MICK THOMPSON
BANK COMMISSIONER

MARY FALLIN
GOVERNOR

STATE OF OKLAHOMA

STATE BANKING DEPARTMENT

October 17, 2012

Ms. Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Federal Reserve Board - Docket No. R-1430; RIN No. 7100-AD87
Regulatory Capital Rules: Implementation of Basel III

Dear Ms. Johnson:

I am writing to express my concerns as a fellow regulator and bank supervisor over the proposed implementation of the Basel III capital requirements. As a member of the Conference of State Bank Supervisors (CSBS), I endorse and support the comment that is submitted by CSBS on behalf of the nation's state bank supervisors as a whole. Additionally, as the Oklahoma State Banking Commissioner, I want to comment on the impact that Basel III will have (and is already having) in Oklahoma.

Oklahoma is home to 169 state-chartered community banks with assets ranging from $8 million to $5 billion. These banks serve as a source of credit in communities where, in their absence, the community would not only fail to thrive, but would fail to exist. Over the past few months, I have personally had discussions with community bankers who have decided to sell their institutions as a result of regulatory burden – of which Basel III has been described as the "last straw." I am concerned that the implementation of the Basel III proposal will have a dramatically negative impact on the willingness of Oklahoma bankers to serve their communities – especially in many communities where no other banking and credit alternatives exist.

While I support strong capital (in both quantity and quality), Basel III will do *nothing* to strengthen the safety and soundness of Oklahoma's community banks. In fact, it will likely serve to create uncertainty in our community banks and will ultimately weaken the communities they serve.

I will not repeat all the ways in which the Basel III proposal is an "International One-Size-Fits-All Reaction" to a problem that never existed in Oklahoma. However, I would like to address in real terms the way it will have a negative impact on Oklahoma and its communities. Specifically, I would like to address the changes that Basel III proposes to make in the risk weighting of mortgage credit.

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I understand that poorly underwritten mortgage credit was one of the reasons for the "real estate bubble" and the resulting financial crisis. However, that problem never existed in Oklahoma. For example, in one year (2005) during the height of the real estate bubble, home prices in California, Arizona, and Florida increased 21%, 35%, and 28%, respectively. During that same period, home prices in Oklahoma increased only 5.6%. One reason for that significant difference is in the nature of the operation of a community bank.

In many Oklahoma communities, the local bank is the only source of mortgage credit. These rural mortgage loans are retained by a bank in its portfolio because they cannot qualify for the secondary market, nor do such loans attract the interest of larger institutions. For safe and sound reasons, the bank will not make (nor would we as regulators sanction) a 15- or 30-year fully amortizing 1 to 4 family mortgage loan that is held in the bank's portfolio. Therefore, under the Basel III proposal, these loans will not fit within "Category 1" risk weighting. Instead, these soundly underwritten loans (HELOCs, balloon payment ARMs, *etc.*) will be Basel III "Category 2" mortgages with a risk weight of up to 200%.

Additionally, although community banks may hold only 10% of the nation's banking assets, they provide 40% of the small business loans – often secured by second liens and HELOCs. The Basel III risk weighting will eliminate a reliable business line for community institutions and an important source of credit for consumers and small business owners. It will not protect against increased risk to community banks nor will it result in stronger capital for community banks. The reality is that the Basel III risk weighting formula is a reaction by the international community to a real estate bubble that has long since burst and that never existed in Oklahoma.

As regulators, we have a responsibility to take careful and thoughtful actions that will foster safety and soundness in the institutions we supervise. However, regulatory action (including rulemaking) that is (1) too complex for the majority of institutions, (2) used as a substitute for the ongoing supervisory process, or (3) implemented without regard to its impact on community institutions, will foster further problems rather than solutions. Unfortunately, the Basel III proposal suffers from all three of these hazards.

In summary, the United States federal banking regulators should recognize that this nation's dual banking system is made up of predominantly community banks for which the Basel III international standards are neither appropriate nor effective for the purposes of strengthening capital. But making piecemeal changes to the Basel III proposal so that it will take into consideration the unique nature of community banks seems unproductive. Therefore, if implemented, the Basel III provisions should exempt completely the vast majority of banks (*i.e.*, community banks) that, even collectively, pose no systemic risk to this nation's economy or to the global economy. The federal banking regulators may then begin the process of crafting capital standards that consider the unique nature of community banking in the United States.

Thank you for your consideration of my views and I look forward to continuing our mutual pursuit of a safe and sound community banking system.

Sincerely,

Mick Thompson
Commissioner

cc:
Thomas Curry, Comptroller, Office of the Comptroller of the Currency
Robert Feldman, Executive Secretary, Federal Deposit Insurance Corporation
Martin Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation
Thomas Hoenig, Director, Federal Deposit Insurance Corporation
Jeremiah Norton, Director, Federal Deposit Insurance Corporation
Richard Cordray, Director, Federal Deposit Insurance Corporation
Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System
Janet Yellen, Vice Chair, Board of Governors of the Federal Reserve System
Elizabeth Duke, Member, Board of Governors of the Federal Reserve System
Daniel Tarullo, Member, Board of Governors of the Federal Reserve System
Sarah Bloom Raskin, Member, Board of Governors of the Federal Reserve System
Jeremy Stein, Member, Board of Governors of the Federal Reserve System
Jerome Powell, Member, Board of Governors of the Federal Reserve System
Roger Beverage, President, Oklahoma Bankers Association
Craig Buford, President, Community Bankers Association of Oklahoma