June 21, 2005

E-mail: Comments@ FDIC.gov
Subject: Docket Number OP-1227
Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

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E-mail: regs.comments@federalreserve.gov
Subject: Docket Number OP-1227
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Feldman and Ms. Johnson:

The Interagency Proposal on the Classification of Commercial Credit Exposures is inappropriate for nearly all Iowa state chartered commercial banks. While it is possible to implement this classification scheme in all sizes of institutions, the benefit for small and medium sized institutions seems negligible. Loan officers, senior credit administrators, and senior bank managers are very familiar with classified credits in small and medium sized institutions and are able to analyze both the borrower and collateral using the current system. Iowa Division of Banking examiners discuss classified credits with loan officers and bank managers and have a consistent record of accurately identifying loss exposure.

Implementation of this proposal will produce costs for small and medium sized banks that far outweigh the benefits of the proposed classification scheme. Nearly all Iowa state chartered banks have loan watch lists that conform to the current classification system. Implementation of the proposal will require the banks to retool their internal rating systems, credit review procedures and internal reporting systems. We find the vast majority of the credit rating, review, and internal reporting systems currently used by Iowa state chartered banks adequately identify credit exposures. Complete retooling of these systems is unnecessary and a waste of resources.

The retooling of banks' credit administration systems will include rewriting loan policy and procedures, rewriting allowance for loan loss adequacy methodology, rewriting of loan administration and collection procedures, and retraining of personnel to implement the changes. Loan policy will need to be changed to address all of the new terms and nuances generated by the proposal. Credit review procedures will also need to be changed to conform to the new policy.

The methodology for analysis of the adequacy of the reserve for loans and lease losses will need to be changed to conform to the proposed classification of commercial credit exposures. At the same time all these additions to policy and procedures are to be added, the old system of analysis, classification and reporting must be retained for real estate, consumer and other non-commercial extensions of credit.

Grundy National Bank
603 7th Street/529 G Avenue
P.O. Box 246
Grundy Center, Iowa 50638
319-824-5431
Fax: 319-824-3854
Toll Free: 800-545-0172

GNB Insurance Agency
510 F Avenue
P.O. Box 248
Grundy Center, Iowa 50638
319-825-5295
Fax: 319-825-3815
Toll Free: 800-688-5295

www.gnbbank.com

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In addition to the immense cost of retooling bank policy and procedures, there will be substantial cost increases for bank regulators. Examination manuals will need to be rewritten, examination report formats will require changes and additions, and examiners will need additional training. Senior management of bank regulators will be required to devote significant time and energy to implementing new policy and procedures. The Iowa Division of Banking uses software developed by the FDIC to prepare reports of examination. This software will need significant reprogramming to accommodate the proposed classification scheme. Additionally, classification is monitored and analyzed using various computerized systems within the Division of Banking. All of these programs will require changes to conform to the proposed scheme.

The examples provided by the proposal clearly demonstrate the additional regulatory burden generated by this proposal. The proposed classification scheme is complicated and burdensome for small and medium sized banks. It may have some merit for large, complex banking organizations whose management and regulators have little or no contact with loan officers and borrowers and limited knowledge of individual problem credits. Burdening the entire banking industry with this new classification system for commercial credit to satisfy a perceived need at a relatively small number of large, complex institutions seems unreasonable and cost prohibitive.

The resultant ratings created from the proposal are no more clear and reasonable than the ratings generated by the current system. Under the current system, lenders and examiners analyze credits by looking at all of the factors considered in the proposed system. After analyzing those factors, credits are passed or classified. Almost all bankers and regulators understand the current system. In my experience as a regulator and a banker, the current system has provided a valid assessment of the risk in bank loan portfolios. This proposal is a solution in search of a problem.

The proposal's treatment of guarantors is almost as reasonable as the rest of the proposal. In my experience as a lender, some guarantors are good and some are not. Predicting the value of a guaranty is similar to predicting the weather — the longer the time horizon of the prediction, the less certain it is.

If the Agencies decide to put additional effort into development of a new classification scheme, they should first perform a cost/benefit analysis on the proposal to determine its value to the industry and regulators. I suggest the proposal should be tested in the largest and most complex banking organizations.

If there is some benefit demonstrated throughout an entire business cycle, the proposal might be refined and improved to a degree that its implementation costs could be outweighed by its benefits.

I urge the Agencies to refrain from implementing this proposal. If it is implemented, I urge the Agencies to restrict it to large complex banking organizations. Small and medium sized institutions already bear an excessive amount of regulatory burden imposed by inappropriate and irrelevant federal regulation. There is no valid reason to impose a new commercial loan classification system on small and medium sized banks.

Sincerely,

David H. Graham
Ag/R.E. Loan Development Officer