction.
- Such changes would force us to label these securities as Held to Maturity, thereby reducing First Federal's liquidity or its ability to convert these securities into loans as market conditions warrant.
- First Federal might avoid market swings by shortening the maturity of the investment portfolio which would result in lower yields and earnings.

Another area of concern is that the proposed Basel III rules place severe restrictions on residential lending. Mortgage and home equity loans are held on our books and make up more than 70% of our asset mix. Under the proposed rules, First Federal's risk based capital would fall by several hundred basis points (to under 14%) due to the punitive effects associated with the risk weighting of mortgages by loan-to-value. First Federal's excellent residential historical loss experience has shown that capacity to pay and employment stability are more reliable predictors of default than LTV. Prudent lenders should be encouraged to make loans based on fundamental underwriting standards, not variable measures like collateral value. Recent regulatory emphasis continues to be on borrower capacity, not collateral value in evaluating risk.

In fact, Basel II previously introduced the concept of expected loss given default in setting loss ratios. Most banks have set their loss factors based on previously introduced concepts tied directly to the probability of default and loss given default and have set aside reserves accordingly. Expected losses should be managed through a rigorous loan loss methodology.

More troublingly is the rules impact on our communities. First Federal is concerned that rules tied to LTV will restrict access to credit in many center cities and inner suburbs in Northeast Ohio, areas that have many first time and low to moderate income buyers. These buyers often have excellent capacity and repayment prospects but have purchased or are refinancing homes whose values have declined over the past several years. Basel III will delay and set back the increase in home values in our most vulnerable communities. Such LTV rules will also inhibit first time home buyers from otherwise acquiring mortgages written with adequate borrower capacity and full documentation as safeguards.

First Federal also believes that a risk rate of 150% on delinquent loans is redundant since the residual risk of loss is thoroughly accounted for through existing allowance and impairment methodologies. Community banks, through their prudential regulators and external auditors, are held to high standards in this area and are criticized if allowances or methodologies are weak related to recognition of accurate impairment of non-performing loans. Basel III's placing of additional capital reserves beyond the current impairment methodology will force First Federal, which has an excellent work-out record, into taking more aggressive foreclosure action on loans that are more than 90 days past due. Such rules will eliminate our willingness to work with a borrower to remediate the issues and, hopefully, allow them to stay in their home. We are concerned that, under the proposed rule, working out a borrower may ultimately be an unsafe and unsound practice given the higher risk based capital requirement. In short, this redundancy is unnecessary and excessive.

Finally, First Federal believes that these proposed rules will have a devastating cumulative effect on our community. Northeast Ohio has seen rapid banking consolidation and it is only thrifts, like First Federal, that are providing fair, diverse and dependable residential lending with servicing retained in our market. The Basel III scheme will limit products offered to our local market, will slow any housing recovery, and will result in foreclosures that might otherwise be prevented.

First Federal of Lakewood asks that risk-based capital rules related to loan to value on one to four family mortgages and gains in losses on AFS in calculating capital be removed from the proposed Basel III framework. Eliminating such rules or exempting community banks from the rules would allow mutuals, like First Federal, to continue to serve safely our communities and strengthen our local housing markets.

Thank you for your consideration.

Sincerely,

Sincerely yours,

Ronald W. Dees
Chairman of the Board

W. Charles Geiger
Director

Gary R. Fix
Director

William C. Huffman
Director

Thomas J. Fraser
Director