Michigan Bankers Association

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Board of Governors of the Federal Reserve System
Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

I am writing on behalf of the Michigan Bankers Association. The MBA represents the entire banking industry of Michigan. With members ranging in size from less than $40 million to the nation's largest banks, our median-sized member bank is $200 million in assets.

We urge you to reject the Basel III standards.

The impact of Basel III to member banks, their customers, and communities will be substantial. It will curtail lending and contribute to pressures on the viability of smaller institutions. These institutions are vital to consumers, businesses and communities across our state.

As national data indicate, increased regulatory demands for capital for banking generally substantially raised capital ratios in recent years. In Michigan, as with the nation, this result was achieved in smaller institutions not by raising new capital, which is typically not available, but by shrinking assets, reducing lending. The general thrust of Basel III to raise capital levels further will drive the same result. Banks will be forced to shrink assets.

This will negatively impact credit availability and sap economic growth.

The specific issue within Basel III of the greatest concern to MBA members is residential mortgages and risk weighting. These members are concerned that further restrictions in their ability to write mortgages in their communities will be detrimental to banks, access to credit for consumers, and the communities they serve. Members relate the following:

First the proposed rule assigns different weights to residential mortgage risk based on whether the mortgage is a "traditional" mortgage (category 1) or not (category 2). Specifically MBA members are concerned with the default treatment of all balloon mortgages as Category 2 loans:

1. The preamble to the proposed rule asserts that category 2 mortgages are subject to higher risk weights because they "generally are of higher risk," whereas category 1 mortgages "reflect those underwriting and product features that have demonstrated a lower risk of default through supervisory experience and observations from the recent foreclosure crisis." In many cases the balloon mortgage could and should be used for the benefit of the borrower and, properly underwritten, reduces risk exposure.

2. MBA members offer a full array of mortgage products, however are increasingly writing a majority within Fannie Mae and Freddie Mac fixed rate loans. Stronger internal underwriting processes, economic uncertainty, artificial interest rate environments, and regulatory pressure are moving product to conforming standards. Customer options and customer choice of mortgage products are based primarily upon:

   - The borrower's perceived cost of different products,
   - Their long term intention of holding real estate being financed, and
   - Property eligibility for financing through Fannie Mae or Freddie Mac.

The last factor is of particular importance, since many properties in rural Michigan are ineligible for long-term fixed rate financing through Fannie Mae or Freddie Mac due to property acreage exceeding the allowable limits, property use (mixed residential and commercial including agricultural), or many properties unable to meet the strict appraisal guidelines imposed by the GSEs.

MBA members viewing the unacceptable interest rate risk of long-term fixed-rate mortgage loans on their balance sheets in the current interest rate environment look to other options. Balloon mortgages meet both lender and customer needs. Well managed and underwritten properly a balloon mortgage may in these instances serve the bank, the community, and the customer's best interests—with no added risk.

A second area of specific concern is the NPR risk weighting treatment of 1-4 Family Residential Mortgages (FRM), the use of loan to value (LTV) as the sole determination of the risk weighting, and the exclusion of any consideration of the credit enhancement provided by private mortgage insurance.

There are many factors to be considered in evaluating the credit worthiness of borrowers. Over reliance on LTV ignores many heretofore effective points of borrower dependability and lending success. These include; the consumers debt to income ratio, credit payment history, net worth, private mortgage insurance, and employment history.

Throughout the conversations concerning Dodd/Frank it was represented that judgment-based, customer-tailored banking lending decisions should be protected to assure access to credit and most favorable treatment for borrowers. Specifically numerical qualifiers and algorithmic inclusion thresholds were to be avoided.

Lastly the proposed treatment of **all** junior liens as category 2 loans with loss exposures of 100% or more is unwarranted. HELOC and other junior liens are at worst unsecured lines of credit and should be risk rated no higher than unsecured commercial or consumer debt. This is contrary to banks' efforts to restore consumer confidence generally and expand economic activity. It will unreasonably impede lending.

In conclusion, the MBA urges the rejection of Basel III. Its requirements will unnecessarily impede lending and negatively impact our banks' customers and communities.

MBA urges that the proposal be revised to include best practices of the finest members of the banking community.

Thank you for your consideration.

Sincerely,

Dennis Koons

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