OKLAHOMA BANKERS ASSOCIATION

We make bankers better!

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October 12, 2012

Via E-mail: regs.comments@occ.treas.gov
Office of the Comptroller of the Currency
250 E Street, Southwest
Mail Stop 2-3
Washington, DC 20219
Basel III OCC Docket ID OCC-2012-0008
OCC Docket ID OCC-2012-0009

Via E-Mail: comments@FDIC.gov
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, Northwest
Washington, DC 20429
Basel III FDIC RIN 3064-AD95
Standardized Approach FDIC Docket No.
RIN 3064-AD96

Via E-Mail:
regs.comments@federalreserve.gov
Jennifer J. Johnson, Secretary
Board of Governors, Federal
Reserve System
20th Street & Constitution Avenue NW
Washington, D.C. 20551
Basel III Federal Reserve Docket No.
1442

Good Day:

On behalf of our 233 member institutions we submit the following comments regarding the proposals noted above, referred to collectively as "Basel III."

At the outset, Oklahoma bankers clearly understand the need for sufficient and quality capital in our nation's banks. It's fundamental to their safe and sound operation. Given that understanding, our primary concern is these proposals will have a negative impact on the ability of community banks to serve their customers and their communities.

I – Overview – The OBA's Position:

A. REGULATORY CAPITAL RULES: REGULATORY CAPITAL, IMPLEMENTATION OF BASEL III, MINIMUM REGULATORY CAPITAL RATIOS, CAPITAL ADEQUACY, TRANSITION PROVISIONS, AND PROMPT CORRECTIVE ACTION:

The Oklahoma Bankers Association is opposed to this proposal as published. These rules will reduce the lending capacity of community banks and, thus, exacerbate the nation's current economic crisis. Capital is a cushion for the ups and downs of the markets, not a transmitter and amplifier of volatility. This proposal should be withdrawn and not re-issued. If it is reissued, it should be applicable only to banks of $50 billion or more in total assets.

B. Regulatory Capital Rules: Standardized Approach for Risk- Weighted Assets; Market Discipline and Disclosure Requirements:

The proposed one-size-fits-all approach is a bad fit for community banks. The Oklahoma Bankers Association is opposed to this proposal. It should be withdrawn and not reissued. At a minimum the proposal should not apply to banks under $50 billion in total assets.

C. Advanced Approaches and Market Risk:

This part of the proposal (which applies to large banks) needs major attention in order to be made workable and practical for the nation's largest banks. We specifically agree with the American Bankers Association's comments with respect to this proposal.

D. Applicability to Credit Unions:

We note at the outset that these proposed rules do not apply to credit unions. This "exemption" continues to demonstrate a lack of understanding of, or an appreciation for, the reality of competition faced every day by traditional community banks from a very aggressive credit union industry in our state.

This is particularly true in the wake of credit union efforts to dramatically expand their reach by making an increased number of residential mortgage and small business loans. We believe this omission is entirely without justification. If these proposals are not withdrawn then, at a minimum, the proposed rules should be amended so that when it comes to residential or commercial real estate lending activities, all credit unions should be subject to the same capital rules as those that apply to commercial banks and thrifts.

II – Oklahoma – Our state's 238 insured institutions have over $90 billion in total assets, nearly $9.4 billion in total capital and employ more than 22,000 Oklahomans.

- Equity-capital-to-total-assets for our state's FDIC-insured institutions stands at 10.42 percent (11.64 percent for banks of $100 million and less);
- Core capital is at 9.62 percent (10.95 percent for banks of $100 million and less); and
- Total capital to risk-weighted assets stands at 15.69 percent (19.63 percent for banks of $100 million and less).

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Given these statistics, it's highly probable that most of our member banks would not be adversely affected by these proposed rules **AS THINGS STAND TODAY**. That will not, however, be the case when rates change and start going back up.

Our state includes a large number of smaller, traditional community banks. At June 30, 2012, 102 of the state's insured depository institutions were less than $100 million in total assets with 136 entities above that mark.

The median-sized bank in Oklahoma is approximately $95 million with some 30 - 35 employees. They serve Oklahoma communities from large cities to small and from border to border. Many are located in one-bank communities, particularly in Western Oklahoma.

These small, traditional community banks do not have large compliance staffs. Moreover, they do not have the resources necessary to enable the bank to hire more compliance experts or retain lawyers to assist them as they try to meet the mandates established by the growing number of regulations emanating from Washington.

In our view there are a number of issues that make applicability of these proposals to community banks impractical. We believe these proposals will collectively limit the ability of Oklahoma banks to meet the credit needs of borrowers in their communities. We also believe these proposals, when taken together, are likely to substantially limit the availability of credit for certain types of borrowers and, at the same time, significantly increase the borrowing costs to certain business owners and consumers.

III – Risk-Based and Leverage Capital Rules

A. Initial Observations and Questions:

As we have worked through the language of this proposal a few fundamental questions are obvious. For instance, what is it about traditional community banks that suggests such redundant layers of capital are necessary? After all, community banks were not at the heart of the financial melt-down four years ago.

What is the likely impact of these higher capital redundancies on community bank customers and the economy as a whole? Specifically, what will be the impact on housing and small business lending? These are significant issues but it appears that very little thought has been given to the unintended consequences that are likely to flow from them, especially for community banks.

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B. INCORPORATING AOCI INTO THE CAPITAL CALCULATION:

The proposal should strike the language that mandates inclusion of Accumulated Other Comprehensive Income (AOCI) in a bank's capital account, especially for community banks. We believe this requirement will cause significant problems when rates begin to rise again.

Federal banking regulators surely understand that the current rate environment will not continue forever. By including unrealized losses of AFS securities in Common Equity Tier 1 capital, rising interest rates will result in substantial downward pressure on bank capital levels. As a result, banks will have to reduce lending growth in order to maintain adequate capital levels under these propose rules. This reality will keep the banking industry from contributing to the nation's economic recovery in a rising interest rate environment and will increase the risk of liquidity-crunches during times of economic expansion.

In addition, demand for many securities implicitly and explicitly guaranteed by government has increased dramatically. When the economic recovery begins to take hold, fair values of bank bond portfolios will fall, causing an AOCI decline. That means more dollars for capital and fewer dollars for lending.

Every dollar of additional capital required by federal banking regulators means less that's available for lending purposes. In addition, state lending limits are tied directly to a bank's measure of capital. Reducing a bank's capital and changing its lending limit simply in reaction to an **UNREALIZED LOSS** in the value of a bank's bond holdings is counter-intuitive and will negatively impact a community bank's ability to provide loans to consumers.

Moreover, leaving this requirement in place will create unnecessary and increased volatility in regulatory capital balances. It will **ADVERSELY IMPACT THE ABILITY OF SMALLER COMMUNITY BANKS TO MAKE THE LOANS NECESSARY TO SERVE THEIR CUSTOMERS AND THEIR COMMUNITIES**. This increased volatility will mean that loans to small businesses, farmers and ranchers will decrease, thus hampering the nation's economic recovery.

Different asset classes react differently to interest rate swings, and such swings will create stress in specific markets that are likely to shut off credit completely to certain groups and maturities. As an example, many banks purchase nonrated, bank-qualified, local municipal bonds and longer-term, 10- to 15-year bonds. If this proposed requirement is adopted, it's likely many of those same banks would no longer support long maturity or local bond issuances. Such a result has the potential to devastate the financial ability of local governments to adequately perform their duties.

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In summary, we believe this requirement will hurt the ability of community banks to serve the lending needs of its customers, especially their small business customers. Such a result will, we believe, further hamper the nation's anemic economic recovery. It will harm both bank customers and the communities they serve.

C. Phase out of Trust Preferred Securities as Capital Instruments:

During the Congressional debate on Dodd Frank, one of the more hotly debated issues was the so-called "Collins Amendment." It resulted in a compromise in which banks with less than $15 billion in total assets were permitted to keep Trust Preferred Securities (TRUPS) as a part of the bank's capital. They can no longer issue new TRUPS, but Congress agreed to let smaller banks maintain the ones they currently have.

The proposed phase out of TRUPS is inconsistent with the intent of the Collins amendment. The proposed Basel III capital rule **DOES NOT** grandfather Trust Preferred Securities for institutions with less than $15 billion in total assets. Instead, it mandates the write-off of these capital instruments at the rate of 10 percent per year through 2021.

- More than one-third of OBA-member banks have issued TRUPS. Phasing out this source of capital on an accelerated basis will especially burden these community banks and their capital plans.

- Privately-held banks in our state have few alternatives for raising capital. It's one thing to invite investors to invest in a bank with the prospect of generating a return on that investment. It's an entirely different matter if investors are being asked to fill capital holes caused by arbitrary changes in regulation. This will make it even more difficult for community banks to replace Trust Preferred Securities.

- The losses incurred as a result of this accelerated phase out will necessarily require banks either to reduce lending or shrink the size of the bank. How else will they be able to comply with these new requirements?

- The Congress, through enactment of Dodd-Frank, never intended for this type of instrument to be phased-out on an accelerated scale for community banks.

The proposed rule should be revised to fully recognize the intent of the Collins amendment by permanently grandfathering outstanding Trust Preferred Securities for institutions under $15 billion in total assets.

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D. Capital Conservation Buffer.

Most Oklahoma bankers believed that the allowance for loan and lease losses already serves as a "buffer" against potential loan losses. We believe existing rules and regulations are sufficient to enable federal banking regulators to deal with the circumstances under which the payment of dividends and executive compensation is appropriate and permitted.

For example, any insured institution that is deemed to be operating in an unsafe or unsound manner is subject to enforcement actions that restrict both executive compensation and the payment of dividends until things improve. We believe these restrictions are adequate for regulatory purposes.

Oklahoma has 163 Subchapter "S" entities among its 238 insured institutions and the proposed new "buffer" provides no exception for these banks. Dividend distributions to Sub "S" shareholders are crucial because that's how they fund their respective tax liabilities. This is the way Subchapter "S" banks operate. This proposed "buffer" will work to lessen not only the attractiveness of this structure for potential investors but it will also hamper the ability of all banks to retain and recruit bank executives.

This new "buffer" is not needed and is redundant. It should be stricken. Oklahoma bankers believe the current system provides the necessary and appropriate framework by which federal banking regulatory agencies can impose restrictions on capital distribution and compensation matters on a case-by-case basis.

IV – THE STANDARDIZED APPROACH

A. GENERAL OBSERVATIONS:

First and foremost, and as noted earlier, we strongly believe **THIS PROPOSAL SHOULD NOT APPLY TO COMMUNITY BANKS**. These new capital requirements, if adopted, will become the major driver of how banks are managed going forward because banks will be incentivized to focus their attention on less "risky" loans.

The proposal was originally drafted by banking regulators who are unfamiliar with our nation's community bank model. It's apparent that very little thought was given as to how these proposals will impact Oklahoma's many small business borrowers and consumers.

The risk-weighting proposals generate more questions than they answer. For example, Residential mortgages will have various accelerated risk-weights ranging from 35% to 200%, based on the loan-to-value (LTV) ratio of the house. What's the basis for such a formula and how were such values determined?

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Moreover, what impact will the predicted decrease in lending, particularly in the area of residential mortgage lending, have on the public generally and its confidence in the banking system as a whole? Has anyone thought about this issue and what it means for housing?

Our primary concern is this: the complexities inherent in the proposed standardized approach for calculating risk-weighted assets will simply force smaller banks to get out of the residential real estate lending business rather than run the risk of not getting it "right."

In many Oklahoma communities today smaller banks are no longer making residential real estate loans. They have gotten out of the business because they are being buried by an avalanche of new rules and regulations with which they can no longer keep up. The truth is smaller traditional banks cannot afford the costs or the regulatory risk associated with residential real estate lending in the current regulatory environment.

B. BALLOON NOTES AND RISK-WEIGHTING MORTGAGES

1. **BALLOON NOTES:** Here's what's happening on the ground in Oklahoma:

   - Nearly two-thirds of OBA-member banks use "balloon notes" when financing real estate purchases. They've been doing it this way for decades, as a risk-management tool that enables them to keep the customer local.

   - Based on a recent OBA survey, 80 percent of the banks that use balloon notes will simply stop making these kinds of loans because of the proposed risk-weighting rules that would apply to such transactions.

   - Moreover, and based on that same survey, about half of OBA- member banks believe the loss of the 120-day exclusion period for credit-enhancing representations and warranties will adversely affect the bank's willingness to make fixed-rate 1-4 family residential mortgage loans in **ANY** form.

Smaller banks simply don't have the staff, the resources or the depth of knowledge that will be required if this regulatory avalanche continues. We believe the "Standardized Approach" will exacerbate the problem of driving community banks out of residential and some commercial real estate lending, and Oklahoma consumers will suffer because of it.

2. **RISK-WEIGHTING FOR PAST-DUE LOANS**:

   - Delinquent loans will become so expensive for a bank to carry on its books that the bank will be strongly motivated to resolve the delinquency as soon as possible.

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- The bank will have a reduced incentive to work with the borrower to have the loan brought current and eventually repaid in full.

- Banks will become more aggressive in their effort to minimize capital that's required for past-due loans.

- Increased foreclosures and increased collection activities are not in the best interest of the customer and are harmful to consumers and the communities served by the bank.

3. Risk-Weighting for Existing Mortgage Loans:

Importantly, this proposal includes new methodologies for risk weighting mortgages that apply to **EXISTING** mortgages as well as future ones. They are heavily dependent on data and can increase risk weights up to 200%.

- The problem is the proposed mortgage categories did not exist at the time existing mortgages were originated. This is especially true for community banks.

- There is no uniformity among our member banks about how data was recorded or retained. Many banks simply don't have it available in a format that would allow current holders of such mortgages to assign the appropriate risk weight. Underwriting criteria will be particularly difficult—if not impossible—to obtain. All of it will amount to an excessive cost on community banks and, ultimately, that cost will be passed on to consumers.

- For example, the proposal defines a category 1 mortgage to mean one in which the "standards used to underwrite the residential mortgage exposure . . . [t]ook into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance (including mortgage guarantee insurance), and assessments." The fact is some banks may simply not have recorded this kind of data when the loan was originated and, as such, have no way to comply with the terms of this proposal for existing mortgages already on the bank's books.

At a minimum, existing mortgages should be grandfathered and excluded from this proposed requirement. Existing mortgages should be assigned risk weights under the current general risk-based capital requirements at 50 percent.

4. Loan-to-Value Ratios:

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The details of the proposals are exceedingly complex, and even federal banking regulators had difficulty agreeing on a methodology to assist banks in calculating their impact. There are also a number of questions about these proposals, beginning with the loan-to-value analysis involved in every real estate loan. For example:

1. What will be the frequency required of banks to calculate the LTV ratio?

2. Is it only required at the inception of the loan, or are continual updates also required?

3. How frequently will updates need to be added to the loan file?

4. What happens to a loan in which the LTV met the specific standard at the outset (when the loan was made) but which comes in at a lower rate because the value of the property has deteriorated for some reason?

5. Who will conduct the appraisals in smaller communities that are necessary to enable these LTV calculations to be made? The reality today is that there is an insufficient number of appraisers available outside of the state's three major metropolitan areas. These are the areas in which most of the state's smaller banks are located.

As noted earlier, our fear is that residential and some commercial real estate lending in areas outside of the state's urban or semi-urban areas will become more and more difficult and costly for community banks and their customers. Many will simply choose to exit this market because they don't make enough of those kinds of loans, and the risk of doing it "wrong" is no longer worth the cost.

When that happens, the question becomes who will make these kinds of loans in smaller communities if they are not made by the local banks? It most certainly will not be done over the Internet or by larger banks and mortgage operations located in metropolitan areas. Community banks across Oklahoma and the rest of the nation are the lifeblood of those local communities and these proposals will simply accelerate their demise.

If the game plan of federal banking regulators and others in Washington is to shrink the size of the industry and drive community banks out of existence, adoption of these proposals is an excellent beginning.

Respectfully,

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