



October 18, 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:

Thank you for the opportunity to provide comment again on the Basel III proposals<sup>1</sup> 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”). Please accept this letter as a supplement to my previous comment letter dated September 19, 2012.

I am President of Berkshire Financial Services (BFS) a \$363 million Mutual Holding Company. BFS owns Lee Bank, a \$275 million community bank located in Lee, MA, and Freedom National Bank, an \$87 million community bank headquartered in Greenville, RI. Both banks are integral to the local economies and focus on meeting the needs of small businesses and families and individuals in our combined 6 locations. As bank consolidation continues, small businesses and consumers increasingly turn to local community banks to meet their needs. The Basel III proposals, coupled with additional burdens placed on community banks by the Dodd Frank bill, continue to threaten the existence of community banks.

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<sup>1</sup> 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.*

As written, the proposed Basel III rules that pertain to all banks, regardless of size and scope of operations, are not appropriate for small community banks. While I am supportive of higher minimum capital levels than those that exist today, the one size fits all approach is the greatest threat to community banking. As a result, I am opposed to the Basel III proposal as drafted.

Specifically, I am opposed to the following proposals.

- Treatment of Unrealized Gains and Losses on AFS Securities

The new BASEL III rule, as proposed, will require that all unrealized gains and losses on available for sale securities (AFS) flow through the common equity tier 1 capital. As a result, this new rule introduces, in our opinion, an unwarranted element of volatility into the regulatory capital framework - an element which, depending on movement in interest rates, may be substantial and result in less than desirable actions.

Like many community banks, our AFS portfolio consists largely of high-quality U.S. Agency and GSE-issued MBS securities, which carry little credit risk. At present, our portfolio has a net unrealized gain of just over \$0.4 million; but a recent analysis of our portfolio indicates that, in a +300 basis point scenario, this gain would evaporate into an unrealized loss of nearly \$1.9 million. Historically, our bank has held all of its bond investments through maturity, and has never recognized any investment-related loss of capital. This component of the BASEL III proposal would effectively force our bank to treat such a market swing as "lost" capital, and compensate by either reducing its balance sheet, restricting its lending activities, or both. Presumably, a rising interest rate environment would be indicative of economic expansion, where community lending needs would be greater and growth opportunities for our bank more prevalent; but under this aspect of the proposal, banks may be forced to react in a manner that would serve to undermine that expansion.

Along a similar vein, the capital volatility introduced by the movement of interest rates could also have a negative impact on our bank's legal lending limit; and consequently, availability of credit to both consumer and business borrowers. As many community banks do, we have customers who borrow close to our current legal lending limit. Under this proposal, a significant drop in capital caused exclusively by rising rates could effectively lower our legal lending limit and make us vulnerable to losing customers to larger institutions. Loss of significant business relationships under this circumstance would hamper the bank's ability to strengthen capital through normal earnings.

Likewise, in order to limit exposure to this type of capital fluctuation, the bank would likely have to maintain a short-duration investment portfolio and forego reasonable opportunities to improve yield and earnings through longer-term securities.

As an alternative, I believe the current treatment regarding unrealized gains and losses on AFS securities is appropriate.

- Risk Weighting for First Mortgages with Junior Liens in Place

The proposal would increase the risk weighting of first mortgages where the same lender has a junior lien in place on the same property. In most cases, the risk weighting would increase from 50% to 100%. There is no basis for this change. In fact, an increase in the risk weighting would be particularly harmful to community banks like ours. Often times, our banks provide mortgages to borrowers who do not meet secondary market standards for a variety of reasons and keep these loans as “portfolio” loans. By increasing the risk weighting on these loans, the proposed capital rules would inhibit the growth of community banks by requiring higher capital. As well, the higher capital requirements would reduce the flow of credit for home purchases by community banks.

In closing, I again request that the regulatory agencies re-consider the one size fits all approach and the impact of such on community banks like ours.

Sincerely,

A handwritten signature in black ink, appearing to read "David J. Bruce". The signature is fluid and cursive, with a prominent loop at the beginning and a long, sweeping tail.

David J. Bruce  
President