One Mission. Community Banks.

October 3, 2022

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

James P. Sheesley, Assistant Executive Secretary
Attention: Comments RIN 3064-ZA33
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Chief Counsel's Office
Attention: Comment Processing
Docket ID OCC-2022-0017
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219

Ladies and Gentlemen,

The Community Bankers Association of Michigan (CBM) represents banks headquartered in Michigan. We align nationally with the Independent Community Bankers of America (ICBA) on many banking issues; however, we are independent and place our focus on the needs of Michigan community banks. We are staunch advocates for our banks on the local, state, and national level. A big part of our advocacy efforts involves working with all bank regulators on the state, regional, and national level. We have enjoyed a long, excellent, and very candid and productive relationship with the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Department of Insurance and Financial Services (DIFS) in Michigan. We appreciate the opportunity you have provided for us to submit our comments on behalf of Michigan banks.

The proposed policy statement on prudent commercial real estate loan accommodations and workouts overall is reasonable, reflecting safe and sound business practices. It is noted the core of the Statement, through page 35, is the primary focus for edits and modifications. We support and encourage clear guidance to ensure procedures are memorialized and followed, especially during economic fluctuations. There are areas where recommended changes in language, to better ensure transparency, is warranted. Additional comments regarding the various appendix's are also included for consideration and reference.

Section II – Short-term Loan Accommodations

At the bottom of the third paragraph, in the last sentence the proposed statement reads: Prudent internal controls related to loan accommodations include comprehensive policies and practices, proper management approvals, and timely and accurate reporting and communication. Please consider replacing the word *comprehensive* with *descriptive*. Comprehensive may become a burdensome interpretation for smaller, less complex, community banks.

Also, on page 8 in the top paragraph you state – modified loans to borrowers who have the ability to repay their debts according to **reasonable** terms will not be subject to adverse classification solely because the collateral value is lower than the loan balance. We agree that cash flow, liquidity and the capacity and character of the borrower are all important considerations in the loan classification decision. We ask that you put more definition into the term reasonable. What might be reasonable to bankers, CPAs, attorneys and other experienced lending experts should be essentially the same criteria used by regulators. Regrettably in the last recessionary period of 2008-2010 there were instances of forced loan classification and write offs required by regulators who did not provide an empirical basis to support their disagreement with the assessment of multiple experts engaged by the banks. We are not implying they were wrong in every case – but 2020 hindsight has proven many of those decisions were invalid and resulted in excessive and unnecessary losses for banks during a very difficult economic period. We ask that the term reasonable as used be defined or at a minimum that reasonable examples be used to guide regulatory valuation processes. We hope the experiences of the last recession will temper the judgement of regulators on CRE valuation matters in the next downturn. All parties need to keep a longer-term view in mind. America has recovered from every historical recession – all in due time.

Page 17 Last Paragraph

You state – "prudent risk management practices include developing prudent risk management practices including developing appropriate policies and procedures, updating and assessing financial and collateral information maintaining appropriate risk grading and ensuring proper tracking and accounting for loan accommodations." All of these points are important, and a well-run bank will do all of these things. Again, it would be good to codify expectations and appropriate timing. Different regulators have shown they have different standards they are looking for. This never seems to be an issue in exams in good economic times – but in the last recession – some regulators were ok with quarterly updates on these elements, some required monthly actions on these items – and some were just never satisfied no matter how often banks updated their information. Real world experience by our bankers in the last recession leads us to call for some guidance here that banks can rely on as a consistently applied acceptable and reasonable regulatory expectation.

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We agree a credit best practice is to understand the global cash flow of a borrower. The other business activities of the borrower can add strength or detract from the ability to repay a loan. It is not always possible to get financial information on all of the business activities of a borrower – especially when the loan of a community bank represents a very small portion of the operations of a company or a very wealthy individual. Analyzing the global cash flow for all operating entities is the preferred way to look at a credit and large financial institutions are in a much better position to be able to do this. It is often not possible for a smaller community bank to get this information or to effectively analyze it. We agree that without the global cash flow information the revenues generated directly from the underlying real estate and the collateral value of the property become the key risk factors.

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One of the bullet points you highlight in assessing the repayment capacity of commercial borrowers is "Market Conditions." We do agree that market conditions can impact both the capacity of a borrower to repay and the value of the collateral. The difficulty we have is that this can be such a subjective criterion that two very reasonable parties could disagree on what they perceive as market conditions. This was prevalent in the last recession – especially as

the economy started to recover – regulators still looked at the economy as weaker than it was when it began its recovery. It took a few years for regulators to lighten up as the economy recovered. We also found that they painted all areas of our state with a broad brush when certain parts of the state where not impacted to the same extent. Case in point – the Metro Detroit area was devastated in the last recession. Property values of both commercial and residential real estate declined over 40%. Two of the Big Three OEM's filed bankruptcy and countless auto suppliers in the local market filed bankruptcy. The unemployment rate in the Detroit MSA was far greater than the national average. During the same period in the Upper Peninsula of Michigan and in some of the rural areas of lower Michigan – property values fell less than 10% and unemployment rates while up slightly – were not significantly above cyclical norms. Banks in these lesser affected markets were treated as if they faced the same credit "MARKET CONDITIONS" as their urban peer banks – yet the market conditions were totally different. We need a better and more informed regulatory approach during the next downturn which recognizes the difference in market conditions by actual market not on a statewide, multi-state, regional, or national basis.

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The land loan base case example cited here includes the following verbiage – "If weaknesses are noted in the financial institutions supporting documentation or appraisal or evaluation review process, examiners should direct the financial institution to address the weaknesses, which may require the financial institution to obtain a new collateral valuation". It goes on to state – "examiners may adjust the collateral's value to reflect current market conditions and events". This is where many bankers in the state of Michigan felt things went off the rails with regulators in the last recession. Well informed and well-intentioned reasonable people can disagree on a set of information and circumstances even though they are looking at the same or very similar data. Unfortunately, this happened with too much regularity previously. Banks that had multiple market valuations from experienced certified appraisers who really knew the local market, reviewed by senior partners in their auditor CPA firms and also often also signed off on by the senior partners in well regarded and long established law firms representing the bank were at times disregarded by regulators who did not provide empirical documentation to support the valuations they felt were appropriate. This was an unfortunate misstep by bank regulators who we know were under a lot of pressure and we hope things will be much different in the next recession. Regulators who require a write down of loan values that have been well established by a bank and its professional advisors should have to show their empirical data to support their position – just like the banks have to do the same. We saw firsthand where regulators were reviewing loans in mega banks and super regional banks that received TARP funding where these banks wrote some residential development loans down to zero to eliminate regulatory oversight or ongoing criticism of those loans. They were subsidized with TARP - being too big to fail - and used the government supplied capital in some cases to write their troubled loans down to zero. This eliminated further regulatory scrutiny on those loans and allowed the large banks time to let the value of the properties return as the economy recovered. This was a great strategy for the mega banks – but very few community banks received TARP funding – and they could not afford to write these loans down to zero, and they should not have – because there was long term value there. Regrettably, regulatory teams that had seen properties in the same residential development at mega banks written down to zero – in many cases required the community bank to write their loans down to zero even though experienced appraisers and real estate experts could empirically prove there was still value in those properties. Those same parcels that had to be written down to zero in 2008 to 2011 substantially recovered by 2012 and virtually all had been sold from bank books for significant gains by the end of 2013.

We are hopeful banks and their regulators have learned from the missteps on both sides in the last recession and that all take a longer-term view when deliberating on CRE valuations in any future recession. Banks do not have impartial appeals process to look to when they reasonably disagree with regulators on valuation or loan classification issues. Banks have to appeal to the regulator they have the disagreement with and that regulator with no input from outside impartial arbiters determines the viability and then the outcome of any appeal. It is a blatantly one-sided process and so they effectively have no ability to seek a fair hearing for their grievances in these matters. This makes it all the more important for regulators to take a very balanced and long-term view on CRE valuation and classification matters.

Page 27 V. Classification of Loans

Further, examiners should not adversely classify loans solely because the borrower is associated with a particular industry that is experiencing financial difficulties. We agree with this comment. We also understand that some industries can face challenges that other industries do not. This is true today in various segments of commercial real estate. Multifamily and distribution related properties are in high demand whereas office space in certain areas of the country is seeing a softening in value. We agree that the industry cannot be the sole determinant of the loan classification decision – nor can any other factor be considered in isolation. The bank and the regulator need to take all relevant valuation factors into consideration.

Page 30 C. Classification of Troubled CRE Loans Dependent on the sale of Collateral for Repayment

At the bottom of this section, in the last sentence of the paragraph recommend a change. The sentence reads: If warranted by the underlying circumstances, an examiner may use a "doubtful" classification on the entire loan balance. However, examiners should use a "doubtful" classification infrequently and for a limited time period to permit the pending events to be resolved. We recommend changing *for a limited time period* in this sentence with *like special mention such designation is temporary and subject to periodic re-assessment*.

Appendix 1

Numerous scenarios are provided which are hypothetical in nature but do appear reasonable.

Appendix 2

This appendix references accounting terms and standards, and after consultation and review with accountants and firms in Michigan, reflects current accounting standard practices.

Appendix 3

Largely textbook and industry standard distinctions between the use of cap rates and discount rates, with no material edits recommended.

Appendix 4

Standard review of adverse and special mention classifications, which have traditionally been applied to credits for risk grading scenarios.

III. Request for Comment - Questions

Question 1: To what extent does the proposed Statement reflect safe and sound practices currently incorporated in a financial institution's CRE loan accommodation and workout activities? Should the agencies add, modify, or remove any elements, and if so, which and why?

Response: The statement appropriately reflects safe and sound practices. More detail for what constitutes "appropriate" and "reasonable terms" should be added to ensure the desired implementation. If the asset is stressed it should be recorded that way and defined as such within a bank credit policy. Footnote 4's definition of an accommodation as one or more payment deferrals is too conservative and should be refined. A single payment deferral should not meet the definition of an accommodation.

Question 2: What additional information, if any, should be included to optimize the guidance for managing CRE loan portfolios during all business cycles and why?

Response: Section IV lays out elements of a long-term workout in detail but should include the process would most likely be driven by a Special Loan (Watch) Report and be updated quarterly. Adding an appendix regarding components of adequate policies and procedures for the proposed Statement would enhance adoption throughout the industry.

Question 3: Some of the principles discussed in the proposed Statement are appropriate for Commercial & Industrial (C&I) lending secured by personal property or other business assets. Should the agencies further address C&I lending more explicitly, and if so, how?

Response: Yes, expand detail for managing leveraged and other specialty lending areas. The statement should address ICRE properties and the handling of troubled debt restructuring as it pertains to the proposed guidelines.

Question 4: What additional loan workout examples or scenarios should the agencies include or discuss? Are there examples in Appendix 1 of the proposed statement that are not needed, and if so, why not? Should any of the examples in the proposed Statement be revised to better reflect current practices, and if so, how?

Response: Appendix 1 would benefit from increased granularity of the different scenarios and incorporating some subjective classification factors to better reflect real world situations. For example, definitions of enhanced disclosures and adverse classifications and the degree of the restructure being recommended. How the short-term payment relief handled with forbearance agreements and aggressive paydowns or financial requirements compared to foreclosure proceedings.

Question 5: To what extent do the TDR examples continue to be relevant in 2023 given that ASU 2022-02 eliminates the need for a financial institution to identify and account for a new loan modification as a TDR?

Response: Depending on the timing of implementation for ASU 2022-02, TDRs should be removed as they are not relevant. That said, documentation of stressed debt and forecasting possible losses within a portfolio will continue to be necessary as we move forward.

Michigan bankers and the CBM recognize that with commercial real estate there are material market differences within our state, regionally, and nationally. Each market can and will be affected differently as the economy changes. We welcome the continued open dialogue to ensure credits are treated with those differences in mind while relying on a standard framework we can all count upon. We appreciate the opportunity to recommend changes that benefit all stakeholders, and which result in creating more consistency. Thank you for the opportunity to review this proposed statement and for the opportunity to submit comments for your consideration.

Sincerely,

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