John H. Tobin, DMan, MPH
189 Hunters Ridge Road,
Southbury, Connecticut 06488
johntobin90@gmail.com

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

Dear Madam Secretary:

I recently retired after a nearly 40 year career in hospital management, 23 of those as CEO of a not-for-profit community hospital. Throughout my career I also worked, in one voluntary capacity or another, with a variety of not-for-profit community service organizations, the local United Way, the Chamber of Commerce in our region, the local economic development agency and others. I am also proud to serve as a director of a very fine community mutual bank, the Naugatuck Savings Bank headquartered in Naugatuck, Connecticut.

My experience has given me an acute appreciation for the importance of community institutions, not only for the services they provide directly, but also for their importance as employers and drivers of economic activity, and for the essential role they play in community philanthropies and the development of community pride, purpose and cohesion. I am writing, therefore, not just as a director of a community bank, but as a concerned citizen, to respectfully request that your agency not impose the Basel III global banking regulatory framework on our bank and thousands like it across the country. The Basel III framework was never intended for small and mid sized community banks, and the new requirements will increase the cost of capital and drive the cost of regulatory compliance to potentially unaffordable levels. As you surely know, experts have predicted that these unnecessary burdens on smaller banks will force as many as 2000 community banks out of business altogether.

Our Chief Executive Officer has already sent you a detailed analysis of the impact the Basel III framework will have on our organization. I will not attempt to repeat that analysis here, but have attached a copy for your reference. The most significant impacts will be on our capital position as a result of a well funded pension plan—certainly a surprise and an unintended consequence--and other restrictions on regulatory capital in a mutual bank, which can only build capital through retained earnings from operations and investments. Our concerns are for the long term impact and the unintended consequences of regulation, not only Basel III, but the complex Dodd-Frank legislation for which regulations remain substantially incomplete.

Naugatuck Savings Bank offers a wide of financial services, but our main business is and has been mortgage lending to single home buyers and loans and other services to small businesses—exactly the services which are critical to any hope of economic recovery. Because of our close working relationships with our customers and our intimate knowledge of our communities, and our stake in their economic success, Naugatuck Savings Bank has the will and expertise to help sustain struggling companies through difficult times and help new and growing companies as the economy recovers. As a well managed and consistently profitable institution, our bank has also been able to commit a portion of its retained earnings to the funding of a community foundation that has benefited scores of community service programs. Throughout its history, our bank has conducted itself in accordance to the highest standards of banking practice and ethics.

Government agencies should be encouraging and supporting community banking, not imposing punitive regulation, which, in this case, is likely to have negative consequences for our employees, customers and our community at large. As a citizen and taxpayer, I understand the importance of the thoughtful regulation of our financial system, and I also appreciate the benefit to both regulatory agencies and regulated organizations of consistent rules and standards across an industry. However, this is certainly a situation in which a one size fits all approach is totally inappropriate. As you approach a decision in this matter, I hope you will consider the famous injunction of the Hippocratic Oath: "First, do no harm."

Very truly yours,

John H. Tobin

NAUGATUCK SAVINGS BANK
Experience the Difference

October 12, 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 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 and Litchfield counties. The bank has never been a threat to the insurance fund. 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.

[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.*

251 Church Street • Naugatuck, CT 06770 • 203.729.4442 • 877.729.4442

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,

Mark Yanarella
Chairman & CEO

Charles Boulier
President

AMERICA'S MUTUAL BANKS
701 8TH STREET NW SUITE 700. WASHINGTON, D.C. 20001

2012 International Year of Cooperatives

October 22, 2012

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bernanke, Comptroller Curry and Acting Chairman Gruenberg:

America's Mutual Banks ("AMB") welcomes the opportunity to comment on the joint proposed rules released on June 7, 2012 by the Federal Reserve Board (the "FRB"), the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation intended to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision (the "Basel III Proposals"). AMB is an unincorporated association whose membership consists of banking institutions organized under the mutual form of ownership. AMB's membership consists entirely of community based institutions dedicated to serving their communities and fostering the economic growth of those communities. Community based, mutual form institutions are a historically vital part of the fabric of many communities and their future viability must be protected and enhanced. Unfortunately, the impact of the Basel III Proposals on AMB's members and mutual form institutions generally will be harmful, and possibly systemically threatening. While we are focused on the effect of the Basel III Proposals on federally and state chartered mutual institutions, we would note that similar concerns are being raised in other countries by their respective mutual form banking institutions. There is genuine concern globally regarding the longevity of the mutual form of banking institution as a result of Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems ("Basel III").

The members of AMB are in complete agreement with the position that a strong capital base is vital to banking institutions and the maintenance of a safe and sound banking system. AMB fundamentally agrees with the desire to assure that a strong capital foundation is maintained to prevent losses in a systemically important institution which could cause a contagion in the market and possibly negatively impact taxpayers. However, in an attempt to address broad market concerns, the Basel III Proposals paint with too broad a brush and sweep community based mutual form institutions into the same regulatory scheme as systemically large stock form institutions. Indeed, recent reports in the American Banker and other trade publications have suggested the Basel III Proposals have a much more stringent impact on small and mid-sized banks than on the large systemic money center banks. As we will discuss below, the "one-size fits all" approach not only is inappropriate with respect to mutual form institutions, but could very well result in unintended consequences exactly the opposite from what the proposals are trying to accomplish.

Mutual form institutions have been a bedrock for generations and have been and are community based and community focused. As far back as 1852, with the publishing of the treatise "Mutual Benefit Building and Loan Association: their History, Principles, and Plan of Operation; together with a Statement of the Benefits Attending Them, and of the Distinction between American and English Societies" by Joseph Walker and S. K. Cox, mutual form banks have been integral to the local communities of America and even longer in Great Britain and other European nations. Mutual form institutions do not have permanent capital stock like stock form institutions and, therefore, do not have permanent stockholders. The depositors and borrowers of a mutual institution are the residual "owners" of the institution with rights to any surplus remaining in liquidation. We are concerned that the drafters of the Basel III Proposals do not truly understand the value, nature and unique role of mutual institutions. We believe that without an in depth understanding, the drafters could not possibly know the impact these proposals will have on mutual institutions.

In Section 4a. to Addendum 1 to the notice of proposed rulemaking titled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action" ("Proposal 1"), the definition of "Common Equity Tier 1 Capital" is set forth. It is noteworthy that the title of Addendum 1 is "Summary of this NPR for Community Banking Organizations". It is clear that the agencies are attempting to show that they can differentiate between community banking institutions and larger systemic institutions. While this differentiation is certainly appropriate and speaks to the agencies attempt at establishing that they understand the differing nature of community banking institutions from larger institutions, it does not take the next step which is to differentiate between and acknowledge that not all community banking organizations are the same. As the FRB and US Treasury are acknowledging somewhat slowly, banks come in all shapes and sizes. There are systemic money center banks, nationally impactful regional banks, mid-sized and small banks, publicly owned banks, privately held banks, subchapter S banks, mutual banks, co-operative banks, bank subsidiaries of holding companies and banks held by mutual holding companies. Generally, the FRB has defined community banks as banks with under $10 billion in assets; a rather broad and all-encompassing definition which accounts for approximately 98.75% of all banks in the United States holding approximately $2.5 trillion in assets. A subset of community banks are mutual banks. As of March 31, 2012, there were approximately 571 banks organized in the mutual form holding approximately $209 billion in assets. This means that mutual form banks represent approximately 8.9% of community banks and account for approximately 8.4% of the assets held by community banks (24% of assets held by community banks with assets under $500 million). Obviously, a substantial majority of community banking institutions are organized in stock form; an organizational structure completely different from mutual institutions. The nomenclature of Common Equity Tier 1 Capital ("CET1") in and of itself highlights the bias and/or lack of understanding of the agencies concerning mutual institutions. The definition itself is premised on and relates to a stock form institution; the words "Common Equity" can only mean common stock. As if any proof of this bias is needed, subpart 1 of the definition states "Common Stock Instruments ...." The four elements of CET1 are in a descending order. The first of these, and obviously most important to the drafters, is common stock; something only a stock form institution can have and is unavailable to a mutual institution. It would not be wrong to state the obvious, a mutual institution starts at a decisive disadvantage in being able to augment capital. The principal component of CET1 is composed of an instrument that mutual institutions fundamentally and by law are unable to issue.

The agencies provided a limited commentary regarding mutual institutions in Section III, A.4. of Proposal 1 titled "Capital Instruments of Mutual Banking Organizations". Out of several hundred pages in Proposal 1, mutual institutions warranted only three paragraphs. While it is commendable that the agencies have acknowledged mutual institutions, which is not often the case, the reality is that mutual institutions are not being given due consideration by the agencies. Mutual institutions, which provide critical banking services to their communities, seem to have been lost in the crush of proposals directed at larger systemic banks. The drafters stated that "Most of the capital of mutual banking organizations is generally in the form of retained earnings (including retained earnings surplus accounts) and the agencies believe that mutual banking organizations generally should be able to meet the proposed regulatory capital requirements". Unfortunately, this statement is premised on a snapshot in time. While generally accurate now, it does not take into account the increased uncertainty and volatility in asset management, earnings and capital calculations which the Basel III Proposals themselves create. While mutual institutions generally are highly capitalized, the Basel III Proposals unnecessarily deny them alternatives to raising additional loss-absorbing capital. This "one size fits all" approach disregards that the ability of mutual institutions to raise capital beyond retained earnings is severely limited as compared to stock institutions. If left unaddressed, under certain economic scenarios the Basel III Proposals could be the beginning of the decline of the mutual form of organization among banks. Not only is the capital structure of mutual institutions different from large banking institutions, it is different from stock form community banking institutions. To miss this point is to miss the raison d'etre of mutual institutions entirely.

Depending upon market conditions, investor demand and other factors, stock form institutions may have access to capital markets via, among other things, the sale of common equity securities in the marketplace by a public offering or private placement. However, this avenue for capital formation, by definition, has not been, is not now and will not be available to mutual institutions. Members of mutual institutions are not stockholders. They possess none of the important incidents of ownership. Their interests cannot be bought or sold. Mutual institutions have historically enhanced their capital positions primarily through retained earnings. With the inherent volatility of general and local economies, market conditions and the valuation and nature of assets germane to each banking institution to name a few of the variables, the ability to maintain compliance not only with regulatory minimum capital requirements but also the higher levels which undoubtedly will be required by the examiners is paramount to an institution's ability to serve its community. Unnecessarily restricting a mutual institution's ability to raise additional capital or apply historically available sources of capital because not enough attention was paid to the unique nature of the mutual form of organization would be in direct conflict with the Home Owners' Loan Act, which expressly provides for the formation and continued existence of federal mutual institutions, and recent congressional intent to preserve the mutual community banking aspects of our banking system. Preliminary drafts of the Dodd-Frank Act contained a provision for the elimination of the Federal thrift charter and with it federally chartered mutual institutions. Thankfully, Congress realized that such a provision would severely undermine the mutual form community banking aspect of our banking system and eliminated that provision prior to passage. What was realized as detrimental to many communities in our country and just a bad idea and, therefore, not enacted into law, the Basel III Proposals may do via regulation.

Proposal 1 creates the likelihood of wide fluctuations in earnings and capital calculations by banks as a result of the Basel III Proposals. Proposal 1 provides that unrealized gains and losses on all available-for-sale ("AFS") securities held by an institution would flow to and be included in the calculation of CET1. The agencies proffered that such an approach "would better reflect an institution's actual risk". However, the agencies also acknowledged that temporary changes in the market value of securities could create substantial volatility in an institution's regulatory capital ratios, possibly even triggering prompt corrective action. Given the present interest rate environment, it is virtually certain that rates can only rise from where they are today, and that means the market value of securities held will be negatively impacted. Not only can this arbitrary movement (which in most instances the bank has no ability to influence or control) in the market value of securities negatively impact a bank's capital ratios, it quite possibly will negatively affect a mutual community bank's ability to lend and manage its risk. The de-facto mark to market of AFS securities will manifestly increase volatility which will make the capital ratios of mutual community banking institutions harder to maintain. Amplifying the fluctuation of the mutual bank's capital calculations is the provision in Proposal 1 increasing the risk weighting of various residential and other loans originated and held by banks. This provision may impact mutual banks more due to the fact that they generally hold loans in portfolio in greater percentages than larger banks and substantially more than the systemic banks. A mutual bank's asset portfolio generally consists of approximately 70% 1-4 family loans compared to approximately 25% for all other financial institutions. This portfolio concentration in mortgages is generally mandated by federal requirements under the qualified thrift lender test and the Internal Revenue Code. As a result of economic and market forces beyond their control, mutual institutions will be forced to adjust their asset portfolio's to account for this increased volatility without the ability to tap the capital markets like stock institutions to support what could very well be more profitable operations. Without the ability to raise capital beyond retained earnings, many mutual banks may have to curtail growth plans and reduce services to their communities in order to husband capital to meet unexpected future needs which they can neither foresee nor control.

Some have said that one of the sidebar intents of the Basel III Proposals is to force the extinction of mutual institutions. Under the proposed regulatory capital rules, it is possible that one by one mutual institutions will be forced/jawboned into converting to stock form. Indeed, the recent OCC Bulletin on Capital Planning, dated June 7, 2012, OCC 2012-16, contains a statement which infers as much. In the Bulletin, in the first paragraph on page 4 under the heading "Maintaining a Strategy to Ensure Capital Adequacy and Contingency Planning", it discusses a variety of alternatives for banks to strengthen capital and states in relevant part when referring to mutual banks that "... in the case of a mutual institution, a partial or full conversion to stock...." While this wording may have been intended to foster contingency planning, it has fueled the anxiety among mutual banks that the agencies would rather a mutual institution abandon its charter rather than work with it to provide capital raising alternatives. The practical result of the Basel III Proposals is to put mutual banks in the least enviable position of the various banks affected by the Basel III Proposals. AMB believes that the "one size fits all" approach to mutual community banking institutions taken in the Basel III Proposals is a disservice to a proud industry. It should not be the intent or the practical result of the Basel III Proposals to foster an atmosphere where mutual institutions are influenced to consider abandoning the mutual form of organization. As was recently stated in a submission commenting on Basel III by Abacus, the trade association representing mutual form institutions in Australia, to the Australian Prudential Regulation Authority, "It is unacceptable to the mutual ADI sector to be required to demutualize to gain access to external capital". Abacus goes on to state that it does not seek exemption from the Basel III framework, but, rather, seeks application of the framework taking into account the mutual form, as is expressly permitted by the Basel Committee. AMB strongly believes mutual institutions are worth the time and effort to fashion new capital requirements in a focused and deliberative manner with the goal of preserving mutual banks.

While organized for historically different reasons, mutual form banks and credit unions share a common foundation; they are non-stock form. All credit unions are organized as co-operatives which is essentially the same as the mutual form of organization. However, the Basel III Proposals do not apply to credit unions. This is another example of the "one size fits all" approach to banks. Credit unions are exempt because there are no systemic aspects relating to them and it is accepted that they did not contribute to the recent banking crisis. Mutual form community banks, the largest of which is a sixth the size of the largest credit union, also are not systemic and did not contribute to the recent banking crisis. Yet, they are being included in the rules developed for systemically important banking institutions.

Mutual institutions historically have been some of the most well capitalized depository institutions in America while serving their communities with dedication. This is a double edged sword. As Congressman Michael Grimm (R-NY) so clearly stated recently,

> "mutuals have been such solid banking citizens they have not enjoyed the attention of legislators or regulators who have been focused on problem banks. This benign neglect has caused mutual banks to fall behind in their ability to adapt to the many changes in banking regulation, not from a lack of creativity or services but from a lack of complimentary legislation that gives mutual banks the same level competitive playing field afforded to other banks. Perhaps more than any other type of banking institution, they have suffered from the one size fits all regulatory approach."

Representative Grimm has introduced H.R. 4217, the Mutual Community Bank Competitive Equality Act, which provides for, among other things, (i) authorizing mutual institutions to issue mutual investment certificates which would be eligible for inclusion as Tier 1 Capital, and (ii) clarifies that the FRB shall apply its Small Bank Holding Company Policy Statement to any mutual holding company that would otherwise qualify as a small bank holding company, if it were a bank holding company. AMB is confident that the language and intent of the bill is that the mutual investment certificate be counted as the highest form of Tier 1 capital; equivalent to common stock for stock form institutions.

As mentioned previously, and as referred to by the OCC, retained earnings are the primary method by which mutual institutions raise capital. However, the Basel III Proposals not only do not provide for alternative methods for mutual banks to raise capital, they will effectively eliminate two long standing and legally permissible capital formation methods available to mutual banks; pledged savings accounts and mutual capital certificates. The OCC's regulations at 12 C.F.R. § 143.3, relating to the chartering of a de novo mutual federal savings association, provide that a de novo association must have an initial capitalization of at least $2.0 million of "pledged savings accounts." Pledged savings accounts are accounts that are pledged by the institution's founders and act as the initial capital. The OCC's regulations at 12 C.F.R. § 167.5 include pledged accounts as "core capital." That section provides that the definition of core capital includes "nonwithdrawable accounts and pledged deposits of mutual savings associations (excluding any treasury shares held by the savings association) meeting the criteria of regulations and memoranda of the OCC to the extent that such accounts or deposits have no fixed maturity date, cannot be withdrawn at the option of the accountholder, and do not earn interest that carries over to subsequent periods." Thus, historically, interest paying instruments with certain debt like features but no claim by the holder for withdrawal have been included in the definition of core capital.

In addition to non-withdrawable pledged accounts, the Home Owners' Loan Act and the OCC's regulations also permit "mutual capital certificates" as a form of capital for mutual institutions. OCC regulations found at 12 C.F.R. § 163.74 provide that a mutual capital certificate must meet the following requirements:

(i) Be subordinate to all claims against the association having the same priority as savings accounts, savings certificates, debt obligations or any higher priority;

(ii) Not be eligible for use as collateral for any loan made by the issuing association;

(iii) Constitute a claim in liquidation not exceeding the face value plus accrued dividends of the certificates, on the general reserves, surplus and undivided profits of the association remaining after the payment in full of all savings accounts, savings certificates and debt obligations;

(iv) Be entitled to the payment of dividends, which may be fixed, variable, participating, or cumulative, or any combination thereof, only if, when and as declared by the association's board of directors out of funds legally available for that purpose, provided that no dividend may be declared or paid without the approval of the appropriate Federal banking agency if such payment would cause the association to fail to meet its regulatory capital requirements and provided further that no dividend may be paid if such payment would constitute a violation of 12 U.S.C. 1828(b);

(v) Not be redeemable, except: (A) where the dollar weighted average term of each issue of mutual capital certificates to be redeemed is seven years or more and redemption is to be made pursuant to a redemption schedule; (B) in the event of a merger, consolidation or reorganization approved by the appropriate Federal banking agency; or (C) where the funds for redemption are raised by the issuance of mutual capital certificates approved pursuant to this section, or in conjunction with the issuance of capital stock pursuant to part 192 of this chapter: Provided, that mandatory redemption shall not be required; that mutual capital certificates shall not be redeemable on the demand or at the option of the holder; and that mutual capital certificates shall not receive, benefit from, be credited with or otherwise be entitled to or due payments in or for redemption if such payments would cause the association to fail to meet its regulatory capital requirements; And Provided further, for the purposes of this paragraph, the "dollar weighted average term" of an issue of mutual capital certificates shall be the sum of the products calculated for each year that the mutual capital certificates in the issue have been redeemed or are scheduled to be redeemed. Each product shall be calculated by multiplying the number of years of each mutual capital certificate of a given term by a fraction, the numerator of which shall be the total dollar amount of each mutual capital certificate in the issue with the same term and the denominator of which shall be the total dollar amount of mutual capital certificates in the entire issue;

(vi) Not have preemptive rights;

(vii) Not have voting rights, except that an association may provide for voting rights if: (A) The savings association fails to pay dividends for a minimum of three consecutive dividend periods, and then the holders of the class or classes of mutual capital certificates granted such voting rights, and voting as a single class, with one vote for each outstanding certificate, may elect by a majority vote a maximum of one-third of the association's board of directors, the directors so elected to serve until the next annual meeting of the association succeeding the payment of all current and past dividends; (B) Any merger, consolidation, or reorganization (except in a supervisory case) is sought to be authorized, where the issuing association is not the survivor, provided that the regulatory capital of the resulting association available for payment of any class of mutual capital certificate on liquidation is less than the regulatory capital available for such class prior to the merger, consolidation, or reorganization; (C) Any action is sought to be authorized which would create any class of mutual capital certificates having a preference or priority over an outstanding class or classes of mutual capital certificates; (D) Any action is sought to be authorized which would adversely change the specific terms of any class of mutual capital certificates; (E) Action is sought to be authorized which would increase the number of a class of mutual capital certificates, or the number of a class of mutual capital certificates ranking prior to or on parity with another class of mutual capital certificates; or (F) Action is sought which would authorize the issuance of an additional class or classes of mutual capital certificates without the association having met specific financial standards;

(viii) Not constitute an obligation of the association and shall confer no rights which would give rise to any claim of or action for default;

(ix) Not be convertible into any account, security, or interest, except that mutual capital certificates may be surrendered in exchange for preferred stock issued in connection with the conversion of the issuing savings association to the stock form pursuant to part 192 of this chapter, provided that the preferred stock shall have substantially the same voting rights, designations, preferences and relative, participating optional, or other special rights, and qualifications, limitations, and restrictions, as the mutual capital certificates exchanged for the preferred stock; and

(x) Provide for charging of losses after the exhaustion of all other items in the regulatory capital account.

Mutual capital certificates are presently included as supplementary (Tier 2) capital under the OCC's regulations at 12 C.F.R. § 167.5(b)(1)(ii).

In light of the foregoing and notwithstanding that mutual institutions are generally some of the highest capitalized banking institutions, AMB believes that in order to be prepared and to be able to comply with the new and evolving capital standards and changing economic conditions it is imperative to establish alternative methods by which mutual institutions can raise capital which will qualify as CET1 capital. Such capital can be used to grow the institution, expand operations, act as a buffer against the continuing downturn in the economy, finance acquisitions and for other corporate purposes. The establishment of additional methods to raise CET1 capital for foreign mutual form institutions is being considered in multiple countries, including, Great Britain, Germany, France, Spain, Australia, Canada and others. Founded in 1895, the International Co-operative Banking Association (a sectoral organization of the International Co-operative Alliance) is one organization working with the European Commission on this issue. The Basel Committee focused almost exclusively on stock form banks in establishing the capital requirements under Basel III and as such certain criteria and other terms do not apply well to mutual form institutions such as British building societies and US mutual banks. However, as stated in footnote 12 on page 14 of Basel III, the Basel Committee acknowledged that it is appropriate for the specific constitution and legal structure of mutual institutions to be taken into account in applying Basel III to them and, effectively, it is being left to national regulators to determine exactly how the new requirements will be applied to mutual institutions. Clearly, the regulators have the latitude to develop a regulatory scheme which does not hinder the viability of mutual institutions, even if it is different from that developed to address large systemic banks.

The European Commission's Capital Requirements Directive IV published in July, 2011 offers a degree of flexibility. This has encouraged central bankers and regulators in the EU to work with and make an effort to accommodate mutual institutions with capital requirements that will comply with Basel III and be compatible CET1 capital.

As was discussed in an article in the American Banker/Bank Think, dated October 3, 2012, perhaps the farthest along are the British Building Societies. The proposal which has emerged is for the issuance of "core capital deferred shares" or CCDS. Nationwide Building Society, Britain's largest, pioneered the way this past May by obtaining approval in principle from the British Financial Services Authority of the CCDS as a CET1 instrument.

CCDS have no fixed coupon payment but, rather, discretionary payments which are linked to earnings levels similar to the mutual investment certificate discussed below. However, Nationwide may make payments similar to dividends at a rate commensurate with its earnings in good years offering investors an attractive expectation. There is no stated call date. Presently, Nationwide has said it will use the authority as a backup as it, like most U.S. mutual institutions, already enjoys a high capital ratio; 12.5% in its case. The CCDS are not insured by the Financial Services Compensation Scheme. Importantly, what is different in Britain than in the U.S. is that investors and brokers have already accepted the high yields on the CCDS predecessor instruments (permanent interest bearing shares "PIBS") as attractive investments. This has sustained the marketability of the PIBS for many years. The precedent of an active market for PIBS has caused Nationwide (presumably with the advice of its investment bankers) to believe that there will be similar interest in the CCDS. Already, investment articles are appearing which have cautioned as to the risks but seem to suggest CCDS's issued by Britain's strongest Societies the are attractive.

What is needed in the US is a proactive collaboration between the FRB, OCC and FDIC and the mutual banking industry, represented by AMB, in designing and customizing a CET1 capital instrument for use by mutual institutions. Additionally, all involved in this process must realize that any capital instrument designed to meet the requirements of CET1 must also be marketable and sustainable or the capital enhancement will merely be an academic exercise with no real possibility for successfully augmenting loss-absorption capital and achieving the goal of stronger institutions and a stronger industry.

With the same thought in mind as our foreign counterparts, AMB has proposed an alternative capital instrument to be available to mutual institutions. This alternative capital instrument for mutual institutions has enough characteristics under GAAP to qualify as CET1 non-withdrawable capital, which protects the mutual institution and the deposit insurance fund, yet contains no features that are inconsistent with the mutual nature of the institution or jeopardize the tax deductibility of the income payments. The deductibility of the income payments is particularly important to be able to offer an instrument that is economically attractive to both the issuer and the investor. In this regard then, AMB proposes the establishment of a non-withdrawable mutual investment certificate that would have the following characteristics:

- No voting rights, except that holders of the instruments have the right to elect two directors upon the sixth missed interest payment, upon a change of control and upon changes in the capital structure of the bank;
- No holder may put the instrument back to the bank;
- Redemption solely at the bank's discretion;
- Income payable may be fixed or variable or tied to an index;
- Income is payable if and when declared by the board of directors, subject to the capital requirements of the Basel III Proposals;
- Income payments are cumulative;
- Perpetual--no maturity date;
- Repayment is subordinate to the claims of creditors and depositors;
- Convertible into shares of common stock upon a mutual to stock conversion of the bank based on a fixed exchange ratio basis based on the investor's ownership percentage at the time of investment.

Payment of Income

Income payments would be paid if, and when, declared by the board of directors, subject to the capital requirements of the Basel III Proposals. AMB proposes that the agencies permit these payments based on whether the bank has sufficient earnings as follows: the payment would be in the nature of income payments and be paid in an amount up to the lesser of the stated rate or 50% of the bank's net income, provided that the bank exceeds the minimum capital ratios (plus the capital conversion buffer) provided under the Basel III Proposals following the payment. If the bank would not meet the above requirement following the payment, then the bank must receive prior regulatory approval before making the payment and then only if such payment would comply with the capital conversion buffer and maximum payout ratio provided under the Basel III Proposals.

AMB would also propose that the mutual investment certificate allow for cumulative income payments in the event that the bank was not able to pay the stated rate on the certificate. AMB understands that under the terms of the Basel III Proposals cumulative dividends on preferred stock are not permitted as Tier 1 capital for stock institutions. There is good reason for this, however, because if the dividends accumulate for a long enough period of time in a stock institution, there is the potential that the shareholders could put pressure on the board to act in a manner inconsistent with the business plan, safety and soundness principles and/or its fiduciary duties. Stockholders with voting control of the institution would be tempted to act imprudently to protect their junior position. This would not be the case in a mutual institution, since there are no "owners" that would perceive the dilution in the value of their economic stake. In a mutual institution all the deposit accounts would be senior to the mutual investment certificates and in any event the overwhelming number of accounts are fully insured. Finally, while depositor-members do have inchoate claims to any surplus remaining on liquidation, these claims are of negligible value. Thus, it is unlikely that any depositor-members would perceive any reason to force imprudent action with respect to the treatment of cumulated interest. Even in the remote chance a misperception might exist that indefinite cumulated income payments would have an adverse effect on the economic stake of depositor-members they have little practical governance power unlike voting stockholders to influence the board of directors. AMB believes that the cumulative income feature will not raise any quality of capital concerns, while making the instruments more attractive to potential investors.

Voting Rights

Although the mutual investment certificate would not provide for voting rights, the holders would be able to elect two directors upon the sixth missed periodic payment. This right to elect directors upon the failure to make payments is the same right given to the U.S. Treasury by debt and equity instruments issued by participating banks pursuant to the Capital Purchase Program. These instruments are currently deemed to be Tier 1 capital by the FRB and are proposed to be Additional Tier 1 capital under the Basel III Proposals.

In addition to the above, the holders of mutual investment certificates would be able to vote as a class on any merger, consolidation, or reorganization (except in a supervisory case) where the issuing bank is not the survivor; any action which would create any class of certificates having a preference or priority over an outstanding class or classes of non-withdrawable mutual investment certificates; any action which would adversely change the specific terms of a class of non-withdrawable mutual investment certificates; any action which would increase the number of a class of non-withdrawable mutual investment certificates, or the number of a class of non-withdrawable mutual investment certificates ranking prior to or on parity with another class of non-withdrawable mutual investment certificates; or any action which would authorize the issuance of an additional class or classes of non-withdrawable mutual investment certificates without the bank having met specific financial standards as set forth in the terms of the certificates. These voting rights are only for extraordinary circumstances do not impact the efficacy of the instruments loss-absorption capabilities as a Tier 1 capital instrument. The Basel III Proposals are not concerned with the voting rights of common stock or the voting rights of preferred stock, which are contractual in nature. The Basel III Proposals are focused on the maintenance of the capital levels of the bank. Even with these limited voting rights, the depositor-members proxies held by the mutual institution's board of directors will still hold a substantial majority of the voting power on all events which come up for a vote. As long as the next to be issued class of mutual investment certificate is junior to outstanding certificates, there will not even be a vote of the certificate holders triggered.

Conversion

Upon a mutual to stock conversion of the bank, the non-withdrawable mutual investment certificates would be converted into common stock of the bank based on a fixed exchange ratio basis based on the investor's ownership percentage at the time of investment. For example, if the investor had non-withdrawable mutual investment certificates equal to 1% of the bank's value prior to conversion, then such certificates would convert into 1% of common shares upon the conversion of the bank, regardless of the appraised value of the bank pursuant to the conversion regulations. In this regard, then, the conversion would be on a fixed share and variable dollar amount basis thereby qualifying the certificates as equity for generally accepted accounting principles.

Collins Amendment

The Basel III Proposals are in conflict with existing law and recently established congressional intent. Section 171 of the Dodd-Frank Act, also known as the "Collins Amendment", requires the appropriate banking agencies to establish minimum leverage and risk-based capital requirements for depository institutions and their holding companies that are, among other things, not qualitatively lower than the generally applicable leverage and risk-based capital requirements that were in effect for insured depository institutions on the date of enactment of the Dodd-Frank Act. For mutual institutions, non-withdrawable deposit accounts already count towards Tier 1 capital and mutual capital certificates already count towards Tier 2 capital. Current OCC regulations provide some flexibility in that they permit the OCC to develop new forms of non-withdrawable certificates. In this regard, 12 C.F.R. § 167.5 states that core capital includes "non-withdrawable accounts and pledged deposits of mutual savings associations meeting the criteria of regulations and memoranda of the OCC..." Thus, the OCC is permitted to develop criteria for new forms of non-withdrawable capital instruments that are deemed Tier 1 capital. The instrument proposed by AMB meets two of the three tests stated in Section 167.5 in that they would not have a fixed maturity date and cannot be withdrawn at the option of the holder. AMB requests that the agencies consider the cumulative payment of income feature for the reasons set forth above. AMB believes that such a feature, although not in strict compliance with the third test of that section (i.e., the instruments do not earn interest that carries over to subsequent periods), AMB believes that such a feature would improve substantially the marketability of the instruments while not affecting the loss-absorption capability of the instrument. It should be a forgone conclusion of the agencies that if the instruments provided for under the Basel III Proposals are not marketable and sustainable, then capital enhancement is merely an academic exercise with no real possibility for success.

Conclusion

AMB has a responsibility to its members and to their depositors, members and communities to express its belief that if left unchanged, the Basel III Proposals could severely negatively impact the mutual banking industry in the US. While acknowledging that a strong capital base is vital to a safe and sound banking system, to fully include mutual form institutions in the regulatory scheme designed to address systemically important institutions (none of which are mutual institutions) is to adopt a one size fits all approach to regulation. The Basel III Proposals were drafted with stock form banks as the focus and the CET1 capital requirements are a product of that bias. To deny mutual institutions the ability to augment their capital if the need arises, is to effectively diminish their relevance and role in the banking industry and is harmful to their communities. Moreover, the mark to market requirement for available-for-sale securities will increase the uncertainty and volatility of capital calculations of all banks, but will be especially problematic for mutual institutions. Again, not having a potentially available source to enhance capital will make asset management, earnings and capital calculations materially more difficult. AMB strongly believes that by working closely with the agencies, an acceptable resolution can be fashioned. The continuing viability of mutual form institutions should be a common goal which, together we can achieve. As discussed above, AMB believes that its proposal to develop a non-withdrawable mutual investment certificate will enhance significantly the continued vitality of the mutual banking industry and increase the capital cushion protecting the deposit insurance fund.

AMB appreciates the opportunity to comment on the Basel III Proposals and would welcome the chance to discuss its position and thoughts on this matter at your convenience. Please feel free to contact the undersigned at your earliest opportunity.

Very truly yours,

Martin T. Neat
Chairman

Peter M. Boger
Vice Chairman

Charles J. Boulier III
Second Vice Chairman

cc: Douglas P. Faucette
Counsel to America's Mutual Banks

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