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Comments:
March 23, 2006 Ms. Jennifer Johnson Secretary, Board of Governors of the Federal Reserve 20th Street and Constitution Ave. NW Washington DC 20551 Re: Docket No. OP-1248 Ms. Johnson, I appreciate the opportunity to comment on the proposed guidance entitled “Concentrations in Commercial Real Estate, Sound Risk Management Practices”. The proposal sets thresholds for determining whether a financial institution has a commercial real estate (CRE) concentration, with two specific thresholds identified as (1) total reported construction loans, land loans and other land loans which represent 100% + of the total capital of an institution, or (2) total reported loans secured by multifamily or non-farm residential property, and loans for construction, land development or other land which represent 300% or more of the total capital of an institution. Under the proposal, institutions exceeding threshold #1 should have heightened risk management practices appropriate to the degree of CRE concentration risk. Institutions exceeding threshold #2 should quantify the dollar amount of those loans that meet the definition of a CRE loan and should have heightened risk management practices. I am very concerned with the broad scope of this guidance. The stated justification for the guidance is that some institutions have high and increasing concentrations of commercial real estate loans on their balance sheets and the agencies are concerned that these concentrations may make the institutions more vulnerable to cyclical commercial real estate markets. This proposal tends to apply a “one size fits all” approach to the highly individualized world of banking, and additionally ignores the fact that adequate remedies are already available under current legislation. A better approach, in my opinion, would be to evaluate institutions on a case-by-case basis under the existing guidelines. If some financial institutions' loans are not sufficiently diversified and lack risk mitigating factors, then the agencies already have sufficient authority to direct that corrective action be taken. I am also deeply troubled by the stated thresholds. In the absence of information about how these triggers were calculated, the thresholds seem arbitrary and far too low. Using these thresholds would have a disproportionate impact on the nation's community banks. Competition, particularly from the tax-advantaged credit union industry, has forced community banks to direct more of their energies to CRE lending because it remains one of the few consistently profitable areas. Imposing the proposed thresholds could drastically curtail

CRE lending in many markets and lead to job losses. Any resulting shortage of available credit would substantially affect real estate prices and community development. Additional harm could also occur if financial institutions are forced to turn to riskier investments to try to remain profitable. Another very troubling aspect of this guidance is its lack of specificity. The discussion of risk management principles is vague when it comes to what steps should be taken to comply with agency expectations. If the objective is to allow for more flexibility in implementation, that is a commendable goal, but it must be balanced against the need for predictability in examinations. Examples of how the guidance would be applied are needed. As an example, consider a financial institution that has a CRE concentration that is twice the first threshold stated in the guidance. The institution currently has risk management practices similar to those outlined and has consistently been rated as well-capitalized and well-managed. Would such an institution have to divest itself of much of its CRE portfolio or develop a strategy to increase capital in order to be in compliance? The question really hinges on whether the proposed regulation would completely change the regulatory landscape. Financial institutions are greatly concerned about the implications of this guidance and question whether it gives sufficient consideration to their existing underwriting processes. A classic maxim is that no two borrowers are the same. Any proposed CRE lending test (assuming that any new such measurement tests are necessary) absolutely must retain enough flexibility so that loans to well-qualified borrowers can continue to be approved and made. It is also imperative that it take into account the unique character of each real estate region throughout the country. For these reasons, I request that you withdraw or at minimum substantially amend the proposed guidance. Sincerely, William B. Spearman