NORTH CAROLINA BANKERS ASSOCIATION

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Jennifer J. Johnson, Secretary
Board of Governers of the Federal
Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
regs.comments@federalreserve.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552
regs.comments@ots.treas.gov

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
comments@fdic.gov

Re: Interagency Proposal on the Classification of Commercial Credit Exposures
70 Fed. Reg. 58, 15681 (March 28, 2005)
OCC Docket No. 05-08, FRB Docket No. OP-1227, OTS Docket No. 2005-14

Ladies and Gentlemen:

The North Carolina Bankers Association (NCBA) is pleased to have this opportunity to comment on the proposed revisions to the classification system for commercial credit exposures. The NCBA is a trade association representing all 142 banks, savings institutions, and trust companies headquartered or doing business in North Carolina. On behalf of our members, we would like to express some of our concerns with the proposal.

To briefly summarize the proposal, the OCC, Federal Reserve, OTS, and FDIC (the Agencies) recommend replacing the current commercial loan classification system categories of "special mention," "substandard," and "doubtful" with a two-dimensional framework. The proposed changes would include the creation of three new "borrower rating" assessment categories for loans made to borrowers with actual or potential weaknesses. The categories are: (1) marginal, (2) weak, and (3) default. For borrowers with a rating of default, banks would be required to assign four "facility ratings" based on estimated loss severity, taking into account risk mitigants such as collateral. The categories are: (1) remote risk of loss, (2) low, (3), moderate, and (4) high. When combined, the two ratings would determine whether a commercial credit exposure would be regarded as a "criticized" asset or instead as a "classified" asset. The Agencies suggest that the new classification system would be applied to all banks, irrespective of size, and would more accurately measure a bank's credit risk exposure.

Although we appreciate the Agencies' efforts to improve risk assessments, we are concerned that the proposed framework could be both labor-intensive and costly to implement for most banks. In addition to the necessary training costs, banks would need to invest in new software or upgrade existing software. Many of the NCBA's member banks are small community banks which operate with a limited staff and tight budgets. Each staff member must serve in a variety of roles and every added regulation potentially results in less time that they can devote to generating and retaining business. To the extent that the current proposal adds to the regulatory burden on these banks, it may do more harm than good.

We are, however, not suggesting that the proposed changes would adversely impact all North Carolina banks. A few banks may prefer the two dimensional rating system because it expressly allows them to take into account risk mitigants. Nevertheless, it is difficult to imagine how the proposal will substantially curtail disagreements between banks and their examiners as the Agencies suggest. Disagreements will still have the potential to arise because categorizing loans necessarily involves making some value judgments. Rather than disagree over a loan being classified as "special mention," "substandard," or "doubtful," there will be disagreement over placement in the new categories. With even more categories being created, the risk of disagreement may actually increase.

Therefore, we ask the Agencies to further examine the ramifications of their proposal. Overhauling a system that has been in place for decades and is well understood should proceed carefully. More time needs to be devoted to evaluating the impact that it would have on such matters as loan loss reserves and to considering whether it makes sense from a cost-benefit perspective. In addition, the Agencies can use this time to consider whether there are alternative approaches to fix any perceived flaws in the current system.

The North Carolina Bankers Association appreciates the opportunity to submit these comments. If you have any questions, then please contact the undersigned.

Sincerely,

Nathan R. Batts

Nathan R. Batts
Associate Counsel