April 12, 2006

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 1-5
Washington, DC 20219
Attention: Docket Number 06-01

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: Docket Number 2006-01

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

Jennifer J. Johnson
Secretary
Board of Governors of
the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket Number OP-1248

Re: Concentration in Commercial Real Estate Lending, Sound Risk Management Practices

Ladies and Gentlemen:

The Mortgage Bankers Association (MBA) appreciates this opportunity to comment on concentrations in commercial real estate lending, sound risk management practices (Guidance) that is jointly proposed by the Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, and Board of Governors of the Federal Reserve System (Agencies).[1] The proposed Guidance sets forth certain thresholds for assessing whether an institution has commercial real estate (CRE) loan concentrations that would trigger heightened risk management practices.

Prior to addressing the substance of the proposed Guidance, MBA would like to commend the Agencies for jointly proposing the Guidance. The banking industry is well served when guidance and regulations are proposed as a common standard for all regulatory agencies to follow. This fosters consistency and uniformity in banking compliance regulations regardless of the examining regulatory agency. Additionally, MBA commends the Agencies for taking contemporaneous action on a concern that was identified by field examiners and tracking reports. This proactive approach

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[1] **The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.**

identifies and addresses problems as they emerge, which prevents them from growing into a system wide problem.

MBA Recommendations

Presented below are the recommendations that will be addressed in greater detail in the sections that follow:

1. We believe that the Agencies should not view significant bank concentrations in CRE loans by themselves as de facto evidence that heightened risk management procedures and or increased capital is required. Instead, when specified thresholds are met, the burden should be placed on the examining authority to demonstrate that the risk characteristics of a bank's CRE portfolio warrant enhanced risk management practices or increased capital.

2. We recommend that the Agencies develop a definition and guidelines that will avoid the inconsistent application of "heightened risk management practices" in the banking industry.

3. We believe that in terms of evaluating the risk management program of a bank, the following factors should be taken into consideration:

    - Size of the bank
    - Geographic dispersion of CRE loans
    - CRE loan product concentrations
    - Bank CRE lending experience and performance
    - Borrower CRE experience and performance

4. We believe that when evaluating a bank's conformity with the Risk Management Principles (RMP) specified in the Guidance, bank examiners should have the flexibility to take into account the individual circumstances of each bank and the overall evaluation should be based on the totality and effectiveness of the risk management program versus check marks for precise conformity with every RMP specified in the Guidance.

MBA and its members stand with the Agencies in promoting banking practices that foster the safety and soundness of the banking system. Given our members' role in the financing of commercial and residential real estate, we have a strong interest in promoting a banking regulatory framework that guards against imprudent commercial real estate lending practices, which have a derogatory impact on CRE. While we strongly support guidance and regulations that protect and enhance the safety and soundness of the banking industry, we also examined the proposed Guidance in terms of identifying unintended consequences and compliance burdens placed on the banking industry.

Additionally, the proposed Guidance is being evaluated by our members under the broader backdrop of the pending implementation of Basel II as well as the Agencies' consideration of increased risk-based capital requirements for CRE construction lending. Given the uncertainties of both of these pending regulations, there is heightened anxiety in the banking industry over additional regulatory guidance and or regulations that can potentially result in increased levels of risk-based capital. MBA encourages the Agencies when considering the implementation of the Guidance to do so in light of the potential impacts of Basel II and the pending increased risk-based capital requirements for CRE lending.

Recommendation 1 - Commercial Real Estate (CRE) Concentration Risk

We believe that the Agencies should not view significant bank concentrations in CRE loans by themselves as de facto evidence that heightened risk management procedures and or increased capital is required. Instead, the Guidance should require the relative risk of each bank's CRE

portfolio be assessed prior to requiring enhanced risk management practices or increased capital. When the proposed 100 percent or 300 percent thresholds are met, the burden should be placed on the examining authority to demonstrate that the risk characteristics of a bank's CRE portfolio warrant enhanced risk management practices and or increased capital.

Recommendation Rationale

CRE covers a variety of asset categories that include:

1. Office
2. Retail
3. Industrial
4. Multifamily
5. Land
6. Hospitality

CRE covers a large number of product categories that have their individual demand drivers and market cycles. Because of the different demand drivers, the market cycles for individual CRE product categories are not necessarily correlated. Consequently, bank holdings in several CRE product categories with uncorrelated market cycles can have a diversifying effect, not concentration effect, on the overall portfolio. Because CRE is not a monolithic product category, the Agencies should take care in identifying the specific CRE portfolio concentration risk factors (i.e. single product subcategory concentration, lack of geographic diversity, etc.) that represents a threat to individual banking institutions and the banking industry.

MBA members typically have real estate portfolios that contain most, if not all, of the CRE product categories and are widely geographically dispersed. We do not believe that in accurately assessing concentration risk, a bank with a highly diverse CRE portfolio should be judged identically to a bank with a CRE portfolio concentrated in a single asset class in a single market. The proposed Guidance lumps all CRE loans into a single category for concentration testing purposes and does not take into consideration either product or geographic portfolio diversity.

Recommendation 2 – Definition and Guidelines for Heightened Risk Management Practices

We recommend that the Agencies develop a definition and guidelines that will avoid the inconsistent application of "heightened risk management practices" in the banking industry.

Recommendation Rationale

The Guidance does not specify what is meant by "heightened risk management practices". Instead, a reference is made to the "Risk Management Principles" portion of the Guidance. In this section, the Agencies state:

> "This statement is intended to reinforce that guidance [previously issued regulations and guidance] as it relates to institutions with concentrations in CRE loans".

The Risk Management Principles reflect the current expectations of the Agencies, which does not define, "heightened risk management practices". The banking institutions that fall under the guidelines for enhanced CRE lending scrutiny are left to ponder what actual procedures in addition to the existing Agency guidance that they will be responsible for implementing. Will the definition and implementation of "heightened risk management practices" be left to the discretion of individual bank examiners? Will the Agencies jointly develop guidance for bank examiners to use for implementing "heightened risk management practices"? We are concerned that without formal

guidance, the implementation of "heightened risk management practices", when left to the bank examiner's discretion to define and implement, has the potential to be applied in an inconsistent manner to the banking industry. In aggregate, such practices could result in banks implementing needless and costly risk management practices that do not materially improve the safety and soundness of the banks. We also recommend that the Agencies work in concert to apply the "heightened risk management practices" uniformly and consistently from regulatory agency to regulatory agency.

Recommendation 3 – Considerations for Risk Management Program Examination

We believe that a sound risk management program promotes prudent CRE lending and increases the safety and soundness of individual banks and the banking industry as whole. In terms of evaluating a bank's conformity with the RMP provided in the Guidance, we believe the following considerations should also be part of the evaluation process:

1. Overall Asset Size of the Bank – For risk management programs, one size does not fit all. A prudent risk management program implemented by a community bank with $50 million in assets is likely to be significantly different than a bank with $50 billion in assets. Bank examiners need to take into consideration the relative size of a banking institution when examining the risk management program and the differences in staff resources associated with different size banking institutions.
2. Geographic Dispersion of CRE Loans – Wide geographic dispersion helps to reduce the default concentration risk.
3. CRE Loan Product Concentrations – CRE loan portfolios with a large number of product categories have less product concentration risk than single CRE asset loan portfolios.
4. Bank CRE Lending Experience – Bank's CRE lending experience and loan performance history for CRE lending should also be examined when grading the effectiveness of the RMP.
5. Borrower CRE Experience – Is the bank lending to seasoned developers/property owners with established successful loan repayment history or newly formed companies without a loan repayment track record?

Recommendation Rationale

Given the enormous diversity in the banking industry, MBA recognizes the formidable challenge facing the Agencies in fairly and consistently implementing the RMP described in the Guidance. Shown below is a breakdown of the 8,854 banks reporting in the FDIC's Quarterly Banking Summary:

Assets by Institution Size[2]

Category	Less than $100M	$100M-$1 Billion	$1-$10 Billion	$10 Billion+
Average Assets	$52.2 Million	$285.4 Million	$2.7 Billion	$67.0 Billion
Percent of All Banks	44.5%	48.5%	5.7%	1.3%
Percent of All Bank Assets	1.9%	11.5%	12.8%	73.9%

As indicated in the above table, average assets range from $52.2 million for small banks (under $100 million in assets) to $67.0 billion for the largest banks (assets over $10 billion). Average assets held by the largest banks are over 1,000 times greater then average assets held by small

[2] Banking data is from the FDIC Quarterly Banking Summary (Call Report), Third Quarter 2005. The number of banks reported in the Call Report only counts those banks that are subject to the regulatory authority of the FDIC and is not inclusive of all banks and thrifts.

banks. Although banks with assets under $1 billion comprise 93.0 percent of FDIC insured banks, they only account for 13.4 percent of total assets. However, banks with over $10 billion in assets, total 1.3 percent of the FDIC insured banks but possess 73.9 percent of the assets.

In addition to differing capital structures, banks have vastly different business models and service areas. Community banks tend to concentrate their services to a limited geographical area. Regional banks tend to focus on a multi-state region. National banks have a presence in many parts of the United States and in some instances a worldwide presence. Given this wide disparity in bank capital structures and business models, implementing RMP in a highly prescriptive manner with a "one size fits all" philosophy fails to take into account the enormous capital structure and business model differences within the banking industry. For a discussion regarding loan product and geographic concentration risk, see the Recommendation 1 Rational Section.

Recommendation 4 – Examiner Flexibility in Evaluating Bank Risk Management Program

We believe that when evaluating a bank's conformity with the RMP specified in the Guidance, bank examiners should have the flexibility to take into account the individual circumstances of each bank and the overall evaluation should be based on the totality and effectiveness of the risk management program versus check marks for precise conformity with every RMP specified in the Guidance. By doing so, the overall safety and soundness of the bank can be promoted without mandating overly prescriptive, costly, and labor intensive risk management measures that at best tinker at the margins of improving bank soundness.

Recommendation Rationale

Identifying the individual circumstances of each bank was addressed in Recommendation 4, when the differences in banking capital structure, geographic and product CRE loan concentrations were discussed. This recommendation calls for bank examiners to take a reasoned approach when examining a bank's risk management practices for potential enhancements and or increased capital.

MBA greatly appreciates the opportunity to provide these comments to the proposed Guidance. They are intended to bring to the Agencies' attention the need for additional clarification and identify unintended consequences of the Guidance while at the same time supporting our members' interest in promoting prudent risk management practices. Should you have any questions or need clarification about this submittal, please contact George Green at (202) 557-2840 or by e-mail at ggreen@mortgagebankers.org.

Most sincerely,

Jonathan L. Kempner
President and Chief Executive Officer
Mortgage Bankers Association