Millbury National Bank

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KATHLEEN C. MARCUM
PRESIDENT & CEO

May 22, 2006

The Honorable Susan Bies
Governor
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551

Re: The Apparent Impact of the Proposed Interagency Guidance on Concentrations in Commercial Real Estate on a Community Bank

Dear Governor Bies:

It was a real pleasure speaking with you at the recent orientation for new Federal Reserve Bank Directors. Thank you for your interest in the community bank view of the proposed Guidance on Concentrations in Commercial Real Estate. In response to your questions, I would like first to give you my understanding of the general response to the proposed Guidance that I have heard from fellow community bankers. Second, I will review what I think it means to my bank and CRE lending in my community.

<u>General Response of Community Bankers</u>
My bank is approximately $65 million in assets, and I am on the American Bankers Association's Community Bankers Council ("CBC"). Thus, my focus tends to be on issues of greatest relevance to community banks. The CBC held a meeting in April at which I talked to a number of other community bankers about the proposal. I believe that it was the consensus of those to whom I talked about the CRE Guidance that:

> First, the new definitions of a concentration in CRE combine several different types of CRE lending (such as residential construction, office construction, business expansion and small business loans secured by real estate) and establishes triggers for additional action without differentiating the different levels of risk posed by each. Worse, it seems to reflect a regulatory conclusion that CRE lending is inherently riskier than other lending, which simply is not consistent with our own experiences. For instance, CRE lending with 60% to 80% LTV appears to us to be far safer than lending for operating expenses and taking inventory as collateral, making unsecured consumer credit loans, or making consumer loans secured with portable collateral such as autos.

Second, all of us read the Guidance as meaning that at our next examination we would be told we needed to raise capital. I realize that regulators are now telling bankers on visits to the Agencies that that is not what was meant, but that is what was heard by us.

Third, there seemed to be a strong suggestion that community banks are not properly reserving for the high risk in their CRE portfolios, again something that we find hard to see in our own banks.

Fourth, the bankers I have talked to all have credit review and risk monitoring systems in place that they believe are appropriate for their lending. Most of us tend to specialize in one or two forms of CRE lending, and so when we read the Guidance, we were concerned that examiners would be requiring us to greatly increase our risk management systems, no matter how well we are currently monitoring and controlling our risks. Many felt that it would be easy for the examiners to conclude that, because guidance was issued, there must be a problem, notwithstanding the actual condition of a particular bank's CRE loan portfolio.

All of this discussion led to a feeling that problems with a few banks were being solved by using a really big hammer on all of us, which just did not seem to be good supervision.

How I See the Impact of the Guidance on My Bank

I would like to describe my bank's lending policy for CRE and our banking strategy. We specialize in providing financing to help small businesses grow. We provide lines of credit, capital expenditure lines of credit, term loans, and commercial mortgages for owner occupied buildings as well as investment properties. As a rule, we take all business assets to collateralize a small business loan. At times this results in our taking a security interest in commercial real estate and including the rental income or sales proceeds in our underwriting of the loan, notwithstanding that the loan could have been made without that collateral. The guidance could lead to such loans being included in the basket of commercial real estate loans, causing the appearance of a greater CRE concentration (and the related supervisory issues a concentration raises) than the facts support.

If we were to be limited on CRE lending as described in the guidance, it would have a dramatic effect on our ability to provide financing required for small businesses in central Massachusetts to grow. In addition, we would have to severely restrict lending for the purchase and rehabilitation of multifamily and mixed use buildings in Worcester County.

In summary, I agree that having too many loans with similar risks creates a "concentration", which should be avoided. Our bank, like most, has control systems in place to identify, monitor, measure and mitigate risks presented by loan concentrations.

I disagree that all business loans secured by commercial real estate present "similar" risks given the different industries represented and the various sources of loan repayment.

I thank you for the opportunity to address my concerns regarding the proposed guidance for "concentrations in CRE Lending".

It was a pleasure to meet you and I will look forward to seeing you again at my next visit to The Federal Reserve Board in Washington.

Regards,

Millbury National Bank

Kathleen C. Marcum

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President & Chief Executive Officer