From: Ed Morse [mailto:morseandco@verizon.net]
Sent: Tuesday, January 19, 2010 3:44 PM
To: Comments
Subject: Proposed rulemaking for clawback provisions; Rules under 12 CFR 327; RIN # 3064-AD56

Dear FDIC:

I am submitting comments on your proposed rule [12 CFR 3327; RIN # 3064-AD56] to change, among other things, employee compensation and risk evaluation for FDIC insured lenders. Your proposed rules are a small and in-adequate step, but one in the right direction. Generally, my comments suggest additional rule-making is needed in the following three areas:

I am a real estate appraiser and consultant, and have a BS, MBA, and JD degrees. I have 35 years of experience of real estate appraising; served two terms on the state real estate appraisal and licensing board, and two terms on the Appraisal Foundations Qualification board. I hold the CRE, and MAI professional designations. I am familiar with the licensing, discipline, and qualifications of real estate appraisers. In my experioence and positions as a state and national regulator, I have seen, or been exposed to, or had to try to regulate around many of the frauds, scams, falures and recurring problems of loan losses, and lending failures. This includes the original savings & loan bailout; to the current financial crisis. Many of these problems are systemic, always recurring because of inherent failures in the regulatory system due to inadequate lending controls, and poor FDIC regulatory oversight that has never touched the root causes.

In simplist form, lending consists of two major parts: Credit and underwriting; and collateral valuation. Proper credit and underwriting reduces loss, and proper collateral valuation minimizes those losses incurred. Most bank failures involve failures of one or both of these basic lending functions.

To correct recurring failures, FDIC needs to look at the following three areas:

1. Inadequate management oversight by the bank Board of Directors, and bank Board members that lack adequate supervisory and oversight qualifications.

It is no secret that management and officer compensation is out of sync with major public corporate and national bank performance. Boards have not exercised adquate oversight of officer compensation. This is only possible if the Board of Directors is lax, unqualified, not independent, and not adequately involved in officer compensation; and if the Board is not fully informed on the risk, and short and long terms policies and implications of management's activities. This is generally true of virtually every public bank board I am aware of. Most members of the Boards of Directors are cronies of managemnt, a rubber stamp for the compensation committee; and many lack a basic understaning of the lending process so they are unable to identify risk, and poor lening practices. A successful besiness man or politician, or similar public figure does not make a good and knowledgeable member of a bank board of directors. FDIC should insure that members of insured bank Boards of Directors are adequately compensated; and adequately qualified. Adequalte qualifications include knowledge of finance, economics, and should include experience in lending, credit, or collateral valuation. Most members of failed bank boards had inadequate qualifications, and could not, and did not identify the risks they undertook. You should require that every bank board has at least one member that has extensive business experience in credit and loan underwriting; and appraisal or collateral valuation. Absent such qualifications, the Board will not even recognize subtle and inherent risk that is magnified in times of recessions and market down-turns.

FDIC should consider changing the rules for banks to obtain FDIC insurance, where upper managent and boards of directors have a higher duty to manage, supervise, forecast, and insure bank policies reflect the highest degree of good business judgement; almost rising to a fiduciary duty. This can be done by changing personal liability exposure for bank board members or bank Boards of Directors that are not adquately independent, adequately qualified, and that do not exercise adequate independent oversight. If banks don't want 'hands on' board members, make bank managemnt and Board members personally liable for all loan losses to FDIC insurance programs. Get bank mangement off their private Lear jets, get Boards of Directors members independent, and qualified, and you will have fewer and lower losses. Just have the guts to draft some real rules.

When I served on AQB and when I was a state regulator, I spoke and served on panels that discussed valuation fraud, bank and loan losses, and the inherent problems and conflicts with lenders that want to make loans with FDIC insured funds, and the pressure on appraisers to independently establish the collateral value that often limits the amount of the loan. Too often, the commissioned loan officer is teamed up with the commissioned real estate agent. Both are compensated only if the sale and loan closes. This compensation structure is inherently risky, and fraught with conflicts and the potential for fraud. It is never addressed by FDIC rulemaking, and it must be. I have pointed out to FDIC, FNMA, and OTC officials that requireing lending and managing audits to inquire into, and report loan production by loan officer, and defaults, and to identify loan officers that only use single appraiser, or the failure of managemnt to identify and verify that both the lending, underwriting, credit, and valuation relationship are objective and arms-length increase risks of loss, and risk of loans. Most lender's policies and supervisions in these areas, as well as FDIC rules are in-adeuate. One simple solution is to make loan officers salaried, not commissioned. Another solution is to prohibit the misleading practices of 'fixing' poor credit, and inflating borrower income. It was too complex for FNMA and the GSA's to understand that borrowers needed income to service the loans the government guaranteed. The safeguards of accurate credit, accurate loan underwriting, and accurate asset value must be protected by FDIC.

To demonstrate the systemic failure of FDIC and most federal oversight rules, simply look at the recent failure of WAMU, which engaged in wholesale presuure on appraisers, ignored prudent loan credit and underwriting, and their managemnt ignored internal risk controls. Or examine the failure of Westsound Bank in Bremerton, WA. As I understand the Westsound failure, it will cost FDIC $100 million. In that failure, one individual made 83% of the bad loans, and they were paid $1.2 million in compensation. That loan officer took down the bank, and the FDIC will incurr $100 million in losses, and the loan offficer walks with the money. Is that adequate managemnt or Board oversight? You must require more from the Boards of Directors, as well as invoke a 'claw-back' provision for bad loans.

Management must supervise loan officers, better supervise the credit and underwriting process, and better supervise the appraisal and valuation process to manage risk. After 25 years of problems in these areas, banks still do not have appraisers on staff or retained to advise managemnt in these areas; and banks do not adequately supervise loan production. Your rules need to focus in these areas.

2. Inadequate internal controls and lack of understanding and managing risk by FDIC insured lenders, bank management, and bank auditors.

Not only does FDIC lose money, but investors lose money when banks fail. The current accounting rules and bank regulations are inadequate to asses risk, or to assure that bank management, and bank auditors examine loan production, default rates, default per loan officer, and loss per appraiser, and identify those risks. What is the average income to debt coverage ratio for loans in the banks portfolio? That is a key risk metric that is not even required to be reported for banks. It would help and assist investors, as well as regulators for banks. It would

help investors, consumers, and regulators make more informed decisions of risk, and to identify risk exposure. These metrics do not appear to be required by regulators, managemnt, or auditors. Auditors look only to loans, not to the quality of the loans, not to the credit of the borrower, and not to the collateral behind the loans. The audit rules need to be changed. When the loans go into default, and the 'house of cards' comes tumbling down, it seems to be a 'surprise', when proper management controls can predict, or identify such risks. Reporting and auditing these basic metrics will reveal risk, and the potential for massive loss or recovery claims when bad
loans are sold. Likewise, require that all FDIC insured lenders disclosue the percentage of sub-prime loans they hold, originate, sell, or buy. Disclosure of all high-risk instruments, hedges, and loans should be required, not just to the FDIC, but also to investors and the public. As history as shown, bank management is not capable or qualified to judge the risk, or value of poor loans, hedges, and complex financial instruments, so the next best thing is to simply require total and complete disclosure of the critical elements of all such investments to allow consumers, and investors, and regulators, to arrive at decisions of risk and the value of the portfolio with the assistance of qualified financial and valuation experts.

3. Inadequate reporting metrics must be improved to allow investors, and FDIC regulators to better assess risk and management controls.

FDIC should require all insured banks to describe to FDIC, and allow access to such information by SEC and investors for public companies, all such audit and reporting metrics disclosures, including what internal controls, audit protocols, supervisor qualifications, and Board of Directos qualifications the institution has. The disclosures should include what procedures the bank has in effect to identify, manage, and minimize loan losses; describe the required reporting metrics and audit procedures; and disclose the audits. Reporting metrics should include loan production by loan officers, loan losses by loan officer, loan default by loan officer, income to debt ratios in the portfolio, the % of sub-prime loans, the percentage of loans that were appraised by any single appraiser or firm, and similar risk metrics. FDIC insured lenders should be required to disclose and describe all steps, if any, they take to insure against fraud, collusion, and to identify risk, and to fully report risk. Risk management procedures should meet basic minimum requirements established by FDIC. Use of commissioned loan officers should require public disclosures. Serious consideration should be given to prohibiting commissioned loan officers for FDIC insured lending.

I encourage this small, but inadequate step in an ongoing reform of the deposit insurance programs that continually cost taxpayers billions of dollars of losses from inadequate lending managemnt and oversight.

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