June 10, 2005

E-mail: Comments@FDIC.gov.
Subject: Docket Number OP-1227
Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW.,
Washington, DC 20429.

E-mail: regs.comments@federalreserve.gov.
Subject: Docket Number OP-1227
Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551.

Dear Mr. Feldman and Ms. Johnson:

After reviewing the Interagency Proposal on the Classification of Commercial Credit Exposures, I feel that it is inappropriate, not only for our financial institution, but likely for many other smaller banking operations as well. It is certainly possible to implement this classification scheme in all sizes of institutions. However, the benefit for small institutions, such as ours, seems nonexistent. Our loan officers and senior bank officials are very familiar with our classified credits and are able to analyze both the borrower and collateral using the current system. Bank examiners discuss classified credits with our bank's loan officers, and as such we have a consistent record of accurately identifying loss exposure very early on in the process.

Implementation of this proposal will produce costs that far outweigh the benefits of the proposed classification scheme. Our bank, as is the case with every other small institution, has watch lists that conform to the current classification system. The implementation of this proposal will require us to retool our internal rating systems, credit review procedures, and internal reporting systems. We believe that our existing credit rating, review, and internal reporting systems more than adequately identify credit exposures. As such, a complete retooling of these systems is unnecessary and a waste of our limited resources.

The retooling of our credit administration systems will include rewriting loan policy and procedures, rewriting allowance for loan loss adequacy methodology, rewriting of loan administration and collection procedures, and retraining of personnel to implement the changes. Loan policy will need to be changed to address all of the new terms and nuances generated by the proposal. Credit review procedures will also need to be changed to conform to the new policy. The methodology for analysis of the adequacy of the reserve for loans and lease losses will need to be changed to conform to the proposed classification of commercial credit exposures. At the same time all these additions to policy and procedures are to be added, the old system of analysis, classification and reporting must be retained for real estate, consumer and other non-commercial extensions of credit.

In addition to the immense cost of retooling bank policy and procedures, there will be substantial cost increases for our bank regulators. Examination manuals will need to be rewritten, examination report formats will require changes and additions, and examiners will need additional training. Senior management of bank regulators will be required to devote significant time and energy to implementing new policy and procedures. The Iowa Division of Banking uses software developed by the FDIC to prepare reports of examination. This software will need significant reprogramming to accommodate the proposed classification scheme. Additionally, classification is monitored and analyzed using various computerized systems within the Division of Banking. All of these programs will require changes to conform to the proposed scheme.

The examples provided by the proposal clearly demonstrate the additional regulatory burden generated by this proposal. The proposed classification scheme is complicated and burdensome for small institutions such as ours. There may be some merit for large, complex banking organizations whose management and regulators have little or no contact with loan officers and borrowers, as well as limited knowledge of individual problem credits. However, burdening the entire banking industry with this new classification system for commercial credit to satisfy a perceived need at a relatively small number of large, complex institutions is simply unreasonable and cost prohibitive.

The resultant ratings created from the proposal are no more clear and reasonable than the ratings generated by the current system. Under the current system lenders and examiners analyze credits by looking at all of the factors considered in the proposed system. After analyzing those factors, credits are passed or classified. All bankers and regulators understand the current system. In my experience as a banker, the current system has provided a valid assessment of the risk in bank loan portfolios. As such, this proposal is a solution in search of a problem, and that problem quite frankly does not exist.

I urge the Agencies to refrain from implementing this proposal, and if it is implemented, I urge the Agencies to restrict it to large complex banking organizations. Small institutions already bear an excessive amount of regulatory burden imposed by inappropriate and irrelevant federal regulation.

In closing, there is simply no valid reason to impose a new commercial loan classification system on small banks, especially during a time when the Agencies have been trumpeting the sound of regulatory relief, of which very little has been truly realized.

Sincerely,

Timothy R. Kluender
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