From: "Karen Thomas" <Karen.Thomas@icba.org> 06/12/2006 06:05 PM

Subject: Interagency Concentrations in Commercial Real Estate Lending

Dear Governor Bies: I am forwarding an email (pasted below) from one of our community bank members we received today. It responded to a report in our weekly newsletter about remarks you made last week on the pending CRE guidance. I have pasted the story we ran below, too. This email is typical of the sentiment of community banks about the proposal.
Best regards,
Karen

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Cam, I appreciate ICBA communicating that the CRE proposed rules would be difficult to implement and shouldn't be applied to all banks with the same brush. But seeing the comment made by Ms. Bies sends chills up my spine. She cannot possibly imagine the impact this 'guideline' will have on community banks as I can't wait for an examiner to sit in judgment as to how well "robust, well documented and transparent quantitative approaches" are implemented. "Say what?"

Maybe Ms. Bies wasn't listening when ICBA made its last complaint and for the rest of us tiny banks on the prairie please let her know again. Please!

ICBA Washington Weekly Report, June 9, 2006

Bies Speaks on CRE Concentration Guidance

In a speech this week, Federal Reserve Board Governor Susan Schmidt Bies defended pending interagency guidance on commercial real estate (CRE) lending, guidance that has generated a flood of complaints from the banking industry, including ICBA. She said the guidance isn't designed to cap or rein in banks' commercial real estate lending activities as the industry has warned.

Bies said that the guidance is intended to be applied flexibly and consistent with the size and complexity of each institution. Examiners should use the "threshold" ratios of CRE loans-to-capital only to identify banks with concentrations of CRE loans that need a closer look, not as a "hard" or definitive measure that such portfolios are too risky or not properly managed. Upon review of banks that exceed the thresholds, examiners may find that given the characteristics of the CRE portfolio, the bank has sound risk management and sufficient capital, Bies said.

Seeming to respond to complaints from many small banks about the burdens of new stress testing requirements—a complaint ICBA communicated to the regulators—Bies said that the agencies do not necessarily expect smaller banks to be able to conduct regular, extensive and sophisticated quantitative stress tests, but they should have clear and coherent methods to evaluate the potential outcomes associated with concentrations and their exposures more broadly. Where market data is lacking or their geographic area is small, banks may have to turn to less quantitative approaches that are "robust, well documented and transparent."

Bies said some institutions' strategic and capital planning processes may not adequately acknowledge the risks from CRE concentrations. Recent credit conditions have been benign, but that may not continue. Institutions should focus on emerging conditions and the potential cumulative impact on their portfolios if conditions deteriorate.

Bies emphasized that the proposed guidance is intended to cover "true" CRE loans, not commercial loans with a business's cash flow as the source of repayment and where real estate collateral is a secondary source of repayment. The guidance covers CRE loans where repayment depends on third-party rental income or on the sale, refinancing, or permanent financing of the property—loans that are dependent on the condition and performance of the real estate market.

ICBA has strongly objected to the proposed guidance, and asked regulators to abandon it. As proposed, it is a "one-size-fits-all" approach that insufficiently recognizes today's conservative underwriting and risk management systems. Bies did not indicate what next steps regulators might take toward approving the proposed guidance.