CARDINAL
Bank

**Christopher W. Bergstrom**
*President & Chief Credit Officer*

1009

April 10, 2006

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

Re: **FDIC** (No docket ID); **FRB** Docket No. OP-1246; **OCC** Docket No. 05-21; **OTS** Docket No. 2006-01; **Proposed Interagency Guidance on Concentrations in Commercial Real Estate**; 71 Federal Register 2302; January 13, 2006

Mr. Feldman:

I am writing to comment upon the proposed guidance entitled, "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices", and identified by the above-referenced dockets. I am President and Chief Credit Officer of a state-chartered community bank.

While I understand and agree with some of the concerns expressed in the proposal, I believe that others are unwarranted. More specifically, I agree with the idea that having too many loans that present similar types of risk constitutes a "concentration" of risk that ought to be avoided. Nonetheless, I strongly disagree:

- with the incorrect premise that all business loans secured by real estate present similar kinds of risks and, therefore, should be considered a single "concentration" of loans for the purpose of evaluating credit risk;

- with the incorrect premise that loans secured by real estate constitute a greater risk of loss to banks than loans that are not secured by real estate;

- with the conclusion (drawn from these two incorrect premises) that community banks with a large number of real estate loans should be required to hold higher levels of capital than other banks because they present a riskier profile;

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- with the further conclusion that community banks with a large number of real estate loans should be required to hold higher levels of loan loss reserves than other banks because they present a riskier profile; and

- with the amount of time, money, effort and paperwork that community banks would be required to do to disprove the assumption that they have an unsafe "concentration" of real estate loans.

Community banks have been gradually squeezed out of being able to do significant volumes of most types of consumer lending. Auto lending has been dominated by the captive finance companies at the point of sale. Credit card lending has become dominated by those companies with only the largest mass media and processing capabilities. Other types of consumer lending are often absorbed by the large credit unions that use their tax-exempt status to price below their smaller community bank competitors.

It is true that some avenues for commercial lending not secured by real estate remain available to community banks, but few people would consider these less risky than loans secured by real estate. Obviously, unsecured business lines of credit are much riskier, especially for the types of small businesses that gravitate toward community banks. So, quite naturally, community banks have moved toward doing more of the safest type of lending that remain available to them, loans secured by real estate. But these loans hardly constitute a single type of loan.

In March of 2004, former Federal Reserve Chairman Alan Greenspan noted in a speech in San Diego that the growth in commercial real estate lending by smaller banks was a "natural evolution of community banking and … quite profitable, helping to sustain both earnings and growing equity capital of community banks." He went on to state that "the evidence suggests that community banks have avoided the underwriting mistakes that led to so many problems ten to fifteen years ago."

Since commercial lending is so very critical to community banking, and since the proposed guidance would negatively impact smaller banks much more than larger banks, I am very concerned about what this proposal would mean for the very survival of our community banks. This is particularly true when, as former Chairman Greenspan observed, there is no evidence suggesting that there is a problem that needs fixing. Accordingly, I urge the federal banking agencies to abandon the proposal.

I oppose the proposed guidance in its current form for the following specific reasons:

**1. The proposed guidance incorrectly assumes that all commercial loans secured by real estate constitute one "concentration" risk.**

The commercial real estate loans our community bank makes are not all alike. We make a variety of types of commercial loans secured by real estate in different geographic areas. A community bank may have a line of credit to a law firm secured by the firm's office building, a construction loan to a home builder, a mortgage loan secured by a multi-unit apartment building, and so on. While all of the loans are secured by real estate, they are all different in terms of the risk of non-payment. The risk of loss depends much more on circumstances unique to each borrower than the fact that they are secured by real estate. Yet the proposed guidance assumes that all these loans represent the same kind of risk. I believe this is a mistaken assumption. It is inappropriate in my view to impose burdensome new requirements based on the premise that simply because loans are secured by real estate, they represent greater risk.

Moreover, I believe many loans should not be considered commercial real estate loans in any event. Specifically, loans to finance 1-4 family residential construction where the contractor already has a contract for the house (a custom home contract as opposed to "spec housing") should be excluded. Likewise, some real estate loans are made directly to consumers for the construction of a home.

Also, the proposed guidance isolates the collateral type as a potential point of concern. The guidance does not take into account a potentially low loan-to-value ratio, strong guarantor(s) or an excellent debt to service ratio of a particular loan.

**2. The proposed guidance fails to recognize that commercial loans secured by real estate present less of a risk than loans not secured by real estate.**

One of the underlying premises of the proposed guidance is that commercial real estate loans pose greater risks than other loans. I disagree with this premise.

Would a bank be in a safer position with an unsecured line of credit as opposed to a line of credit secured by real estate? Of course not, but that is how the proposed guidance treats the two loans.

Indeed, I believe that commercial loans secured by real estate pose less of a risk of loss than commercial loans secured by certain other types of collateral. Real estate has historically been a reliable source of collateral.

**3. The proposed guidance would impose significant new compliance burdens on community banks.**

Community banks are already struggling under a debilitating regulatory burden. The proposed guidance would add significantly to that burden.

In particular, while community banks should track their loan portfolios to guard against any legitimate concentrations of risk, the extensive and difficult requirements set forth in the proposed guidance would be burdensome. The proposed guidance provides for increased board oversight, new policies and procedures, strategic planning, new underwriting guidelines, contingency plans, new risk ratings, feasibility studies, sensitivity analysis, stress testing, monitoring, and so on. Attempting to comply with all of these requirements will require a great deal of time and expense.

**4. Requiring additional capital of community banks with higher levels of commercial real estate loans will hurt these banks competitively.**

The proposed guidance indicates that banks meeting the thresholds for commercial real estate loan concentrations will be required to have higher capital levels. Community banks that are forced to hold a much higher level of capital against their assets than a larger competitor bank will be forced to accept a lower return on shareholder equity. Increased capital requirements threaten the very survival of many community banks.

**5. The proposed guidance adopts a "one-size-fits-all" approach when any concerns would be better addressed on an individual bank basis.**

I believe the proposed guidance would unfairly punish all community banks for the problems (now or in the future) of a relative few. I urge the federal banking agencies to reconsider the approach of the proposed guidance.

In particular, I believe the agencies would be much better served if they applied existing guidance to problem banks rather than subjecting all banks to complicated and burdensome new requirements. In particular, I believe that fears associated with a handful of banks are no justification for strangling an entire industry with new regulatory burdens. In short, the agencies can use existing law and their supervisory and examination authority to require those banks that pose unique risks to take the appropriate steps to address those risks. It is simply unnecessary to harm all banks in attempting to cure a few.

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Thank you for considering my views.

Sincerely,

Chris W Bergstrom

Christopher W. Bergstrom
President and Chief Credit Officer