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 Secretary Johnson,

We appreciate the opportunity to provide comments on the Basel III proposals recently approved by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve Board.

Salem Five Bancorp is a bank holding company with two bank subsidiaries, Salem Five Cents Savings Bank (Salem Five Bank) and Stoneham Savings Bank.

Founded in 1855, Salem Five is a mutual savings bank with $3.034 billion in assets and 23 retail branches as of September 30, 2012. In addition, through our subsidiaries – Salem Five Mortgage Company, LLC, Salem Five Investment Services, LLC, our full service brokerage company and Salem Five Insurance Agency, LLC we provide a diverse set of services to consumers and small and middle market companies throughout our region.

Stoneham Savings Bank was acquired by Salem Five Bancorp in February 2012. It is $336 million in assets with 6 retail branches as of September 30, 3012.

General Comments:

Although Salem Five Bank is a well-capitalized bank which doesn't engage in the high risk investment and lending practices which contributed to the recent financial crisis, we do believe a number of the risk based and leveraged capital requirements and the standardized approach for risk-weighted assets could be detrimental to "community banks" and their core constituencies. Our comments on the rules considered to be most punitive are provided below.

Inclusion of AOCI in Calculating Tier 1 Capital

Our concerns about recognizing unrealized gains and losses on available for sale securities relates to the impact it could have on our ability to effectively manage our liquidity, earnings, and community giving over the long term.

Currently, Salem Five has a modest equities portfolio of approximately $25 million and our bond portfolio is, for the most part, limited to government backed securities which will continue to carry a 0% risk weighting. Nevertheless, the contemplated changes could pressure the bank to sell equities from its portfolio at exactly the time it may need earnings from it or to not invest at all for fear of recognizing losses due to short term swings in the market. Very often we use the gains that come from this portfolio to fund charitable contributions that are so important to the communities we serve. In addition, because many equities are held for long periods, the earnings that come from dividends and gains can act as a much needed cushion in challenging economic times.

The bond portfolio rule of "rates up 300 basis points", could impact our earnings by forcing us to shorten maturities to avoid temporary unrealized losses, or could limit our liquidity options by incenting us to move the securities to "held to maturity".

Phase out of Trust Preferred Securities and Capital Investments

Trust Preferred Securities is one of the only ways for mutual and privately held banks like Salem Five to raise capital for critical strategic reasons like branch expansion, technology investments, and movement into businesses like insurance which diversifies our sources of non-interest income. The inability to access this capital could also limit our ability to offer safe and secure services and loans to small businesses and consumers.

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

Salem Five Bank is a substantial originator and servicer of residential mortgages. In each of the last four years, we have originated over $1 billion in mortgages and, currently, we service over $2.2 billion for other investors.

The proposed rule changes raises two very important issues for Salem Five. First, capital requirements will rise for traditional first mortgage loans which are fully documented, amortizing, with prescribed caps on ARMs and no balloons. This means that loans to first time homebuyers putting down 5% and getting mortgage insurance to cover the rest will require higher capital allocations, and the bank will move to reduce its exposure to this important part of our economy. At any one time, the mortgage loans held on our balance sheet that relate to this group can reach 5%. At the present time, we hold $850 million in residential mortgages on our balance sheet so the 5% translates into $42.5 million. Second, home equity lines would be hit with a risk weighting of 200% if the loan/value reached 90% on a commitment basis inclusive of the first mortgage. Typically, we don't make home equity loans that reach 90% but if we do there are other safeguards added to our underwriting guidelines. This includes the requirement that Salem Five hold both the first and second mortgage, credit scores have to be 700 or above, and we will not subordinate to another lender during the life of the loan.

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

There are a number of provisions in the Proposals that would force institutions to substantially increase the risk weightings for certain loans and investments. If these rules are adopted, we think it is prudent to eliminate the regulatory limitation of 1.25% on the amount of an institution's Allocation for Loan and Lease Losses (ALLL) that it can include in Capital. Banks should be encouraged to build reserves during good economic times and removing this restriction would encourage a healthier funding of our ALLL.

Each topic covered in this letter can negatively impact the ability of Salem Five Bank and other mutual banks to properly manage capital, liquidity, and earnings throughout economic cycles. Taken together the rules could disadvantage us competitively and limit the types of lending traditionally handled by community banks.

Thank you for your consideration.

Sincerely,

Kim A. Meader
Executive Vice President
Business Lines