Putnam Bank

October 9, 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 appreciate the opportunity which has been afforded to provide comment on the Basel III proposals recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Putnam Bank and all community banks should continue to be permitted to adhere to the current Basel I framework for computing their capital requirements. I firmly believe that Basel III was designed to apply exclusively to the largest, internationally-active, banks. It has never been a practice for community banks, like mine, to engage in the highly leveraged activities. Recent history clearly demonstrates that the severely depleted capital levels of the largest banks created panic in the financial markets attributed to their speculative business practices.

We operate on a relationship-based business model that is specifically designed to serve customers in our communities on a long-term basis. This model contributes to the success of community banks all over the United States through practical, common sense approaches to managing risk. The largest banks operate purely on transaction volume with little regard to the customer relationship. This difference in banking models demonstrates the need to place tougher capital standards exclusively on the largest banks to better manage the ability to absorb losses.

The suggested inclusion of Accumulated Other Comprehensive Income (AOCI) in capital for community banks will simply serve to increase volatility in regulatory capital balances and could rapidly deplete capital levels under certain economic conditions. AOCI represents unrealized gains and losses on investment securities held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. Recently, both short-term and long-term interest rates have fallen to historic lows generating unprecedented unrealized gains for most investment securities. Recently, demand for many implicitly and explicitly government-guaranteed securities has risen due to a flight to safety and government intervention in the capital markets. This increased demand has caused credit spreads to tighten, further increasing bond valuations. Interest rates have fallen to levels that are unsustainable long-term once an economic recovery accelerates. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become negative. This decline will have a direct, immediate impact on common equity, Tier 1, and total capital as the unrealized losses will reduce capital balances. At my bank, for instance, if interest rates increased by 300 basis points, my bank's bond portfolio would show a paper loss of $4.441 million. This would reduce my bank's Tier 1 ratio from 8.24% to 7.03%.

Large financial institutions have the ability to mitigate the risks of capital volatility by entering into qualifying hedge accounting relationships for financial accounting purposes with the use of interest rate derivatives like interest rate swap, option, and futures contracts. We simply don't have the knowledge or expertise to engage in these transactions and manage their associated risks, costs, and barriers to entry, nor I suspect, could we adopt and manage the necessary policies to do so that would be acceptable to our primary regulator. Community banks should continue to exclude AOCI from capital measures as they are currently required to do today.

Implementation of the capital conservation buffers for community banks will be difficult to achieve under the proposal and, therefore, should not be implemented. We will need to build additional capital balances to meet the minimum capital requirements with the buffers in place. We simply don't have ready access to capital. Due to the current historically low interest rate environment, Putnam Bank has diminished earning capacity, further hampering our ability to grow capital. If the regulators are unwilling to exempt community banks from the capital conservation buffers, additional time should be allotted (at least five years beyond 2019) in order for those banks that need the additional capital to retain and accumulate earnings accordingly.

The proposed risk weight framework under Basel III is too complicated and will be an onerous regulatory burden that will penalize Putnam Bank, in particular, and community banks thereby generally jeopardizing the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will deprive our customers of many financing options for residential property. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in their asset liability management. Community banks will be forced to originate only 15- or 30-year mortgages with durations that will make their balance sheets more sensitive to changes in long-term interest rates. Second liens will either become more expensive for borrowers or disappear altogether as banks will choose not to allocate additional capital to these balance sheet exposures. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans. Furthermore, community banks will be forced to make significant software upgrades and incur other operational costs to track mortgage loan-to-value ratios in order to determine the proper risk weight categories for mortgages.

Penalizing the existing mortgage servicing assets under the proposal is unreasonable for those of us with material portfolios of mortgage servicing rights. Any mortgage servicing rights existing on community bank balance sheets should be allowed to continue to follow the current risk weight and deduction methodologies.

I do appreciate the opportunity to make this comment on behalf of my bank and can only hope that it is considered. It's pretty clear who caused the recent near meltdown of the financial system and it was not the community banks. It just seems that at every corner the community banks are asked to pay the price for the greed and malfeasance of the large institutions. Implementation of these proposals will serve no greater purpose but rather will continue to erode the ability of community banks to survive with a greater dependence on the remaining large institutions, causing greater risk of systemic instability to our economy in the long run.

Very truly yours,

Thomas A. Borner
President and CEO