



November 27, 2018

Via Electronic Mail

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Re: Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures (OCC Docket ID OCC-2018-0026 and RIN 1557-AE48; FRB Docket No. R-1621 and RIN 7100-AF15; FDIC RIN 3064-AE90)

Ladies and Gentlemen:

The Bank Policy Institute¹ appreciates the opportunity to comment on the proposal of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation to revise the regulatory capital treatment of High Volatility Commercial Real Estate (“HVCRE”) exposures. The Bank Policy Institute strongly supports the maintenance of robust capital and liquidity levels by all banks as an essential tool for promoting safety and soundness and has long argued that regulatory requirements should be appropriately tailored to the relative risk profile, business model, and other risk-related criteria of the banks subject to those requirements. Section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection

¹ The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

Act (“EGRRCPA”) provides a new statutory definition of “high volatility commercial real estate acquisition, development or construction” (“HVCRE ADC”) loan that improves the risk sensitivity and other aspects of the current definition of HVCRE exposure in the agencies’ capital rules. Accordingly, we appreciate the agencies’ proposal to facilitate the consistent application of the HVCRE exposure definition by revising the definition in the capital rules to conform to the statutory definition in EGRRCPA.

We offer recommendations that would help clarify the revised HVCRE exposure definition and further the agencies’ supervisory objectives of achieving clarity and consistency in the application of the revised HVCRE exposure definition. Our recommendations include clarification on the application of the HVCRE exposure definition to loans secured by vacant land that is intended to remain undeveloped, as well as the applicability of the exclusion for loans secured by 1-4 family residential properties to certain loans financing condominium construction and lot development. In addition, we provide suggestions regarding the “as completed” appraisal value component of the borrower contributed capital exclusion, as well as updates that should be made to the agencies’ HVCRE-specific FAQs.

We also believe that the agencies should consider eliminating the regulatory classification of HVCRE exposures after a review and assessment of the scope of exposures that would remain classified as HVCRE per the revised definition. The new statutory definition excludes certain loans that previously were classified as HVCRE exposures. As acknowledged by the agencies in their proposal, application of the revised definition would continue to impose costs on institutions because of the need to evaluate their portfolios for purposes of classifying exposures as HVCRE or non-HVCRE exposures. Those efforts would, however, in all events result in a much more limited population of loans being classified as HVCRE exposures than under the current definition. Although Section 214 of EGRRCPA addresses which exposures may be subject to a higher risk weight, it does not require that the agencies apply a higher risk weight to any exposure. Accordingly, the agencies should consider whether continuing to require institutions to classify and apply a higher risk weight to HVCRE exposures is appropriate in light of the attendant burdens as well as the other mechanisms for the regular, ongoing supervision of institutions’ commercial real estate lending practices.

- I. **The agencies should revise certain aspects of the proposal to provide greater clarity for institutions and supervisors and promote the consistent application of the revised definition of HVCRE exposure.**
 - A. **Other land loans should not be included in the scope of the revised HVCRE exposure definition where there is no intent to develop the land and the loan is not dependent on income or sales proceeds from the land for repayment.**

The agencies “propose to interpret that other land loans (generally loans secured by vacant land except land known to be used for agricultural purposes) would be included in the scope of the revised HVCRE exposure definition,” consistent with the treatment of other land loans in the Call Report.² Further, in Question 2, the agencies request comment on “whether loans secured by vacant land except agricultural land should be included in the scope of the revised HVCRE exposure definition.”³

It is clear that loans secured by vacant land are not within the scope of the statutory definition of HVCRE ADC loan where the borrower has no intention of developing the land securing the loan and the loan will not be repaid using income or sales proceeds from the real property. The proposal provides that the agencies would

² The proposal, at 83 Fed. Reg. 48993.

³ *Id.*

interpret the HVCRE exposure definition based on the Call Report definition of “a loan secured by real estate,”⁴ which, read broadly and in isolation from other Call Report instructions, could potentially broaden the scope of the HVCRE exposure definition to include land acquired by an obligor with no intent to develop. The reference to “a credit facility secured by land or improved real property” should not be interpreted and applied in a manner that broadens the scope of the statutory definition and does not give effect to the other requirements of the definition.

Consistent with the statutory definition, the proposed revised HVCRE definition would require that three conditions be met in order for “a credit facility secured by land or improved real property” (which would be interpreted as “a loan secured by real estate”) to qualify as an HVCRE exposure—specifically, that it (1) primarily finance the acquisition, development or construction of the property, (2) have the purpose of providing financing to acquire, develop or improve the property into income-producing property, and (3) be dependent upon future income or sales proceeds from the real property for the repayment of the credit facility. If a loan does not meet all three of these requirements, the loan would be excluded from classification as an HVCRE exposure. The proposed interpretation introduces ambiguity as to the scope of the definition of HVCRE exposure, and the agencies should confirm that using the Call Report definition of “a loan secured by real estate” would not broaden the scope of the HVCRE exposure by disregarding these three requirements.

For example, a loan secured by vacant land should not be an HVCRE exposure where the loan is not extended on the basis of, and will not be repaid from, future income produced by the land or from the sale of the land. In this case, the land serves as collateral for the loan, but the land’s function is the same as any other type of collateral. There is no reason, policy-based or otherwise, why a higher risk weight should apply to this type of loan as compared to a loan secured by other collateral or, indeed, an unsecured loan. Even if the first two requirements might be satisfied (for example, if the loan were extended so the borrower could purchase the vacant land), the third requirement that the loan be dependent upon future income or sales proceeds from that property for repayment would not be met. Therefore, the agencies should confirm that, where one or more of the three requirements is not satisfied, the loan would be excluded from the revised definition of HVCRE exposure. The statutory definition mandates this result, and the proposed interpretation of “a credit facility secured by land or improved real property” should be applied in a manner consistent with the full statutory definition of HVCRE ADC loan. This clarification would promote consistency with the statutory definition and consistency in the application of the proposed revised definition of HVCRE exposure. It would also make clear that loans that are not collateral-dependent and finance otherwise non-exempt real property acquired with no intent to be developed would be excluded from the revised definition of HVCRE exposure. This would prevent the proposal from interfering with non-economic transactions that we do not believe the proposal was intended to affect.⁵

In addition, this clarification would exclude loans refinancing non-stabilized property with no planned development from the revised HVCRE definition, notwithstanding that the loan does not meet the exclusion for loans on existing income-producing properties that qualify as permanent refinancings.⁶ Specifically, because in such a

⁴ FFIEC, Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC 031, 032, 033 and 034), at A-59 and RC-C-2. “Loans Secured by Real Estate” are defined broadly as “. . . loans predicated upon a security interest in real property. A loan predicated upon a security interest in real property is a loan secured wholly or substantially by a lien on real property for which the lien is central to the extension of the credit—that is, the borrower would not have been extended credit in the same amount or on terms as favorable without the lien on real property. All loans satisfying the criteria above are to be reported as loans secured by real estate . . . regardless of the purpose of the financing. Only in transactions where a lien on real property has been taken as collateral solely through an abundance of caution and where the terms as a consequence have not been made more favorable than they would have been in the absence of the lien, would the loans not be considered to be secured by real estate and not be classifiable as loans secured by real estate in the Report of Condition.”

⁵ For example, the acquisition of vacant land for the purpose of preserving a historic structure or parcel of land.

⁶ See the proposal, at 48994.

case there is no planned development, the second prong of the statutory definition that the refinancing have the purpose of acquiring, developing, or improving the property into income-producing property would not be met. Therefore, we believe that the failure to satisfy the second prong should result in the exclusion of a credit facility refinancing non-stabilized property with no intent to develop from the revised HVCRE definition.

B. The exclusion for loans secured by 1-4 family residential properties should also exclude certain loans financing the construction of condominiums from the revised definition of HVCRE exposure and clarify the scope of the exclusion for lot development loans.

The proposal states that “loans to finance the construction of condominiums and cooperatives would generally not be included in the scope of the 1-4 family residential properties exclusion under the revised HVCRE exposure definition.”⁷ Further, in Question 3, the agencies request comment on whether it is clear “which types of townhomes, condominiums, cooperatives and mobile home-related loans are excluded” from the exception to the revised definition of HVCRE exposure.⁸

As noted in the proposal, the agencies aligned the exclusion for loans secured by 1-4 family residential properties with the agencies’ interagency real estate lending standards, which differ from the definitions in the instructions to the Call Report,⁹ noting that “the Call Report’s usage of the one- to-four family [sic] residential property definition—as a category of permanent financings . . . [is] for different reporting purposes,” whereas the “interagency real estate lending standards . . . state that the construction of condominiums and cooperatives are multifamily construction.”¹⁰ The proposal would therefore classify condominium construction as multifamily construction, and as a result, loans financing such construction would be outside the scope of the 1-4 family residential property exclusion. Therefore, they would be subject to HVCRE classification and a higher risk weight, unless another exclusion applied. Consequently, the proposal will include loans financing condominium development in the revised HVCRE exposure definition, even if only in respect of 1-4 family residential properties. The agencies should classify loans financing the development of condominiums in respect of 1-4 family residential properties as within the scope of the 1-4 family residential property exclusion from HVCRE exposure. If the agencies do not accept this recommendation and adopt the capital rule revisions as proposed, then in order to promote consistency across regulatory reporting requirements the agencies should make clarifying revisions to the Call Report and FR Y-9C instructions for HVCRE exposure treatment of loans financing the construction of condominiums to align with the revised capital rule HVCRE definition.

The agencies propose to include credit facilities that combine the acquisition, development or construction of 1-4 family structures, including lot development loans, in the scope of the 1-4 family residential property exclusion under the revised definition of HVCRE exposure,¹¹ and invite comment in Question 3 on “whether it is appropriate to include 1-4 family lot development loans within the scope of this exclusion” from the revised HVCRE exposure definition.¹² We support the inclusion of those lot development loans within the scope of that exclusion. The

⁷ The proposal, at 48993.

⁸ *Id.*, at 48993-94.

⁹ This approach also differs from definitions used in the instructions to the Federal Reserve’s FR Y-9C. Classifying these loans with reference to the Call Report definitions would promote greater consistency among the capital rules and these reporting form definitions.

¹⁰ The proposal, at 48993 (and footnote 19). The Call Report provides that “revolving and permanent” loans secured by individual condominium dwelling units are reported as 1-4 family residential properties, even if the building has more than five dwelling units. See Call Report instructions for Schedule RC-C, Part 1, Item 1.c(3) (“Loans secured by 1-4 family residential properties”) (referenced in the proposal at footnote 19).

¹¹ The proposal, at 48993.

¹² *Id.*, at 48994.

instructions to the Call Report do not classify loans secured by “vacant lots ... in areas set aside primarily for 1-4 family homes” as secured by 1-4 family residential properties, and instead classify these loans as construction, land development, or other land loans.¹³ However, it would be inconsistent with the purposes of the exclusion for loans secured by 1-4 family residential properties to include these loans within the HVCRE exposure definition. A loan extended to acquire land and develop 1-4 family residential properties is exactly the type of loan that is intended to be excluded from HVCRE. To further the objectives of the revised definition of HVCRE exposure, we recommend that the agencies confirm that loans financing the acquisition or development of vacant land that will be divided into multiple lots, but that each separate lot will contain 1-4 family residential properties, would be excluded from the definition of HVCRE exposure under the 1-4 family residential property exclusion.

C. A borrower should qualify for the contributed capital exclusion using an “as completed” appraisal value for the portion of the project financed.

The proposal excludes from the revised definition of HVCRE exposure certain commercial real property projects that are underwritten in accordance with supervisory underwriting standards and that have borrower-contributed capital equal to 15 percent of the property’s appraised “as completed” value for the project. To determine whether this 15 percent threshold has been met in a multi-phase project, the loan financing a particular stage must have its own appraised “as completed” value in order to be deemed a separate “project” eligible for exclusion under the proposal. Given that, in many cases, a single credit facility finances an entire multi-phase project from beginning to completion, the agencies should provide that the use of “as completed” values for certain phases of a project would not require several appraisals at the various project stages, but instead would allow the HVCRE determination to be based on the lending commitment amount relative to the “as completed” value for the entire project. Allowing credit facilities financing an entire multi-phase project to seek exclusion based on a single appraisal value in this way would reduce undue administrative burden on the subject institutions, as well as promote longevity in project-specific lending practices. Likewise, where a credit facility finances only certain phases of the project, the “as completed” appraisal value should be with respect to the phases that the credit facility finances, and the institution should be able to use a single “as completed” appraisal value as compared to the lending commitment amount with respect to those phases.

D. The FAQs relating to HVCRE exposures should be updated to reflect the revisions to the definition of HVCRE exposure, once finalized.

The agencies should update the HVCRE-specific FAQs published on the agencies’ websites to reflect changes to the definition of HVCRE exposure once the proposal is finalized.¹⁴ For example, HVCRE Exposures FAQ 2 addresses the application of the current definition to loans made prior to the effective date of the capital rules. The proposal would revise the treatment of loans extended prior to January 1, 2015 and this FAQ would conflict with the proposed definition. Accordingly, revising the FAQs to reflect changes to the definition of HVCRE exposure would promote clarity and the consistent application of the definition. We recognize that the agencies present the FAQs related to HVCRE within a single interagency document containing questions on the regulatory capital rule, including questions on the definition of capital and other real estate and off-balance-sheet exposures in addition to HVCRE.¹⁵

¹³ See Call Report instructions for Schedule RC-C, Part 1, Item 1.c (“Loans secured by 1-4 family residential properties”).

¹⁴ OCC, Federal Reserve and FDIC, Frequently Asked Questions on the Regulatory Capital Rule (2015), *available at* <https://www.occ.treas.gov/news-issuances/bulletins/2015/bulletin-2015-23a.pdf>. The FDIC also publishes a separate website page with FAQs specific to HVCRE. FDIC, Regulatory Capital: Frequently Asked Questions, High Volatility Commercial Real Estate (HVCRE) Exposures (last visited Nov. 27, 2018), *available at* <https://www.fdic.gov/regulations/capital/capitalfaq-hvcre.html>.

¹⁵ OCC, Description: Interagency Frequently Asked Questions (last visited Nov. 27, 2018), *available at* <https://www.occ.treas.gov/news-issuances/bulletins/2015/bulletin-2015-23.html>; Federal Reserve, SR 15-6: Interagency Frequently Asked Questions (FAQs) on the Regulatory Capital Rule (2015), *available at* <https://www.federalreserve.gov/supervisionreg/srletters/sr1506.htm>.

Therefore, our suggestion to revise the FAQs is limited to those questions that are specific to HVCRE. Moreover, we recommend that the agencies retain FAQs that would not be superseded and would remain relevant. For example, FAQ 1 addresses the timing of borrower capital for purposes of the borrower contributed capital exclusion and would remain applicable if the proposed definition is adopted. Further, to avoid any industry misunderstanding as to the applicability of the FAQs, the information provided by the FAQs that remain relevant under the EGRRCPA definition should be included within the rule text of the revised HVCRE definition and exclusions, or else clearly stated in the preamble to the final rule.¹⁶

- II. We recommend that the agencies consider eliminating the regulatory classification of HVCRE exposures in light of the burdens of maintaining the definition and other mechanisms for the supervision of institutions' commercial real estate lending practices, after a review and assessment of the scope of exposures that would remain classified as HVCRE under the revised definition.**
- A. The agencies should consider whether it is appropriate to maintain a separate classification and higher risk weight for HVCRE exposures in light of the limited population of HVCRE exposures under the revised definition and the burdens and costs associated with HVCRE exposure classification.**

We believe the agencies should consider eliminating the regulatory classification of HVCRE exposures entirely. The proposal would revise the definition of HVCRE exposure under the capital rule to conform to the statutory definition in the EGRRCPA. Specifically, the proposed rule would conform the agencies' "HVCRE exposure" definitions to the EGRRCPA definition of HVCRE ADC loans.¹⁷ The revised statutory definition under EGRRCPA will reduce the population of HVCRE loans by introducing broader exclusions and, accordingly, a narrower scope relative to the definitions currently included in the agencies' capital rules.

For example, the revised definition, relative to the definitions currently included in the agencies' capital rules, (i) excludes loans originated prior to January 1, 2015 that would otherwise qualify as HVCRE loans under the revised definition, (ii) includes a broader exclusion for loans financing agricultural land, and (iii) includes a broader exclusion for certain commercial real property projects with borrower contributed capital. The remaining population is therefore expected to be reduced to a sufficiently small subset of loans that we believe the agencies should evaluate whether the burdens and costs to identify and classify the limited remaining population of HVCRE loans for purposes of applying a higher risk weight are justified by the supervisory benefit of doing so. The FDIC specifically acknowledges in its required Regulatory Flexibility Act analysis that the "proposed rule could pose some administrative costs for covered institutions" as "it is likely that covered institutions who hold some volume of HVCRE loans will incur some costs to evaluate their portfolios to determine if they are excluded from the proposed definition of HVCRE."¹⁸ The FDIC further acknowledges that "it is difficult to accurately estimate the costs associated with evaluating each institution's portfolio of HVCRE because it depends on the characteristics of each institution's portfolio, the resources each institution has to manage these assets, and the labor decisions of senior management at each institution."¹⁹

¹⁶ We note that the agencies, in Question 11, invited comment on the "potential advantages and disadvantages of incorporating the agencies' interpretations of the terms used in the revised HVCRE exposure definition into the rule text or in another published format" and asked "what type of information should be included?" See the proposal, at 48995.

¹⁷ Although Section 214 of EGRRCPA applies only to depository institutions, the revised definition would also apply to all Federal Reserve-regulated institutions that are subject to the Federal Reserve's capital rules, including bank holding companies, savings and loan holding companies, and intermediate holding companies of foreign banking organizations, in order to avoid the burden of complying with separate definitions for HVCRE exposures at different levels of an organization.

¹⁸ 83 Fed. Reg. 48990, 48998.

¹⁹ *Id.*

Although Section 214 of the EGRRCPA restricts the agencies' ability to assign higher risk weights to HVCRE exposures effective immediately upon its enactment, it does not require the agencies to assign a higher risk weight to any exposure.

B. Eliminating the regulatory classification of HVCRE Loans would not have a significant impact on capital and regular, ongoing supervisory processes can provide sufficient regulatory oversight for commercial real estate lending.

As discussed above, the remaining population of HVCRE loans post-EGRRCPA is expected to be relatively small. Accordingly, the impact on capital of eliminating the HVCRE regulatory classification, and the application of a 150 percent risk weight to that small subset of loans, is likely to be minimal and may not justify the compliance costs that continued classification would require.

We recommend that the agencies consider whether regular, ongoing supervision of the institutions subject to this rule is adequate for purposes of maintaining the supervisory benefits of monitoring an institution's high volatility commercial real estate lending. Current interagency rules and guidance on commercial real estate lending²⁰ address the risks inherent in commercial real estate lending and the supervisory expectations and regulatory requirements for prudent risk management. For example, in addition to other regulatory limitations, the agencies' uniform real estate lending regulations and Interagency Guidelines for Real Estate Lending Policies require that each insured depository institution adopt and maintain a written policy—which must be “comprehensive” and “consistent with safe and sound lending practices”—that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements.²¹ An institution's real estate lending policy is required, among other things, to include “prudent underwriting standards that are clear and measurable, including loan-to-value limits, that are consistent with these supervisory guidelines.”²²

Likewise, the agencies' Statement on Prudent Risk Management for Commercial Real Estate Lending²³ notes that “supervisors from the banking agencies will continue to pay special attention to potential risks associated

²⁰ The agencies have adopted a uniform rule on real estate lending. See 12 C.F.R. Part 365 (FDIC); 12 C.F.R. Part 208, Subpart E (Federal Reserve); and 12 C.F.R. Part 34, Subpart D (OCC). Pursuant to the uniform rule, the agencies have also issued Interagency Guidelines for Real Estate Lending Policies, included in the FDIC's regulations as Appendix A to 12 C.F.R. Part 365, in the Federal Reserve's regulations as Appendix C to 12 C.F.R. Part 208, subpart C and in the OCC's regulations as Appendix A to 12 C.F.R. Part 34, subpart D.

²¹ The Interagency Guidelines specifically require institutions to establish real estate lending policies that include portfolio diversification standards, prudent underwriting standards including loan-to-value limits that are consistent with supervisory guidelines, loan administration procedures, documentation, approval and reporting requirements, and procedures for monitoring real estate markets within the institution's lending area. See Interagency Guidelines.

²² The Federal banking agencies' examination manuals in respect of real estate lending provide support that ongoing supervision in this area may be adequate to address extant supervisory concerns with the remaining population of HVCRE exposures. See, e.g., FDIC, DSC Risk Management Manual of Examination Policies (the “FDIC Examination Manual”), 3.2-20 (real estate lending standards); OCC Comptroller's Handbook, Safety and Soundness, Commercial Real Estate Lending, Version 1.1 (“OCC CRE Handbook”), at 16 (acquisition, development and construction lending). For example, the FDIC Examination Manual and the OCC CRE Handbook specifically provide detailed supervisory guidance for the treatment of Real Estate Construction Loans by regulated institutions specific to the type of loan to be provided (e.g., the FDIC Examination Manual discusses unsecured front money, land development loans, commercial construction loans, and residential construction loans, and the OCC CRE Handbook discusses land acquisition loans, land development loans, tract development loans, construction loans for commercial properties, and bridge loans).

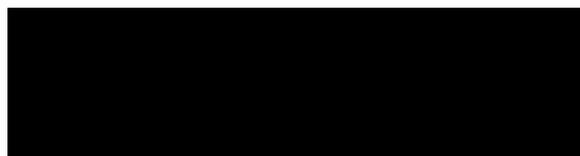
²³ Federal Reserve, FDIC and OCC, Interagency Statement on Prudent Risk Management for Commercial Real Estate Lending (December 8, 2015) (the “Interagency Statement”). The Interagency Statement attaches a list of the agencies' existing regulations and guidance related to CRE lending for reference by the regulated institutions, including Real Estate Lending Standards Regulations and Guidelines (12 C.F.R. 208, subpart E (Federal Reserve), 12 C.F.R. 365 (FDIC), 12 C.F.R. 34, subpart D (OCC)), as

with CRE lending” and “[w]hen conducting examinations that include a review of CRE lending activities, the agencies will focus on the financial institutions’ implementation of the prudent principles in the Concentration Guidance²⁴ as well as other applicable guidance relative to identifying, measuring, monitoring, and managing concentration risk in CRE lending activities.” The Interagency Guidelines further note that “real estate lending is an integral part of many institutions’ business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.”²⁵ Examiner review of institutional real estate lending policies and practices will continue to provide appropriate supervisory oversight addressing the maintenance and adherence of regulated institutions to prudent real estate lending policies.

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The Bank Policy Institute appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by phone at 212-612-9211 or by email at Brett.Waxman@bpi.com.

Respectfully submitted,



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well as eleven additional iterations of interagency supervisory guidance, policy statements or other forms of guidance for regulated institutions related to commercial real estate lending.

²⁴ OCC, Federal Reserve and FDIC, Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices, 71 Fed. Reg. 74580 (December 12, 2006) (the “Concentration Guidance”).

²⁵ Interagency Guidelines. In addition, the FDIC Examination Manual specifically provides that “[w]hen problems exist in the real estate markets that the bank is serving, it is necessary for examiners to devote additional time to the review and evaluation of loans in these markets.” See FDIC Examination Manual, 3.2-21 (commercial real estate loans).