STAFFORD SAVINGS BANK
P.O. Box 25
Stafford Springs • Connecticut 06076
(860) 684-4261
www.staffordsavingsbank.com

Robert 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

August 20, 2012

Gentlemen:

Statistical Perspective

Stafford Savings Bank	June 30, 2012
Total Assets	$232 million
Tier 1 leverage ratio	25.97%
Total Risk Based ratio	45.57

Residential, fixed rate, portfolio (have never sold a loan), 1-4 family lender

Equities and equity mutual funds	$48.5 million at cost
	$64.3 million at market

"True" community bank – 3 branches, all in Stafford Springs.

A case for equities.
Standardized Approach
There appears to be a bias against bank investments in equities. How can a commercial ADC loan with an LTV greater than 90% be given a 150% risk weighting while an equity position in a diversified portfolio of value stocks be given a 300% rating? This decision does not appear to be based on any historical risk return analysis.

The FDIC limits equity investments to 100% of capital at cost. This means dollar for dollar capital coverage.

The bias becomes greater when your have to risk weight unrealized gains at 300%. These gains should be seen as a source of additional protection and a buffer. Based on our numbers, $18.8 million in gains (a 39% buffer in relation to our costs) increase the denominator by $56.4 million dollars. Our risk weighted ratio would be higher if we had no gains.

I am suggesting net unrealized gains should be subtracted from the cost basis and the remainder subjected to a reasonable risk weighting factor. Given the current restrictions on equity investments, I believe 100% is reasonable.

Basel III
The current proposed treatment of equities is distorted even further by the fact that unrealized gains on equities are put into the numerator (capital) at a tax adjusted basis. If the corporate marginal tax rate is 34%, only 66% of the unrealized gain finds its way into capital, while three times the full market value of the unrealized gain finds its way into the denominator.

Our bank has been investing in individual equities for more than 100 years. We have survived 1929 and 2008-9 and points in between. Bill Gross pointed out in a recent Wall Street Journal article that stocks have averaged a 6.6% annual gain on an inflation adjusted basis since 1912.

Our portfolio yields 3% in dividend income prior to Dividend Received Deduction enhancement. This is a vital source of income. Interest rates being manipulated to current low levels have shrunk interest margins across our industry. Fees for overdraft protection have been dramatically reduced with regulatory changes. And our overhead to sustain a compliant operating environment is on an unsustainable climb.

Please do not take equities away from us as well!

A case for Mortgages
Standardized Approach.
During your 8/3/2012 conference call, a question was asked why the change in risk weightings, isn't ALLL supposed to cover losses on loans? In our case, our accountants forced us to reduce our ALLL. We disagreed, saying that cycles in real estate were often longer than 5 years. We asked the FDIC to intervene from a safety and soundness perspective but could not seem to properly motivate you to help us.

It is not surprising the industry did not have appropriate reserves. Specifically in residential lending, it was mainly the exotic mortgage products that caused problems no income verification loans, low document loans, nonamortizing loans, etc.

If these are the problem, deal with them, not 20% down, fixed rate loans that were well underwritten. Another layer of safety in capital is not needed. Use the ALLL for this purpose as it was intended.

One might think we have skimmed the cream to create our residential loan portfolio but one could not be more wrong. Each year we make loans that would not qualify for sale into the secondary market. We can do this because we know the people and the properties. The QM issue could limit our ability to write "nonconforming loans" taking away another source of income. As important, is the fact that as the GSEs force the repurchase of more mortgages, our role as a knowledgeable local lender becomes more crucial to our local marketplace.

HELOCs require the unadvanced portions to be added to the advance portions when applying the risk weighting factor. Since we began offering HELOCs, more than 20 years ago, unadvanced dollars have been around 50% of the approved lines. What is the justification to add all the unadvanced dollars prior to applying the weighting factor?

Reduce the HELOC amounts subject to the risk weighting to the bank's advanced dollars. This number is recalculated every quarter and if take downs began to increase they would be reflected going forward.

The intended and/or unintended consequences of Basel III will be to further alter the community bank business model. It seems to be a model that both regulators and politicians say they like and appreciate. The reality is our advantages are being taken away from us via regulatory homogenization. Once we all look and operate the same way, scale becomes the dominant factor of success not service to our customers.

It is ironic that an effort to control too big to fail has and will lead to bigger institutions.

Sincerely,

Michael J. Muzio
President