Oklahoma State Senate

DAN NEWBERRY
SENATOR
District 37

December 4, 2012

The Honorable Ben Bernake
Chairman
The Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Bernake:

I am writing to express my concerns as a state legislator over the proposed implementation of the Basel III capital requirements. As a member of the Oklahoma State Senate Business and Commerce Committee, I want to alert you to the situation we face in our state in the banking industry and our local communities.

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 fail to exist. 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, Basel III will do nothing to strengthen the safety and soundness of Oklahoma's community banks, and will likely serve to create uncertainty in our community banks and will ultimately weaken the communities they serve. I would like to address in real terms the way it will have a negative impact on Oklahoma and its communities. Specifically, the changes that Basel III proposes to make in the risk weighting of mortgage credit.

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

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reasons, the bank will not make (nor would as regulators sanction) a 15- or 30-year fully amortizing 1 to 4 family mortgage 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 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 legislators, we have a responsibility to take careful and thoughtful actions that will foster safety and solid business solutions to the constituents we serve. 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 only foster further problems rather. The Basel III proposal suffers from all three of these hazards.

In summary, the Unites 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. 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,

Senator Dan Newberry
State Senate District 37

cc:
James Inhofe, United States Senator, State of Oklahoma
Tom Coburn, United States Senator, State of Oklahoma
John Sullivan, United States Representative, Oklahoma Congressional District 1
Dan Boren, United States Representative, Oklahoma Congressional District 2
Frank Lucas, United States Representative, Oklahoma Congressional District 3
Tom Cole, United States Representative, Oklahoma Congressional District 4
James Lankford, United States Representative, Oklahoma Congressional District 5