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October 19, 2012

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

Office of the Comptroller of the Currency
250 E. Street, SW
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Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: *Official Comments for "Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements" as referenced by the following Banking Agencies in their Joint Notice of Proposed Rulemaking- known collectively as "Basel III" hereafter. The specific Docket References to which this letter refers are:*

FRB: **12 CFR Part 217 [Regulations H, Q, and Y; Docket No. R-1442]; RIN 7100 AD 87**
FDIC: **12 CFP Part 324 RIN 3064-AD96**
OCC: **12 CFR Part 3 [Docket ID OCC-2012-009] RIN 1557-AD46**

Ladies and Gentlemen:

We appreciate this opportunity to respond to the request for commentary and feedback as made by the Federal Reserve System, Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (hereafter referred to collectively as "the Agencies') regarding the Joint Notice of Proposed Rulemaking related to the implementation of the *Standardized Approach for Risk Weighted Assets*[1] as part of the overall Basel III set of proposals.

As part of SpiritBank, a 96 year old Oklahoma owned and operated community bank with just under $1 Billion in assets, SpiritBank Mortgage assists an estimated 1200 plus individuals and families with their long term mortgage financing needs each year. As part of the communities in which we live and serve, we bring home finance solutions to those who need it.

SpiritBank Mortgage is a provider of traditional fully documented Agency loans that conform to Fannie Mae and Freddie Mac standards and we are a Direct Endorsement FHA lender as well as LAPP lender for VA. We are also a proud participant in both USDA's Section 502 Guaranteed Loan program helping to meet the needs of our rural markets as well as in HUD's Section 184 Native American Lending program where we are also a Direct Guarantee lender serving the needs of the Native American Community in our State. All of these loans are made on a correspondent basis where we as a fully delegated lender originate, underwrite, close and fund in our name and present the loans for sale post closing on a servicing released basis.

[1] Federal Register Vol. 77 No. 169 from Thursday August 30, 2012 running from pages 52887 to 52975 and found at http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-17010.pdf

In short, our daily focus is on our customers and the communities in which they live and work. We take seriously the role of a community bank in our market's economy, realizing the fundamental part we play in being a provider of credit is not one to be taken lightly. Likewise we also understand today ***as we have throughout our history***, that sound and prudent underwriting of borrowers and their credit requests is an equally important role that we must play in order to weather the occasional economic storms that ensue.

INTRODUCTORY REMARKS TO OUR COMMENTS—THE NECESSITY OF COMMUNITY BANKS

First, we wish to go on the record as stating our strong support for safe and adequate capital levels within the nation's banking and financial systems. The financial crisis of 2007-2008 bears out the need for adequate levels of capital within any institution. While hindsight is "20/20" as the old saying goes, it is as clear today as it was during those of the meltdown, **that community banks were not part of the problem.**

While the large investment banks of Wall Street were peddling their esoteric mortgage programs during the boom leading up to the bust, community banks were focused on basic traditional mortgage lending. It is estimated that the 5 major investment banks were leveraged at a 40 to 1 ratio in 2007[2]. It is little wonder then that Lehman Brothers imploded into bankruptcy and the other investment major investment banks (Merrill, Morgan Stanley, Goldman Sachs, Bear Stearns) either sold out to competitors or converted to bank holding companies during the fall of 2008[3].

During this time community banks such as ours continued to serve our customers and communities by being providers of credit for housing and other needs. However traditional community and commercial banks must now face the fallout that was provoked by the recklessness of the Investment Banking "casino model". Through the specific provisions of this section and others of the Joint NPR as proposed by the Agencies, in addition to Dodd-Frank, we and other community banks are being made to pay the penalty for the sins of others.

It is utterly amazing to contemplate moving to a capital based system such as this especially given the fact that non-bank financial firms are exempt from this rule—or at least there is no enforcement agency mechanism if they are somehow subject to it. The non-bank/shadow banking system is where the last financial crisis of 2007-2009 had its beginning.

This Joint NPR, if unaltered, will only serve to push more and more borrowers out of regulated banking and into that non-bank financial sector. This was not good for the nation's economy in the past as evidenced by the financial crisis nor can it be expected to be any better in the future.

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[2] **Official Report of the Financial Crisis Inquiry Commission** as stated on page *xix* of the introductory section of "conclusions" and found at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

[3] **Official Report of the Financial Crisis Inquiry Commission** as stated on Page 154. Found at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

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Christopher Whalen writes in *HousingWire*:

"The increased capital requirements of Basel III and the specific sanctions on housing assets alone are sufficient to push activities such as mortgage conduits into the nonbank sector, as we learned at HousingWire's REthink Symposium. As one Washington insider observed to me over dinner recently, the net effect of Dodd-Frank is going to be the expansion of the nonbank, gray market financial sector, which is precisely where a large part of the subprime crisis began."[4] *(Emphasis Added)*

Paul Muolo at *Origination News* also adds:

"It appears the future is looking much brighter for the nonbank sector of residential finance. Thanks to Basel III and other draconian regulatory changes banks (going forward) are not likely to be the fierce competitors they once were."[5]

We would strongly advise the Agencies to heed the wisdom of those who are calling for calm, measured and thoughtful action in the drafting and implementation of these guidelines and who are calling for the Agencies to consider the deleterious impacts of Basel III on the Community Bank model.

This is especially true in light of the fact that Basel itself is fully intended to apply primarily to institutions with international reach and presence. Rushing to finish these will not serve any purpose but to harm community banking and further prevent the economy from recovering. As Mr. Stephen Calk writes in the September 7, 2012 edition of *Origination News*:

"Basel III is designed to level the playing field among major banking institutions that operate internationally. Force-feeding these same rules to community banks in the United States is unnecessary and in fact counter-productive, particularly in the current economic environment."[6] *(Emphasis Added)*

Mr. Calk's statement could not be more accurate or timely given the content of the Joint NPR. With the caution of Mr. Calk's statement in mind, we will focus the majority of our comments on the issues that raise to us the gravest threat to our continued ability to offer Residential Mortgage Lending solutions to our customers.

IMPACTS OF THE STANDARDIZED APPROACH TO RESIDENTIAL MORTGAGE LENDING

There is no clearer way for us to state the impacts that the Standardized Approach for Risk-Weighted Assets (hereafter "Standardized Approach") as proposed, will have on our Retail Mortgage lending operation. In short, the impacts will be incredibly detrimental.

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[4] Christopher Whalen ***"The Stiff Arm of Dodd Frank"*** *HousingWire* July 2012 found at http://www.housingwire.com/news/stiff-arm-dodd-frank

[5] Paul Muolo ***"What We're Hearing— Are Nonbank Loan Officers Making Double Their Bank Counterparts?"*** *Origination News* 9/18/2012 found at http://www.originationnews.com/blogs/hearing/nonbank-loan-officers-out-earn-bank-officers-1032250-1.html

[6] Stephen Calk ***"Don't Let Basel III Hold Back Community Bank Lending"*** *Origination News* 9/7/2012 found at http://www.originationnews.com/blogs/compliance/basel-III-holds-back-community-bank-lending-1032122-1.html

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In order for us to maintain our current Tier 1 Capital rating we would have to raise, at a minimum, at least $8.5 million in new capital if the final rule contains the provisions for credit enhancing representations and warranties for Early Payment Defaults and Early Payoff on sold loans. This does not take into account additional capital needed should our volume of loan production grow as it has with the exit of other lenders since the financial crisis of 2007-2009. As a family owned bank we have limited means by which to raise capital, lacking the access to deeper capital markets that larger multi-billion dollar assets institutions possess.

There is an extremely high if not almost certain probability that the Standardized Approach as it is being proposed would force us to shutter our Retail Mortgage Lending operation for good.

This is not an exaggeration. This is not an embellishment. This is not the melodramatic cry of some Chicken Little that *"The sky is falling!"* This is the cold, brutal and hard fact of the matter. The proposed Standardized Approach is a completely unrealistic and unworkable system for the thousands of community banks left in this nation, us included, who provide the necessary housing and mortgage lending credit to our fellow Americans.

How specifically does it impact a Community Bank Mortgage Lender such as SpiritBank Mortgage? Besides the basic economics of creating an unlevel playing field between banks and nonbanks, there are very specific portions of the Joint NPR which will decimate our business model which is ***the basic business model of community bank secondary market mortgage lending.***

While we have numerous concerns with the methodology and basic "Matrix" that the Agencies have proposed based on a sole and singular filter of Loan to Value (LTV), we have specific concerns that are unique to our own business model.

Our primary area of concern is that of the proposed change to the treatment of credit-enhancing representation or warranty on sold assets to a third party if such a sale has provisions for "early default" or "premium-refund" embedded within it[7]. We believe that as proposed, the Joint NPR does not reflect an accurate understanding by the Agencies of the real world implications of such a proposed policy.

Our department is a Correspondent Mortgage Lender. We have contractual agreements with larger institutions, mainly other commercial banks to which we sell closed and funded residential mortgage loans originated by our Bank. In the industry parlance, these institutions that purchase loans on a servicing released basis are referred to as "Investors".

The loans are processed, underwritten and closed by our Bank in our name using our "Delegated Underwriting Authority". We are given this "delegation" of authority by the

[7] Joint NPR as referenced in Footnote # 1 above. Federal Register Vol. 77, No. 169 Thursday 8/30/12 at page 52902 under Point # 11 "Other Assets" starting with the second full paragraph of the second column on said page and continuing into column 3. Found at http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-17010.pdf

Investor to underwrite the loan in accordance with their standards and guidelines which tend to mirror those of FHA, VA and Conventional parameters. Investors may place their own "overlays" on certain programs. An overlay is literally when the Investor "lays over" their own stricter requirement upon that of the program's normal requirements.

For example: FHA states that a borrower who has a FICO score must have a 580 or higher FICO score in order to qualify for the minimum 3.5% down. Most of our investors require a 640 Minimum FICO for an FHA loan which is allowed for by HUD.

Our Loans Purchase Agreements contain clauses where we make representations and warranties (hereafter referred to as "reps & warrants" or R&W) for early payment default and/or early payoff. It is important for us to differentiate the meaning of these two terms.

Early Payoff (EPO): The EPO R&W clause is triggered by the borrower paying off the loan within a pre-determined period after purchase by the Investor. Most EPO clauses may last from 120 to 180 days from the purchase of the note by the Investor from the Originating Lender. The exposure is limited to a refund of the pricing over 100 par as paid by the Investor to the Originating Lender and the Service Release Premium (SRP) if applicable.

- **For example:** We originate and sell a Loan to Investor ABC for $100,000 at a price of 102.500 meaning we are paid $102,500 for the $100,000 loan. Assuming that loan pays off within the EPO timeframe we would owe Investor ABC back the $2500 amount paid to us at purchase.

Early Payment Default (EPD): The R&W clause for an EPD is triggered when a sold loan reaches a certain stage of delinquency within a given timeframe after the purchase of the loan by the Investor. Most EPD clauses are for 120 days after purchase of the loan by the Investor. Most of our Investors have pre-set EPD clauses that are triggered when a loan reaches 90 days+ past due typically within the first 4 payments that are due to the Investor after they buy the loan.

How EPOs & EPDs Work in the Real World

What we believe is important for the Agencies to consider are the following points, both of which are missed by the proposal in the Joint NPR for the standardized approach related to credit enhancing reps & warrants. Proper understanding of how these R&W's work within the framework of Correspondent Bank Mortgage Lending for a community bank lender such as SpiritBank is vital to getting any rule correct. Failure to understand or appreciate this process can only lead to a fragmentation of this industry, exit of players from the market and thus higher costs and less choice to consumers.

The Agencies must realize the following "realities" that exist with EPOs & EPDs:

- An EPO exposes us not to the full amount of the loan being refunded but just the amount paid for the loan by the investor;

- An EPD is almost always satisfied for a flat fee paid to the Investor which may also in some cases **be made in lieu of an actual repurchase.** ***In fact a repurchase of the loan is most always not necessary*** unless fraud or misrepresentation is involved. That extends to fraud or misrepresentation by the borrower even if a lender is not a party to it.

SpiritBank Mortgage- A 25 Month "Look-Back"
We have analyzed the total number of loans closed in the past 25 months leading up to the date of this letter by our department. We have closed over 2,443 loan units for $399,204,430 in total dollars lent.

- 1,696 of those loans totaling $266,345,776 were made to assist our customers purchasing their primary principal residence.

- 434 loans that total $85,844,662 were made to customers looking to refinance their principal residence into a lower rate or shorter term in order to help them save on interest costs and/or build their equity faster.

- 212 loans totaling $36,113,539 were made to customers who were accessing equity in their principal residence for cash out purposes to maybe consolidate their other debts or finance improvements to the home itself.

Over 95% of the loans we made and over 97% of the dollars we have lent were made to borrowers on a primary residence. Almost 7 out of 10 were for someone to purchase a home.

We are extremely proud of this fact. We are also proud of the following:

- 64.59% of all loans had at least one first time home-buyer on the transaction;

- Over 20% of all loans had at least one Non-White Borrower on the transaction;

- Over 7% of all loans made were done through the Oklahoma Housing Finance Agency's First Time Homebuyer Program using Mortgage Revenue Bond Assistance;

- 18% of all loans made were made to borrowers on specifically targeted products such as VA (Veterans), HUD 184 (Native Americans) and USDA's Section 502 Guaranteed Rural Housing (Rural Designated Markets for Borrowers within Income Limits set by USDA).

This is the type of lending that defines the core day to day mission of any community bank. This is the type of lending that will be utterly, totally and completely obliterated if the Basel III rulemaking on Credit Enhancing Reps and Warrants is unchanged.

To give historical perspective to our own performance we have also examined how many EPDs were incurred during this timeframe from loans that closed. We have had 3 total instances of EPDs in this timeframe. Of those 3 all were assessed a payment of a flat fee to the Investor with whom the EPD was incurred. No buyback or demand request for buyback of the loan based upon the EPD rep & warrant being triggered was made.

Furthermore, after recent discussions with our largest investor purchaser with whom we've an EPD Waiver in place, we confirmed that this investor still works with any bank correspondent on any loan to avoid a complete and total buyback and rather seek to find other means including settlement agreements, make wholes, indemnifications, etc. This confirms for us the nature of the Correspondent Mortgage Banking relationship which is based in mutually beneficial incentives, remains true to this day.

There are incentives to both the correspondent bank (i.e. continued access to the secondary markets via a correspondent relationship) and the purchaser (i.e. continued source of mortgage product to purchase and sell) of the loans to have a relationship of collaborative effort and not one of a confrontational nature in settling potential issues that arise.

Finally, it merits mentioning that there are simply some risks that cannot be "foreseen" or underwritten for or against that could trigger an EPD. Examples would be things such as the sudden and unexpected death of the borrower or one of two borrowers (perhaps the main wage earner) or the sudden and unexpected loss of employment. The underwriting of mortgage and credit risk involves sound measurements of "possibility" but cannot completely "wring out" 100% of all risk from a transaction (Credit/Lending) that finds the price of its commodity inherently tied to the very concept of RISK itself!

CONCLUDING THOUGHTS ON RISK WEIGHTING OF CREDIT-ENHANCING REPS & WARRANTS

We would argue that there is no reason or purpose to risk weight the category of Credit Enhancing Reps & Warrants at this time especially with lenders such as we who make traditional, fully documented loans. Furthermore, there is no reason if the Investor levies a flat fee for an EPD in lieu of a buyback or if the investor offers an EPD waiver (common in our industry) to the seller of the loan which is usually calculated as a few basis points on all loans sold and acts as a blanket insurance policy.

IF despite all these arguments to the contrary, the Agencies still feel compelled that they must risk weight this category, then certainly the only logical and feasible methodology the Agencies should employ would be one based on an historical pattern of default. If the Agencies seek to incentivize prudent risk taking, then looking at historical pattern is the best measure by which to create a dynamic standard of risk measurement as opposed to the more static method offered in the Standardized Approach.

That would entail any risk weight criteria take a more specific look at the type(s) of loan(s) a lender has had to buyback under an EPD clause in the past, if any, and from there apply a more rational and metric based system of risk weighting to the actual lender. This might encompass a rather bulky and cumbersome analytical process if the risk weighting is being done for any category of loans that are subject to a Flat EPD Fee and not immediate or even certain "buyback" at any time. This again goes to the heart of understanding how an EPO and EPD clause work in the "real world" of correspondent mortgage banking.

BETTER METHODOLOGY EXISTS FOR RISK WEIGHTING- THE STANDARDIZED METHOD

The Agencies have requested specific comment on the appropriateness of the Standardized Method for risk weighting of residential mortgage assets in terms of "all aspects" of the Joint NPR. This request for comment includes the use of Loan to Value (LTV) ratio to determine the risk-based capital treatment.[8]

Any construct of residential mortgage risk weighting methodology must take into account a more dynamic and fundamentally realistic set of criteria than what the Joint NPR proposes. The fact that LTV alone is the ***sole filter*** by which to categorize and assign risk weightings is quite baffling to say the least.

We would offer the following initial observations of the Standardized Approach's use of LTV:

1) Using the Loan to Value (LTV) ratio ***as the sole "filter"*** by which risk weightings are made is a myopically narrow measure by which to gauge and weight risk. It is not reflective of sound underwriting within a prudent structure of risk management for mortgage lending. It is quite isolative in nature and focuses lenders on simply one measurement of risk—LTV.

   Sound risk management in relation to underwriting is comparable to viewing a mosaic. As a mosaic is an image made up of multiple "tiles" of different colored glass or stone, a good underwriting decision is one which looks at all the different aspects and circumstances of the borrower and collateral. Assembling them together they are able to make a sound judgment related to the "whole picture".

2) Placing a singular focus on LTV will pose serious risks to any chance of economic recovery in those areas of the nation hit hardest by the drop in property values since late 2007. This will only serve to further constrict credit to the areas that need it most.

The Standardized Approach's heavy reliance on LTV ratio is narrow sighted and has on it the proverbial "blinders". It offers no conceivable method by which to measure other underwriting metrics that we take into account each and every day in order to assess the overall risk involved in the extension of mortgage credit to a borrower. The endorsement of LTV ratio alone as the sole criterion for this categorization of risk weighting is imprudent and dangerous as it reflects either a blissful naiveté or willful disregard for the time honored principles of sound credit underwriting as it relates to residential mortgage lending.

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[8] Federal Register Vol. 77, No. 169/Thursday August 30, 2012 at pg 82899 (Question # 5) found at http://www.regulations.gov/#!documentDetail;D=FRS-2012-0250-0001

In fact, the highly singular focus that is given to LTV ratio can only serve as an incentive, albeit a dangerous one, to mortgage lenders to place an overemphasis on the value of collateral alone and not on the “overall credit profile” of a loan being made. This not only flies in the face of decades of sound credit risk management standards but it may lead to an open “conflict” between the dictates of this regulation and others which the Agencies have had a hand in crafting throughout the past several years. We pause in order to advise the Agencies to take great care in the path they are treading in this regard.

Some of those regulations such as that of the High Priced Mortgage Loan (HPML) addition under Regulation Z that implements the Truth-In-Lending Act stand as a testament to this potential conflict that an overly zealous focus on LTV ratio can incentivize.[9]

The creation of the new HPML designation carried with it certain consumer protections that the Federal Reserve Board sought to implement as a way of dealing with the Subprime and Alt-a mortgage markets. In the opening summary of the Final rule the Board declares:

“The final rule applies four protections to a newly-defined category of higher-priced mortgage loans secured by a consumer’s principal dwelling, *including a prohibition on lending based on the collateral without regard to consumers’ ability to repay their obligations from income, or from other sources besides the collateral.”*[10] *(Emphasis Added)*

The creation of HPML sought to create real and tangible “disincentives” to lending based solely on collateral values alone that also place no review of the borrower’s ability to repay their obligations. This has become the foundational ground for the “Ability to Repay/QM” rule referenced later in our comments.

Thus, the Joint NPR’s proposal on the Standardized Approach of Risk Weighting could have the unintended consequence of actually incentivizing banks subject to it, to place greater emphasis on LTV ratio as opposed to other underwriting criteria when faced with loans that could appear to be on the “bubble” in terms of their overall creditworthiness. If logically followed to its natural conclusion, would this incentive carry the potential to create a resurgence of mortgage lending that is in all actuality RISKIER than that without the proposed risk weighting in place?

That is probably not a question we ought to risk the financial system on in trying to answer.

Mortgage Credit Underwriting is Multi-Faceted and Not Myopically Focused In Nature

As a lender we must critically evaluate a whole host of different data that makes up the overall credit profile of a potential borrower. These metrics and data include the borrower’s:

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[9] 12 CFR Part 226 [Regulation Z; Docket No. R-1305] Final Rule and Official Staff Commentary from the Board of Governors of the Federal Reserve System; Federal Register Vol. 73, No. 147/Wednesday July 30, 2008 Pages 44522 through 44614 and found at http://www.regulations.gov/#!documentDetail;D=FRS-2008-0009-0002

[10] Federal Register Vol. 73, No. 147/Wednesday July 30, 2008 at Page 44522 found at http://www.regulations.gov/#!documentDetail;D=FRS-2008-0009-0002

1. Cash flow or their *Debt to Income Ratios*;
2. Credit history such as past performance on other debts, home mortgages and/or rent;
3. Payment Shock – the percentage of housing payment increase from current levels;
4. Employment History and Job Stability;
5. Liquidity in terms of financial reserves or "liquid savings" they possess

All of this is on top of the issue of down payment and/or Loan to Value ratio.

Furthermore the methodology should employ within it an honest and thoughtful approach to risk mitigation that takes place such as that offered by PMI (Private Mortgage Insurance). PMI offers a third party first loss position in which risk to the originating lender is ultimately mitigated and reduced.[11]

The Agencies have asked for feedback in relation to the presence of PMI in Question # 6:

"The agencies solicit comment on whether to allow banking organizations to recognize mortgage insurance for purposes of calculating the LTV ratio of a residential mortgage exposure under the standardized approach. What criteria could the agencies use to ensure that only financially sound PMI providers are recognized?"[12]

We would argue that PMI should be allowed to be used to offset some level and amount of risk taken by lenders as PMI assumes a first loss position. We would further argue that if the private mortgage insurance company underwrites the MI policy itself, as is the current practice within our Retail Mortgage Department, then the risk of a denied claim by the insurer is greatly mitigated.

The mitigation occurs because by the very act of underwriting the MI itself, the insurer has had a full opportunity to fully vet the borrower and their qualifications for the loan. This provides an inherent "rep & warrant" relief to the Originating Bank Lender and any future assignees of the loan for which the policy is written. A lender may use delegated authority, if they possess it, to underwrite the MI policy coverage however they are not under an obligation to do so.

While there should be some tangible level of "risk weighting relief" afforded to any residential mortgage loan that carries a credit enhancement such as mortgage insurance, we'd also pose the argument that such relief ought to be amplified if the Insurer participates and/or conducts the full underwriting of the MI policy itself. The mitigation of the risk of rescission of the policy's coverage due to the direct underwriting brings additional safety and security to the loan being insured.

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[11] "***The Role of Private Mortgage Insurance in the U.S. Housing Finance System***" Promontory Financial Group. LLC January 2011 at Page 3. Found at http://www.promontory.com/uploadedFiles/Articles/Insights/622%20Genworth%20Study%20I%20-%20Role%20of%20PMI.pdf

[12] Federal Register Vol. 77, No. 169/Thursday August 30, 2012 at pg 82899 found at http://www.regulations.gov/#!documentDetail;D=FRS-2012-0250-0001

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In regards to the question by the Agencies as to the criteria to be used to ensure that only financially "sound" PMI providers are recognized—we would argue that if a PMI provider is in good standing with their prudential state regulator as well as the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, that this should provide as ample criteria for soundness as may be required by the Agencies. PMI companies are regulated on the state level like any other insurance company. The state regulator for that company in their home state of incorporation is best suited to know the financial status of that provider.

In the end, any capital formation rule, , must utilize an approach of risk weighting methodology that reflects the reality of what is used in the lending process itself. That methodology is composed of dynamic, multifaceted and relevant criteria. Failing to incorporate this into a final capital formation rule as it relates to the risk weighting of residential mortgage product is unwise and poses a threat to housing credit availability in this nation.

<u>The Standardized Approach Is Proposed In Isolation to Other Rulemakings</u>

We pause to take into account the fact that there are other numerous rulemakings taking place, most of which is courtesy of the curiously titled *Dodd-Frank Wall Street Reform and Consumer Protection Act* (hereafter "DFA" or "Dodd-Frank").[13]

While some would seriously question the actual amount of "reform" of Wall Street and "protection" afforded to consumers that this law has created, there is a relevant point to be made. It is that the imposition of certain other rulemakings mandated by DFA carry with them the goal of reaching the same "safety and soundness" goals sought by the Agencies vis a vis capital levels in the Basel III Rulemaking.

For example, as this NPR itself makes mention, there is the issue of Ability to Repay and specifically the Qualified Mortgage or "QM". We turn to question # 5 found at Pg 52899:

"For example, should all residential mortgages that meet the "qualified mortgage" criteria to be established for the purposes of the Truth in Lending Act pursuant to section 1412 of the Dodd-Frank Act be included in category 1?"[14]

The "QM" is set to be the "gold standard" of all residential mortgage lending. By imposing a minimum standard of measuring a borrower's "ability to repay", the QM Rulemaking which was initiated by the FRB and being finalized by the Consumer Financial Protection Bureau (CFPB) purports to raise the overall quality of residential mortgage underwriting.[15]

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[13] Public Law 111-203—July 21, 2010 found at http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf

[14] Federal Register Vol. 77, No. 169/Thursday August 30, 2012 at pg 82899 found at http://www.regulations.gov/#!documentDetail;D=FRS-2012-0250-0001

[15] Federal Register Vol. 76, No. 91/Wednesday May 11, 2011 Proposed Rules found at http://www.regulations.gov/#!documentDetail;D=CFPB-2011-0008-0001

As the final QM rule may very well carry with it a legal safe harbor that insulates lenders from both the evergreen legal liabilities embedded in the enabling statutory language of Dodd-Frank as well as the defense to foreclosure, there is every reason to consider that such a mortgage loan should not carry with it such a punitive risk weighting as that being advanced in the NPR by the standardized approach. We would strongly encourage that the Agencies provide for the lowest risk weighting possible or preferably, no risk weighting for all QM loans regardless of the loan to value as the loan is adhering to the preferred "gold standard" being established.

THE END OF AN ERA - THE DEMISE OF THE COMMUNITY BANK MORTGAGE LENDER?

For us, the Standardized Approach is the feared ***poison pill*** that will ultimately force our Bank to seriously consider exiting a business line they have been part of for almost all of our state's proud history. We are just one example, but one of many of the 7000 plus banks in this nation who provide the liquidity, accessibility and expertise of local housing markets that will be pressured as well to exit.

What happens then when a SpiritBank Mortgage shuts her doors?

100 or more individuals and families each month are left with ***less choice*** in the marketplace and therefore by default, ***higher costs***. That is ***100 fewer*** of our fellow friends, neighbors and citizens that we are able to assist in meeting their needs and dreams of home ownership. That is a fundamental re-defining of the meaning of the term "community bank."

If this effect is compounded across the country, what is the ultimate impact economically? It is that more lending and banking is concentrated in the hands of fewer institutions. "Too big to fail" goes from being merely a catch-phrase in the political and economic lexicon to being canonized as the *raison d'etre* for all American Banking Agencies. That is because only those that are "too big to fail" will remain.

FINAL THOUGHTS ON THE JOINT NPR

We appreciate the weighty responsibility under which the Agencies have found themselves laboring during this process. We appreciate the effort by those in the Joint NPR who say it represents a sincere effort to prevent the massive amounts of risk accumulation from occurring again as it did leading up to the 2008 financial crisis. However, we must remind the Agencies that banks such as ours did not contribute to the crash but rather have tried as much as possible to participate in the solution to the economic malaise caused by it.

The Standardized Approach, as proposed, is a draconian measure that will have nothing more than a counterproductive impact on the economy. It remains true to the "one size fits all" approach of Basel III which is itself one that is better suited for Toulouse than Tulsa, Brussles than Bristow, Stuttgart than Stillwater and Oslo as opposed to Oklahoma City.

Given the state of affairs in the EU over the past two years, ***theirs should be the last economic and/or financial system that our nation should even conceivably wish to emulate.***

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As we stated in the beginning- we agree with the purpose and intent of creating strong adequate capital levels within the nation's banking and financial systems. However, this cannot be achieved while at the same time attempting to eliminate all risk from the system. We would offer the wisdom given by the former Acting Comptroller John Walsh:

"Nonetheless, it is also an undeniable quality of human nature that, in the frenzy of the moment, we can overreact in response to crisis. Describing this as a swinging pendulum may be a tired cliché, but it's worth asking ourselves: where is that pendulum right now? One of our OCC supervisors created the wonderful malapropism of "trying to keep the pendulum in the middle of the road," but that is surely not where we are today. To put it plainly, my view is that we are in danger of trying to squeeze too much risk and complexity out of banking as we institute reforms to address problems and abuses stemming from the last crisis.[16]"
(Emphasis Added)

There is already concern being raised within financial markets that the impact of the Joint NPR's approach to risk weighting of residential mortgages will lead only to discourage anything but the least risky of mortgage loans. The net impact would be to lessen the availability of credit and increase the costs of what credit is available to borrowers.[17]

The fundamental importance of Community Banks to our national economy cannot be overstated. The Joint NPR and Basel III as a whole only serve to help further the costs to community banks and push many more into the unenviable position of consolidation.[18]

It is an axiom within the science and study of economics that when there are less providers of a particular good or service to those in demand of said good or service that the price of such a good or service will increase. Furthermore the quality of the good or service provided will decrease overall to the consumer or user of the good or service. These are maxims which are firmly established and grounded in the timeless Laws of Supply & Demand.

This is the same impact that will be experienced by consumers should more of our Community Bank siblings be forced to sell or close their doors. There is no scenario imaginable where this can seriously be thought to be "good" for the country as a whole much less the communities these proud and honest institutional pillars of society once served.

If the Joint NPR is left unaltered as to the issues we have addressed herein we cannot see any future result but more consolidation and more Community Bank closings nationally. Sadly,

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[16] John Walsh, Acting Comptroller of the Currency in Remarks before The Centre for the Study of Financial Innovation London, June 21, 2011 found at http://www.occ.treas.gov/news-issuances/speeches/2011/pub-speech-2011-78.pdf

[17] Esther Cho ***"Basel III Will Increase Mortgage Costs, Limit Riskier Lending: Fitch"*** *DSNews.com* 9/21/2012 found at http://www.dsnews.com/articles/proposals-under-basel-iii-will-increase-mortgage-costs-limit-riskier-lending-fitch-2012-09-21

[18] McGladrey LLP **"Bank Notes"** September/October 2012 found at http://mcgladrey.com/Bank-Notes/Basel-III-capital-standard-What-it-means-for-community-banks

these closings will not be due to traditional banking failures caused by imprudent risk taking and management. Rather, it will be due to the frustrated surrender of many Community Bankers faced with the increased costs of government regulatory fiat that has come crashing down upon them, and unfairly so at that.

While the Agencies may very well have authority over the laws of banking capital via regulatory rulemaking such as the Joint NPR, we would very respectfully remind them that they cannot amend, revise nor repeal the basic laws of economics and markets in general. With that in mind we would strongly urge the Agencies to scrap the entire NPR as proposed and after considerable study of the impacts re-work a new proposal to present.

We leave with an appropriate quote once again from Mr. Stephen Calk:

"Community banks are the educators, the neighbors and the safe and sound lenders that know their customer and can most closely evaluate individual risk and provide opportunity for those seeking a better opportunity and better life. Those community banks that have survived the economic devastation of the last three years are the strong survivors that need and have earned the support of the communities they serve."[19]

We couldn't agree more.

We sincerely hope that the Agencies do as well.

I remain—

Cordially,

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CC: The Honorable Senator James Inhofe, United States Senate
The Honorable Senator Tom Coburn, MD, United States Senate
The Honorable John Sullivan, United States House of Representatives
The Honorable Dan Boren, United States House of Representatives
The Honorable Frank Lucas, United States House of Representatives
The Honorable Tom Cole, United States House of Representatives
The Honorable James Lankford, United States House of Representatives

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[19] Stephen Calk ***"Don't Let Basel III Hold Back Community Bank Lending"*** *Origination News* 9/7/2012 found at http://www.originationnews.com/blogs/compliance/basel-III-holds-back-community-bank-lending-1032122-1.html