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
Mail Stop 2-3
Washington, DC 20219

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429

Re: Basel III Capital Proposals

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 (collectively the "banking agencies").

As a community bank that has served Oklahoma for nearly 100 years, we too desire a system which ensures that the entire industry maintain a strong capital position to withstand unforeseen challenges that may face us as a bank individually and an industry as a whole. SpiritBank ("Spirit") has long served rural areas which historically have not been served by larger financial institutions. In the days of the oil bust in Oklahoma, Spirit expanded its footprint from a single rural community to multiple rural areas that had limited or no other banking options when their local financial institutions were not able to survive the economic downturn. These expansion "opportunities" for our financial institution stand as a constant reminder of the importance of a strong capital position for any financial institution.

As Spirit evolved in the late 1990's to early 2000's, it expanded its presence to the metro areas of Tulsa and Oklahoma City and developed a niche in serving small businesses by developing services that expanded beyond typical loan and deposit products. Management sought to offer services that promoted partnership with these businesses by providing a forum for small business to access the specific talents of other small businesses which might help all parties succeed. In short, we designed a model which sought to bring a holistic "community bank" concept to the urban areas of Oklahoma.

The bank then expanded its model by both creating a residential mortgage origination service line and investing in a separate company whose express purpose is to originate or provide mortgage warehouse services for residential mortgages which are then sold to investors. This expanded the bank's footprint to several other states within the central United States. Today, Spirit and its subsidiaries have built a business model which aids in originating or refinancing over $3 billion in residential mortgages annually and maintains an average balance sheet of approximately $1 billion.

In reviewing the Basel III proposals, there are several changes offered into the proposals which have a direct and significant impact on our business model. While we appreciate the objective that Basel III intends to address, we must express our concerns over the ramifications of the certain portions of the proposal as presently written. The following comments stand to highlight our primary concerns.

Implementation Date

First and foremost, we are concerned over the date of implementation as proposed in the Basel III Numerator NPR which suggests that banks be ready to comply with the mandate by the beginning of 2013. Given that many banks have just now started to see relief from the extraordinary measures necessary to rehabilitate their balance sheets or, in too many instances, are still working through troubled asset quality issues, it seems premature to introduce a capital plan that will take away from the efforts to finish these endeavors before turning attention to what would result for us, and we presume many banks, new capital raising efforts. Community banks have limited staff to manage through complex issues such as these simultaneously. To do them properly and effectively, a more forgiving timeline for implementation would be appreciated.

In recent days, the European regulators have noted that implementation in Europe will be delayed. We support the stance as more time should be spent to assess and quantify the impact by both the banks and the regulatory agencies. Perhaps taking extended time to consider the responses from industry bankers on the issues may lead to a better model rather than hastily implementing a flawed model.

Phase out of Trust Preferred Securities as Capital Instruments

SpiritBank's holding company, Spirit BankCorp Inc., has three separate trust preferred issuances, the most recent being issued in 2006. For a relatively small private bank such as Spirit, these sources of capital represented a reasonably low cost capital option to support ongoing operations. Today, that capital represents approximately 29% of Spirit's Tier I capital. Based on the phase out plan prescribed, nearly one third of the company's total capital must be replaced through private issues in the next ten years. In the short-term, there are multiple obstacles we would face along with many of our community bank friends in replacing this established capital line:

- Current economic conditions continue to compress interest margins and earnings for banks making return on investment less attractive to potential investors
- Estimates of at least two to three years of suppressed interest rates will continue the challenge above
- Increased costs relating to current regulatory oversight
- Future increased costs anticipated with unimplemented regulatory mandates associated with Dodd-Frank
- Future increased costs associated with compliance with the new Consumer Financial Protection Bureau
- Limitations of new ownership percentages imposed by the FRB's Policy Statement on Equity Investments in Banks and Bank Holding Companies as revised in 2008

In general, community banks seek capital from a limited pool of investors which is often confined to existing investors, board members and those friendly towards the institution. These groups also represent a limited pool of investors any one community bank can call upon to inject capital and maintain the same vision as the current shareholders and Board of Directors. While capital market avenues and return-oriented investors may be available, the long-term consequences of investors seeking robust returns in a short window of time can lead to undesirable paths which stray from the safe banking practices that have kept so many community banks in business for decades. High risk activities such as aggressive loan expansion and compromised underwriting guidelines to maximize profit margin often follows sources such as "institutional capital" with the eventual outcome of consolidating smaller institutions into larger ones.

The mandate to replace existing capital on the heels of (or in the middle, depending on your outlook) one of the worst global economic downturns in history creates pressure that may lead many community banks down this very line of thinking. Taken far enough, this path may see the elimination of the community banking sector in exchange for a much more limited number of larger, complex institutions where capital at risk is further centralized under the risk appetite of a smaller group of decision-makers. Wall Street banking is largely found

at fault for what our industry is now facing and our regulatory agencies are trying to keep that from happening again. Why set policy that establishes a framework of necessity to send more assets their way?

Pressure to replace capital also comes at a time when regulatory costs are not only stifling in their present form, but an unlimited number of mandates appear to be on the horizon in the form of compliance with components of Dodd-Frank which have not been implemented and CFPB which will have its own set of regulations to enforce. These are just a couple burdensome issues facing the banking industry alone. Costs associated with issues such as the Affordable Care Act and potential tax changes so often mentioned during the election season face all businesses. Astute investors will see difficulty in assuring a reasonable return on their investment dollars in the community bank sector with so many unknown and unquantifiable costs associated with basic survival of a company looming on the horizon.

Overall, as the intent of Basel III is to provide a strong capital position in the industry, it seems counterintuitive to set policy which steers banks toward replacement of existing capital rather than provide a framework which invites new capital to bolster the industry's existing capital base. If trust preferred capital is successfully replaced by smaller institutions, there is inherently a diminished pool of available capital for prudent expansion of otherwise safe and sound financial institutions.

Suggested Change

The Collins Amendment of the Dodd-Frank Act allowed for existing trust preferred capital issued prior to May 19, 2010 by financial institutions less than $15 billion in size to be grandfathered into Tier I capital calculations. As this was passed into law in 2010, it seems that adopting a similar stance for Basel III requirements would better align banking regulation with existing law. As these capital instruments have already been deployed into the banking system and business models already developed with this capital utilized, allowing the industry to focus on new capital to strengthen the industry would appear to be a more fruitful avenue.

Credit Enhancing Representations

As noted previously, Spirit originates and sells a large volume of residential mortgage loans to investors. Most contracts with investors contain language about low level recourse representations such as early payment default provisions which currently are excluded in the general risk-based capital rules. If this proposal is adopted in its current form, based on current 1-4 family mortgage sales where Spirit or its subsidiaries retains this low level risk, Spirit would need to raise approximately $70 million in additional capital to support this off-balance sheet exposure. As Spirit's holding company has capital (including trust preferred securities) totaling $95 million, we would have to increase our existing capital by nearly 75% of its current total to support this change. Significant to this issue is that this new capital would not translate to increased earnings.

To further illustrate its impact, if the bank is earning a 10% ROE on the capital currently in place, this additional capital injected would drive the ROE of the bank to 5.8%. Given the already limited capital markets noted previously, this proposal all but eliminates Spirit's ability to provide this service due to lack of return on investment. There is not a cost-cutting provision or revenue-enhancing alternative that could be developed to overcome the cost of this capital requirement.

The current proposal stresses an institution to its highest level possible under these contracts. Spirit does not discount that potential risk exists, only that the possibility of a 100% repurchase of loans with outstanding low-level recourse provisions is far too aggressive a stance to impose on capital. The proposal gives no perspective to historical losses actually sustained by an institution, prudent underwriting guidelines or internal/ quality control systems in place. In reality, the number of loans repurchased under these early payment default provisions calculates to less than .01% of the total loans originated and sold by Spirit in the last five years. That result is in the face of the worst downturn in the mortgage industry on record.

Applying our capital issue to the community banking industry, it would appear that this mandate would eliminate a number of institutions that currently have the infrastructure and expertise to provide this service. There will be a captive number of residential mortgage loans that would be kept in the community banking system, though likely at rates higher to the customer than what is being made available through these services

now. The remainder of the volume would gravitate towards either large, highly-complex institutions that have access to capital markets to support these volumes or worse yet, towards non-regulated alternative companies that will be established to service this volume of homebuyers. Either way, we would argue the industry has not fortified itself but has weakened the service line to customers and forced them into areas of higher risk. As our country has recently experienced, this further weakens the entire industry. The customer can either go to a highly-complex institution which symbolizes volume over service and risk assessment or to an unregulated institution which is not bound to the same prudent underwriting standards banks already have in place.

As noted in a separate letter from a colleague in our mortgage department, the low level risk representation and warranties rarely result in the push-back of these loans to the originating bank. Generally, the settlement is an amount that may be some or all of the fees and gains received by the originating bank or a settled fee far less than 100% of principal. The effect of this mandate is to simply require twice the capital in the industry for the mortgage loan over the time that this credit representation is in place. It certainly fortifies the capital structure of the industry as a whole in theory, but it is short-sighted in adequately measuring the true risk of an institution. Information regarding the volume of loans involved in repurchases and indemnifications has been captured in bank Call Reports since 2008. There should be some amount of information to assess what the true effect of capital may be to the originator and seller. As indemnification suggests a fee charged to cure the issue rather than full principal returned to the originator, even these numbers would be an overestimation of capital necessary to combat these low level recourse representations. However, they would provide a starting point for further analysis.

Suggested Change

Spirit would like to see a study of the true industry risks relating to this issue. Information should be available from the financial institutions offering this line of business to assess what the historical effect of low recourse repurchases have been on banks under $15 billion. Based on our specific history, we would anticipate that the effect of capital has not been nearly as imposing as the current proposed mandate suggests.

Spirit would further suggest that guidelines be established which require a framework for financial institutions to evaluate the risk in their off-balance sheet activity. Given that historic performance does not always dictate future risks, the process should be a practical approach not unlike allowance for loan loss reserve calculations. Weight should be given to historical losses and management's evaluation of risk factors in the process. Should circumstances, such as underwriting shortcomings or fraud be identified, then the risk of potential buyback should be adjusted in the capital calculation accordingly. A process like this would allow for practical considerations such as quality of management over the process, the type of loans being originated, and underwriting standards employed. The process would be open to examination by the regulatory agencies allowing for an evaluation of the overall quality of the process and the results derived from it.

Unrealized Gains and Losses on Available-for-Sale Securities

The Basel III Numerator NPR suggests that the current methodology of excluding unrealized gains and losses on AFS debt securities be eliminated in the new capital calculations and become a part of the CET1 capital calculation. Spirit currently maintains a modest, low risk investment portfolio whose total as a percentage of the balance sheet has continued to shrink over the past three years due to management's concern over extension risk inherent in available investments offering less than desirable returns. The bank investment portfolio currently on hand has been designed to maintain a minimum level of reserves determined from a liquidity risk driven perspective. The change in Basel III calls into question whether the importance of desired levels of liquid securities are worth the potential cost to capital.

The addition of AOCI in capital adequacy assumes a 100% sale or dissolution of the bank's investment portfolio at any given point in time. Effective management includes policies and procedures to manage a securities portfolio during times of distress to minimize the economic impact of loss positions. This change also suggests that bank's compartmentalize investments and measure their impact without giving equal time and measure to offsetting components of the balance sheet where investments may have been established to match liabilities, some of which are often fixed-rate deposits which are not fair market valued.

Bank management is also concerned that administration of this capital item will gravitate to default to the most punitive measure possible rather than a current measurement perspective. When under examination, will banks be allowed to recognize positive AOCI currently on the books or will it be measured by possible interest rate shocks that may diminish the value of that current position? As any shock up to interest rates in today's market will lead to the decrease in unrealized gains, what is the real measure to capital? Is it where the bank is today or possibly what the market tells the bank its investment position may be tomorrow?

To further illustrate, if a bank meets the minimum CET1 capital adequacy ratio with a $1M unrealized gain on investments today, will an interest rate shock that suggests a diminished value of that unrealized gain be applied to the bank's capital during examination so that the capital component of its CAMEL rating does not mirror the well-capitalized position suggested by Basel III measures? It seems reasonable to think that the same concerns by bank management over volatile capital impact will be equally concerning to the regulatory agencies' examiners and a divergence from stated policy and enforcement of policy may become standard practice. The result would be an inherent capital buffer to overcome this temporary component of capital. This is in addition to the capital conservation buffer and, possibly, the countercyclical buffer already suggested in Basel III.

From a reporting and management perspective, management will likely run dual measures that both include and exclude the effects of AOCI to senior management and the Board of Directors in order to present a full picture of the bank's capital structure so that incidences where AOCI gains may be discounted are not met with surprise or misunderstanding. It is management's belief that this change adds a layer of white noise to the message when discussing capital and only stands to confuse decision makers when balancing interest rate risk, liquidity risk, earnings, and capital adequacy.

Currently, the unrealized gain recorded by our bank represents approximately 1.25% of total capital and approximately 1.45% of Tier I capital. A recent rate shock analysis below shows the capital impact of our current investment portfolio on capital.

Rate Shock	Unrealized Gain/Loss in Equity	Change
Current	$1.117M	$ -
+100 bps	345M	(773M)
+200 bps	(613M)	(1.732M)
+300 bps	(1.604M)	(2.723M)
+400 bps	(2.571M)	(3.690M)

With all other operations being equal, a 400 basis point change would decrease our current Tier I capital ratio 53 basis points. This change has little to do with the decisions made by bank management and has added a level of volatility to the balance sheet and perceived "core capital" when this current capital position could easily reverse itself tomorrow. Introducing market fluctuation stands only to diminish or potentially mask the other decisions made by an organization which have a true and measureable impact on capital.

Suggested Change

We strongly suggest that BASEL III continue to mirror the current risk-weighting rules when it comes to recognizing an AOCI-filter in the capital calculation. There are selected other analysis tools which stand to provide a more global assessments of a bank's balance sheet and capital under market shocks, such as the EVE calculation, which are currently employed by banks as a tool of measurement. We suggest that we allow analysis tools to remain just that and not use selected components of the balance sheet to project capital.

Risk-weighting of 1-4 Family Residential Mortgage Loans

Spirit acknowledges the problems created by poor underwriting, hybrid products and other issues surrounding the residential mortgage market collapse. It is obvious and we do not pretend to respond as if those issues were not prevalent. To try and introduce a capital plan which would withstand a return to these loose underwriting practices, the Standardized Approach NPR attempts to assign risk-weights of residential mortgage loans based on two broad categories, Category 1 and Category 2, and then further risk-weight each category measuring the original LTV's on a sliding scale. Currently, the bank has through its operations and that of its subsidiaries

approximately 3,600 residential mortgage loans on its balance sheet which must be evaluated to find the proper risk-weighting under the Basel III proposal. Most of the bank's loans are assigned a risk-weighting of 50% or lower. Historically, the residential mortgage segment has represented a very low portion of losses experienced by the bank. Based on the last three years of call report data, the bank has taken approximately $1.3M in charge-offs in loans secured by residential mortgage property. Over that same time period, the bank has maintained an average balance of residential mortgage loans totaling approximately $263M, the majority of which are held for sale. These figures demonstrate low historic loss history and thus would assume a lower risk sector of our banking operation.

The low losses we believe are partially because both the bank and its mortgage subsidiary have offered standard mortgage products and stayed away from the exotic hybrid products that impacted the industry so negatively. Of the $263M average balance noted above, approximately $225M represent loans which have been originated with the express purpose of selling to the open market. These loans are underwritten to the specifications of our bank's investors, and as such, meet the underwriting standards of larger, more complex financial institutions which specialize in this sector of lending. In most situations, these loans are written to FHA/VA underwriting standards with more strict guidelines imposed by the investor. Therefore, we believe that our underwriting is prudent to industry standards and considers factors that extend beyond a single measure such as LTV.

In reviewing the Category 1 requirements, we feel that the lending that we engage in will primarily conform to this category. This new proposal seeks to identify prudently written loans and risk-weight accordingly. However, the basis for segmentation is simply LTV. While understanding that this measure is probably the most universal underwriting measure to relate to all regions of the United States because income and net worth measures change as local economic factors change. However, it is simply a part of a complex mix of financial data that is not being considered. Since the mortgage "bust", stricter underwriting guidelines have been instituted to measure the financial stability of a borrower and eliminate hybrid products which polluted the market. We question whether, under the new underwriting standards, LTV properly measures the inherent risk of loans that were never hybrid or loosely underwritten in the first place. We are of the mind that Basel III attempts to place capital reserves against many banks that did not need capital for this market issue in the first place.

As of September-end, the bank has loans held-for-sale that from the Basel LTV guidelines suggest we move approximately $100M in loans that are 50% risk-weighted into the 75% and 100% risk-weight buckets. These are loans which are temporary, underwritten to industry guidelines, and historically have resulted in low losses to the bank. There is no evidence to support a need to severely increase the risk measure that will be assigned to them. Additionally, we are also unable to locate information that proves that loans meeting the underwriting criteria used by the bank have resulted in losses that support this mandate.

In regards to loans that have high LTV values, we also question the concept that the original LTV will stand as a permanent risk-weighting for the life of that loan. Mortgage loans that are held by banks stand to remain on the books up to 15-30 years according to their contractual terms. There seems to be no consideration to long-term performance of loans. We question a system that would consider a 30-year mortgage loan 10 years into its life having never missed a payment and reduced its principal obligation as a permanent 100% risk-weighted asset. Historic performance of this asset changes its original risk-profile assigned under the proposed model. However, per the terms of the mandate, there is no softening or opportunity to re-measure seasoned, performing loans. The inflexibility of the model proposed potentially locks up capital against a proven low-risk loan for an extended period of time which will inhibit potential lending to others.

Suggested Change

First, we would request that a more in-depth analysis be performed to isolate the true losses sustained by community banks. We find it difficult to believe that losses sustained in this sector of banking will show justification for such punitive increases in risk-weighting. If relief cannot be supplied through this study and evaluation of the results, we would request that there be a system of re-evaluating the assets (at each bank's discretion as some may not have the tools or manpower) after a point in time which would allow for reduced risk-weighting. We do not ask that the measures surround re-evaluation of the LTV based on the original appraised value, but qualitative factors such as percentage of principal reduction, historic past due issues and

age of the asset be considered. An approach such as this would better assess the ongoing risk profile for individual loans and better align the capital necessary to support this type of lending.

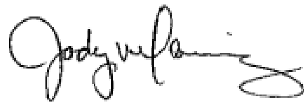
Summary

We fully support initiatives which serve to strengthen and protect community banks as well as the communities we work to serve. We also understand the difficulty in designing a system intended to mitigate risk across the industry. Every bank has a different model and a different story to describe their tales of success. To design prudent regulation which offers guidance and protection while allowing various banking models to flourish is a difficult task. We do not diminish that effort. However, we firmly believe the full implementation of Basel III as it is proposed will have significant negative impacts to our bank and to the overall survival of our industry. So many of the Basel mandates are a broad-based attempt to repair the industry as a whole, but work to do the very opposite for community banks which represent a vital sector within the industry.

We hope that our concerns are viewed as a constructive effort to keep a vital sector of the economy prospering so that community banking can be a key component for the return to a healthy economy and not a barrier to that end.

Respectfully submitted,

Greg Caldwell
SpiritBank Chief Financial Officer



Jody Manning
SpiritBank Controller