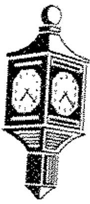

American National Bank
AND TRUST COMPANY

P. O. Box 191 • 628 Main Street
Danville, Virginia 24543-0191
Phone 434/792-5111

March 20, 2006

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attention: No 2005-56
regs.comments@ots.treas.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal
Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
regs.comments@federalreserve.gov

Office of the Comptroller
of the Currency
250 E Street, S.W., Mail Stop 1-5
Washington, D.C. 20219
regs.comments@occ.treas.gov

Re: **FDIC** (No docket ID); **FRB** Docket No. OP-1246; **OCC** Docket No. 05-21 **OTS** Docket No. 2006-01; **Proposed Interagency Guidance on Concentrations in Commercial Real Estate;** 71 Federal Register 2302; January 13, 2006

Comments on Proposed Regulations

Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices

We concur with the comments submitted to you by the Virginia Bankers Association (attached) and we urge you to give them full consideration.

Under the proposed guidance, the defined 100% and 300 % thresholds that would indicate/trigger possible "need for additional capital support" and heightened regulatory scrutiny are by their nature arbitrary, and provide no basis for specific consideration of the strength and quality of underwriting (including the fact that well underwritten non owner occupied financed property can provide significantly enhanced credit quality if the borrower has significant additional and/or unrelated sources of income for debt service). If this factor does not exist, then current regulatory oversight of "safe and sound" practices provides the regulators with more than ample ability to remedy and sanction the affected institution.

As proposed, this guidance will leave the examined financial institution to only wonder and guess what capital related sanctions might apply if the 100% or 300% thresholds are

exceeded. Again, current and long existing regulatory authority is already in place to remedy any "unsafe and unsound" lending practice that this proposal envisions. This proposal will only add a layer of less than well defined concern/potential uncertainty to the financial institution's already significant agenda.

Weak and unsound underwriting practices, undue concentrations of any type, less than appropriate allowances for loan losses and capital levels are all currently in the active domain of regulator authority and prescriptive remedy. Regulation H and other real estate guidelines, policies and regulations should be applied and enforced to deal with the stated concerns; not addressing them by adding new, broad and vague guidelines and sanctions to increase the regulatory burden.

Thank you for considering our views.

Sincerely,

Charles H. Majors
President and Chief Executive Officer

Attachment

March 15, 2006

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

Jennifer J. Johnson, Secretary
Board of Governors of the Federal
Reserve System
20th Street & Constitution Avenue, N.W.
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Re: **FDIC** (No docket ID); **FRB** Docket No. OP-1246; **OCC** Docket No. 05-21; **OTS** Docket No. 2006-01; **Proposed Interagency Guidance on Concentrations in Commercial Real Estate**; 71 Federal Register 2302; January 13, 2006

Ladies and Gentlemen:

I am writing on behalf of the Virginia Bankers Association (the "VBA") to comment on the above proposal. The VBA represents the interests of nearly all of the commercial banks and savings institutions doing business in the Commonwealth of Virginia.

In March of 2004, former Federal Reserve Chairman Alan Greenspan noted in a speech in San Diego that the growth in commercial real estate lending by smaller banks was a "natural evolution of community banking and ... quite profitable, helping to sustain both earnings and growing equity capital of community banks." He went on to state that "the evidence suggests that community banks have avoided the underwriting mistakes that led to so many problems ten to fifteen years ago."

The former Chairman's remarks underscore the importance of commercial real estate lending to community banks. Our community banks rely heavily on commercial real estate lending to survive and make a profit. They do so because they have been squeezed out of so many other areas where they once did a significant business. For example, the car manufacturers now have captive finance companies that dominate car lending. Realtors now take advantage of their position as the first contact in the home-buying process to arrange mortgage financing for buyers through their mortgage

company affiliates. Credit unions use their tax-exempt status to aggressively compete against banks and gain an ever-increasing market share. Hence, commercial lending is perhaps now more than ever our community banks' "bread and butter."

Since commercial lending is so very critical to community banking, and since the proposed guidance would negatively impact smaller banks much more than larger banks, we are very concerned about what this proposal would mean for the very survival of our community banks. This is particularly true when, as former Chairman Greenspan observed, there is no evidence suggesting that there is a problem that needs fixing. Accordingly, we would urge the federal banking agencies to abandon or significantly modify the proposal.

We oppose the proposed guidance in its current form for the following specific reasons:

1. **The proposed guidance incorrectly assumes that all commercial loans secured by real estate constitute one "concentration" risk.**

The commercial real estate loans our community banks make are not all alike. They make a variety of types of commercial loans secured by real estate in different geographic areas. A community bank may have a line of credit to a law firm secured by the firm's office building, a construction loan to a home builder, a mortgage loan secured by a multi-unit apartment building, and so on. While all of the loans are secured by real estate, they are all different in terms of the risk of non-payment. The risk of loss depends much more on circumstances unique to each borrower (e.g., does the law firm succeed) than the fact that they are secured by real estate. Yet the proposed guidance assumes that all these loans represent the same kind of risk. We believe this is a mistaken assumption. It is inappropriate in our view to impose burdensome new requirements based on the premise that simply because loans are secured by real estate, they represent greater risk.

Moreover, we believe many loans should not be considered commercial real estate loans in any event. Specifically, loans to finance 1-4 family residential construction where the contractor already has a contract for the house (a custom home contract as opposed to "spec housing") should be excluded. Likewise, loans made directly to consumers for the construction of a home should be excluded. There are minimal risks associated with such loans, and what risks exist are based on "consumer"

rather than "commercial" reasons. In addition, we believe that the 100% capital threshold is much too low. It should be raised to 200% to the extent there is any threshold at all. Also, we believe that commercial real estate loans with a loan-to-value ratio of 65% or less should not be counted toward the thresholds, as the risk of loss on such loans is minimal or non-existent.

2. The proposed guidance fails to recognize that commercial loans secured by real estate present less of a risk than loans not secured by <u>real estate.</u>

One of the underlying premises of the proposed guidance is that commercial real estate loans pose greater risks than other loans. We disagree with this premise.

Would a bank be in a safer position with an unsecured line of credit as opposed to a line of credit secured by real estate? Of course not, but that is how the proposed guidance treats the two loans.

Indeed, we believe that commercial loans secured by real estate pose less of a risk of loss than commercial loans secured by other sources of collateral, such as receivables, inventory, or equipment. Covering losses by foreclosing on other forms of collateral is subject to all kinds of perils, such as bad behavior on the part of the borrower. Real estate, on the other hand, is a very reliable source of collateral.

Furthermore, even if the value of real estate securing a commercial loan falls, it would have to fall significantly before the bank loses any principal. This is because most such loans are made with a loan-to-value ratio of 75% or less. Add to that the fact that a borrower will likely have paid some principal before defaulting, and you can see that the real estate would have to drop roughly 30% before the first dollar of loan principal is put at risk. For this reason, far from representing a "concentration" risk, commercial real estate loans are some of the safest loans on our community banks' books and thus should not be targeted for the kind of burdensome new requirements that have been proposed.

3. The proposed guidance would impose significant new compliance <u>burdens on community banks.</u>

Our community banks are already struggling under a debilitating regulatory burden. The proposed guidance would add significantly to that burden.

In particular, while community banks should track their loan portfolios to guard against any legitimate concentrations of risk (and our banks do this), the extensive and difficult requirements set forth in the proposed guidance would simply overwhelm them. The proposed guidance provides for increased board oversight, new policies and procedures, strategic planning, new underwriting guidelines, contingency plans, new risk ratings, feasibility studies, sensitivity analysis, stress testing, monitoring, and so on. Attempting to comply with all of these requirements will require a great deal of time and expense for our community banks, and, no matter how hard they might try, full compliance with all these complicated new requirements will be virtually impossible. Indeed, our community bankers are struggling to understand what all of these provisions mean in terms of what would be required of them, much less how they could possibly manage to comply with them.

The burden associated with these requirements threatens the very future of community banking. Our community banks, unlike larger banks, have limited resources to devote to new requirements such as these. And yet, perversely, it is the community bank that is most likely to meet the thresholds set forth in the proposed guidance triggering all the compliance burdens therein. This will put community banks at a competitive disadvantage relative to other financial institutions making commercial real estate loans that don't have to comply.

4. Requiring additional capital of community banks with higher levels of <u>commercial real estate loans will hurt these banks competitively.</u>

The proposed guidance indicates that banks meeting the thresholds for commercial real estate loan concentrations will be required to have higher capital levels. Again, this will hurt community banks, and, we believe, force many to sell to larger banks.

Quite simply, a community bank that is forced to hold a much higher level of capital against its assets than a larger competitor bank will be forced to price much higher than its competitor or accept a lower return on shareholder equity. Neither approach would lead to growth, which is why, again, an increased capital requirement threatens the very survival of many community banks.

5. The proposed guidance adopts a "one-size-fits-all" approach when <u>any concerns would be better addressed on an individual bank basis.</u>

We believe the proposed guidance would unfairly punish all community banks for the problems (now or in the future) of a relative few. We urge the federal banking agencies to reconsider the approach of the proposed guidance.

In particular, we believe the agencies, and more importantly, community banking, would be much better served if the agencies applied existing guidance to problem banks rather than subjecting all banks (the vast majority of which pose no problem at all) to complicated and burdensome new requirements. In particular, we believe that fears associated with isolated geographic areas or a handful of banks are no justification for strangling an entire industry with new regulatory burdens. In short, the agencies can use existing law and their supervisory and examination authority to require those banks that pose unique risks to take the appropriate steps to address those risks. It is simply unnecessary to harm all banks in attempting to cure a few.

* * *

In conclusion, we emphasize that the proposed guidance would primarily impact our community banks. It will surely make it more difficult for our community banks to compete in the safest and most profitable business left for them. If the federal banking agencies care about the survival of community banking, they should not adopt this proposal.

Thank you for considering our views.

Sincerely,

Walter C. Ayers
President and CEO

WCA/sk