April 12, 2006

Office of the Comptroller of the Currency
250 E Street, S.W.
Mailstop 1-5
Washington, DC 20219
Attention Docket No. 06-01
regs.comments@occ.treas.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors
Federal Reserve System
20th Street & Constitution Ave. NW
Washington, DC 20551
Attention: Docket No. OP-1248
regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
comments@FDIC.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC
Attention No 2006-01
regs.comments@ots.treas.gov

RE: Comments on Proposed Guidance and Risk Management Practices for Institutions with Concentrations in Commercial Real Estate Lending (As Published in the Federal Register on January 13, 2006)

To Whom It May Concern:

Introduction and Overview of the Ohio Bankers League

The Ohio Bankers League ["OBL"] is a non-profit trade association that represents the interests of Ohio's commercial banks, savings banks, savings associations and their holding companies. The OBL has nearly 250 members that include the full spectrum of the financial services industry, from small savings associations that are organized under mutual ownership or locally owned and operated community banks to large multistate holding companies that have several affiliates and do business from coast to coast. Throughout our history we have been the only voice for all FDIC-insured depositories in Ohio. This remains true today.

Virtually all of our members make loans that are classified as Commercial Real Estate Loans ["CRE"] under your proposal. Many of our members currently have CRE concentrations as defined by your proposed guidance, and will be required to go to great lengths at substantial expense to have the enhanced management oversight and additional capital required by the proposed guidance.

Recommendation of the Ohio Bankers League

For the reasons we outline in more detail below, we respectfully encourage all of the regulatory agencies to withdraw the proposed guidance. The OBL believes that existing real estate lending guidelines are more than adequate for addressing increased risk at banks and thrifts due lending concentrations in commercial real estate. Furthermore, current practice permits regulators to focus their resources on institutions that have increased risk instead of forcing substantial additional compliance costs on all institutions that happen to cross an arbitrary threshold, without any analysis of increased risk in their CRE portfolio.

There is no Evidence that Concentrations of Commercial Real Estate Loans are currently a Problem, or Beyond the Capacity of Lenders to Address within the Existing Regulatory Framework.

This is not the 1990s. The factors of the 1980s that led directly to the failure of several commercial lenders 15 years ago were unique to that time. While the OBL believes it is an appropriate role for the regulators to look over the horizon and consider systemic risks, the conditions in the markets today are dramatically different than they were at that time.

It is generally accepted that one of the main factors that destroyed real estate markets in that era was the Tax Reform Act of 1986. That legislation abolished or substantially reduced tax benefits of investing in real estate, which completely changed the fundamental financials of real estate development and investment. Ohio banks however see no parallels in the current market. In fact, we are not aware of any financial institution failure in the last decade that is directly attributable to concentrations in the commercial real estate market. Many of the loans that led to the contraction in the 1990s were made without recourse, with extremely high loan-to-value ratios, and for projects that had yet to find the first tenant. Bankers learned from that experience. Ohio bankers simply do not see similar excesses in the markets today.

Finally, our survey of current data released by the regulators reflect that past due and other problem loans are at an all time low. Ohio banks and thrifts see nothing in the data that would warrant the extraordinary new regulatory burdens and additional reserves and capital contemplated by the proposed regulation. While there is no doubt that there are individual banks and thrifts that have concentration or credit quality issues, those problems are better dealt with on a case-by-case basis through the existing exam process.

The Biggest Shortcoming of the Proposed Guidance is that it Assumes the Real Estate Market is a Single Homogenous Sector That can be Addressed by a One Size Fits All Solution

The proposed guidance grossly oversimplifies commercial real estate lending by treating it as a single fungible coast-to-coast market. In reality commercial real estate is a number of distinct markets, driven by a wide variety of risk factors. The risks can be localized by geography or the proposed use for the loan proceeds. These distinct markets can be influenced by a broad range of risks that operate independently of each other. As a result, it is completely inappropriate to lump all commercial loans together under a single, fixed and arbitrary guideline. As a starting point, our commercial lenders will assure you the lending in Yongstown for any project is far different than lending in Miami, Florida or San Diego, California.

Given the broad definition of a commercial real estate loan under the proposal, loans covered by the proposal will include both light and heavy manufacturing facilities, retail shopping centers, office space, warehouses, multi-family housing and even raw land. The variables affecting the loan quality will vary of course with each category and depending on whether the land is located in an urban, suburban or rural area. The factors influencing the business activity in each of these categories of properties will vary tremendously, determining economic success and in turn the quality and strength of any loan dependant on cash flow from that property. Given this diversity, it is inappropriate for the regulators to treat commercial real estate lending as if all commercial loans will react uniformly to different stresses at different locations and on different sectors of the economy. The American economy is too diverse to justify painting all extensions of credit that are dependent on real estate with the same broad brush.

The Arbitrary and Inflexible Thresholds that Trigger Significant Additional Regulatory Costs and Increased Capital and Reserve Requirements are set too low.

As mentioned above, the major shortcoming of the proposal is that it is based on a sweeping one-size-fits-all approach. Another reflection of this rigid approach is the fixed limitation that will trigger additional oversight and capital requirements. This bright-line test is in sharp contrast to the current guidelines for real estate, which permit the consideration of a range of factors in evaluating a bank's real estate loan portfolio.

Given the input we have received from OBL-member institutions, if the banking regulators continue to insist that a fixed ceiling on CRE lending is warranted, we believe these triggers as proposed are set much to low. Absent clear data, Ohio banks don't believe such a low threshold actually reflects the risk inherent in loans secured by commercial real estate. Since these loans are secured by sound collateral in addition to being justified by current cash flow, higher levels of commercial real estate lending should be permitted before the additional oversight and capital requirements of the proposed rule are effected.

Fixed limitations on any line of business limit a bank's ability to generate earnings and have been proven as economically unsound methods or even to be effective ways to control an activity. We refer you to the credit limits imposed by an erring administration in the late 1970's. If it can be clearly demonstrated by regulators that a Bank's risk profile in conjunction with risks identified in a bank's ALLL analysis determines reserves (capital) are needed in addition to other capital in the form of net worth and retained earnings; then let's have a demonstration of that regulatory data by individual markets and by individual banks so all can see this apparent risk that is purported to be in existence in our banking environment today.

In Addition to Amending the Thresholds, the Regulators need to Change the Type of Loans Considered in the Commercial Real Estate Pool

In addition to changing the thresholds for increased regulatory scrutiny and capital, the regulators need to consider more carefully the make up of the pool of commercial loans considered within the proposal. The regulators should consider deleting from the analysis construction lending that already has permanent take out financing arranged, particularly pre sold residential construction.

Further, while it not clearly within the proposal, regulators should also be explicit that real estate liens that are taken as back up collateral to commercial loans or merely as an abundance of caution are not included within the pool that counts toward the ceiling.

The Proposed Guidance Fails to Take into Account the Risk Management Tools Currently being Utilized by Lenders

The OBL is concerned that your proposal does not take into account the wide variety of risk management tools in use today that were not available even ten years ago. For example, since the last cyclical downturn in the real estate markets we have new appraisal requirements and specific limits on high loan-to-value real estate loans.

The guidance as proposed completely fails to take into account all of the things prudent lenders do to mitigate risk on individual loans. The tools that are currently used include creditworthy guarantors, assignment of rents, commitments of tenants and lower loan to collateral ratios. Finally the guidance should consider proper underwriting and careful credit analysis, which would look at important factors as occupancy level of leased commercial property, financial capacity of tenants occupying the property and even diversification among tenants.

Finally, the enhanced internal and external audit requirements of Sarbanes Oxley have already added an additional scrutiny of all corporate and reporting functions. There is already tighter oversight, reporting and accountability permitting senior management and the board to stay on top of mission critical issues such as credit quality and portfolio concentrations.

The Guidance as Proposed will Dramatically Increase Compliance Burdens, Capital Requirements and Reserves.

One of the reasons Ohio banks and thrifts are so concerned about this proposal is that the regulators are proposing to impose costly compliance new burdens on the industry, without any corresponding reduction in risk or other benefit to the system.

The list of risk management practices required for those banks and thrifts that cross the two-tier threshold is extensive, and includes, among other things (1) Additional involvement by the Board of Directors and the appropriate committees; (2) Revision of the bank's strategic plan; (3) Updating loan policies and underwriting standards, permitting only limited, documented exceptions; (4) Significant new requirements for risk rating CRE exposures; (5) Identifying concentrations, and performing ongoing stress testing and market analysis; (6) Developing new management information systems that can divide and stratify concentrations to be analyzed by geography, industry and borrower.

In addition this new guidance will delegate to examiners the authority to require both increased reserves and capital if a bank or thrift is deemed to have a concentration in commercial real estate loans. These new capital and reserve requirements are independent of how well the bank or thrift is managing the risk in its CRE portfolio, or what loss trends may be. Worse, we see nothing in the proposal that permits community banks to adjust these requirements to their size, focus or market area.

We would also note that all four regulators are already adding to your tools to address these concerns through the proposed capital requirements of BASEL IA. Riskier activity will already require additional capital once those standards are adopted in their final form. Given all of the other tools the regulators have to address concentrations or other concerns, the OBL does not believe additional costs or burdens are warranted at this time.

The Proposed Rule will have Adverse Consequences for the Quality of Earnings for Banks & Thrifts, our Ability to Compete with Credit Unions and Even on the Economy as a Whole.

Commercial real estate lending has become an important market for several OBL member banks, particularly community banks. Your analysis may be correct that CRE today makes up a larger portion of lending portfolios than it did ten years ago. As markets have evolved, captive auto finance companies, and mortgage companies affiliated with realtors have taken a greater share of the auto and purchase money mortgage markets. Credit unions have been able to use their tax-free status to great advantage in lending to the consumer. Commercial real estate is one of the markets left where bankers have a natural expertise and a competitive advantage, so CRE has become an important part of bank profitability. To make it substantially more difficult or expensive for banks and thrifts to participate in those markets will erode profits to the detriment of system safety and soundness.

The OBL leadership accepts that the regulators do not intend to create a hard cap on commercial real estate lending. However when these guideline are applied by examiners in the field, there is a real risk of creating a hard cap that reduces the flexibility and ability of even the most prudent banker to meet the lending needs of their community. As a result, the potential negative impact of the proposed regulation on banking will go beyond just profitability. When banks and thrifts shed commercial loans to comply with the new guidelines, they will have to redeploy those assets somewhere. Lenders will either have to chase lower margins or accept more risk in other, more competitive markets. In either event, we have to assume that the new investments will yield a lower return that current CRE activity, or the banks and thrifts would already be more focused in those markets.

Unfortunately, if banks and thrifts drop out of the commercial real estate market to keep concentration levels below the guidelines, the adverse consequences will go beyond just banking. The reduced availability of credit and increased cost caused by this sudden contraction could have an adverse impact on the entire construction and development market. Much like TRA ’86 this sudden contraction could be a self-fulfilling prophecy and lead to major economic dislocations.

Conclusion

The OBL respectfully requests the four banking agencies to withdraw the proposed guidance. Ohio banks and thrifts do not see the costs and burdens as justified given the current lending practices and risk management. If there is a concern or system risk, the regulators would be better served by using existing guidelines and practices to focus attention on institutions that are carrying the disproportionate risk without the track record to prove they can manage that risk.

Sincerely;

Jeffrey D. Quayle

Jeffrey D. Quayle
Senior Vice President & General Counsel