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April 12, 2006

Jennifer J. Johnson, Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2006-01

Re: Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices,
Federal Register, Volume 71, No. 9, January 13, 2006

Dear Sir or Madam:

The Virginia Financial Group, Inc. has written to comment on the guidance referenced above (the "Guidance") and cited by the Federal Reserve System as Docket Number OP-1248; the Office of the Comptroller of the Currency as Docket No. 06-01; and by the Office of Thrift Supervision as No. 2006-01.

VFGI is a state chartered three-bank holding company with total assets of approximately \$1.5 billion. The affiliate banks are members of the Federal Reserve System.

Community banks have traditionally served local needs. Residential mortgages and other consumer-purpose loans have been the mainstay of these loan portfolios. Large banks and national non-bank lenders have increasingly penetrated large parts of these markets. The market for auto loans has been impacted by pressure from captive finance companies offering subsidized financing as a marketing tool. The residential mortgage market has been fragmented by the proliferation of local mortgage brokers; relationships between real estate agents and nationwide mortgage lenders, LPO's opened by out-of-market mortgage lenders; and Internet-based loan providers. Demand for other consumer-purpose loans has been satisfied by the availability of credit provided by large credit cards issuers. These trends were acknowledged by former Chairman Greenspan who noted that "Residential mortgage finance and consumer credit extensions have dominated the portfolio expansion of the banking industry... that growth, which dominates the aggregate statistics, has been largely a large bank phenomenon." Most community banks do not operate on the scale needed to make these types of lending profitable in the current competitive environment. Therefore, movement by community banks to an increased level of commercial real estate (CRE) lending is the "natural evolution of community banking."

It has generally been recognized that, since the last significant down-turn in the real estate market, the amount of equity required by commercial lenders has increased and credit

underwriting criteria have been made stricter. Agency promulgations have addressed maximum LTV's, appraisal independence and review, environmental due diligence, among other things. Adoption of these guidelines by regulated institutions has had the effect of greatly reducing the risks associated with real estate lending. In addition to increased regulatory oversight, underwriting practices, risk rating regimes and internal loan review processes are designed to identify portfolio risk. We believe that the Guidance addresses an issue that is adequately covered by existing promulgations and sound banking practices.

While some of the Agencies' concerns are understandable others are unwarranted and arbitrary. The increased costs necessary to maintain compliance with the Guidance, along with the increased capital requirements provided for therein, would likely force many community banks to sell out to larger banks due to their inability to operate profitably in a regulatory environment that puts them at an extreme disadvantage.

It is believed that the Agencies should: (1) increase the proposed concentration thresholds beyond the 100% and 300%, respectively; (2) exclude from consideration loans below a certain LTV; say 65%; (3) allow for more detailed review of individual loan portfolios; (4) consider the individual institution's lending practices, risk management techniques and market conditions; and (5) provide more detail concerning the amount of additional capital that might be required, and the timeframes within which a bank would have to meet any additional capital requirements, necessitated by application of the Guidance.

The Guidance, as presented:

- Incorrectly assumes that all loans secured by commercial real estate constitute one "concentration" of risk.

The Guidance does not distinguish between speculative 1-4 family construction loans and pre-sold homebuilder construction loans. Loans in the latter category pose significantly less risk than the former. A loan made to an established operating company for their production facility is treated no differently than a non-recourse loan to a LLC for the construction of a speculative income-producing property. The Guidance similarly does not address loans that might be considered speculative but pose an acceptable risk as adequate LTV margins have been maintained.

- Fails to recognize that commercial loans secured by real estate present less risk than those secured by other assets.

The inherent risk of loss provided by an operating line of credit secured by properly margined commercial real estate is undoubtedly less than that posed by a similarly structured facility secured by inventory, accounts and general intangible assets. We contend that the risks associated with commercial real estate lending pale in comparison to the risks being taken in other areas such as: commercial lending secured by blanket liens; agricultural lending; unsecured or HLTV consumer lending, credit card issuance and unchecked payday lending. For the most part, community banks have had better and more long-standing relationships with their commercial customers than other lending institutions. Applying the proposed capital standards discounts the importance of these customer relationships that have been the foundation of community bank success for decades.

- Imposes an unmanageable new compliance burden on community banks.

The requirements outlined in the Guidance impose costs that, when added to the burden of existing regulations, threaten the continued economic viability of community banks. The amount of time, money and other resources required to meet the heightened standards such as: increased board oversight and review; strategic planning requirements; enhanced underwriting and portfolio management; stress testing of the loan portfolio and associated contingency

planning; and revamping of compensation plans, to name a few, place community banks at a competitive disadvantage relative to other financial institutions that do not have to comply with the Guidance. The resource commitment necessary to meet the heightened oversight required by the Guidance will impair the ability of community banks to compete with larger institutions that have the capacity to allocate these costs over a larger portfolio and more diverse income streams.

- Adopts a "one-size-fits-all" methodology that does not consider the lending practices and risk management policies of the individual institution.

The Agencies should consider a revision that does not automatically require an increase in capital if the defined concentrations are exceeded. Any finding that requires an institution to increase its capital account due to heightened CRE concentration should be made only after in-depth review of the composition of that particular institution's loan portfolio. The Guidance does not consider such fundamental risk-mitigating factors as: guarantor support; low LTV; strong DSC; collateral type; property use; etc. The one-size-fits-all approach similarly does not consider bank-specific internal controls such as: the expertise of management and lending personnel, the current and historical performance of the loan portfolio; the robustness of the bank's existing risk rating and loan loss methodologies, or the relative strength of the markets within which the bank operates.

- Arbitrarily imposes increased capital requirements that will hurt the competitive and financial position of these banks

The Guidance requires that banks exceeding the threshold will be required to hold a much higher level of capital than banks not subject to the Guidance. A majority of Virginia community banks would exceed the Agencies' thresholds. It would take many years for these banks to generate the capital necessary to meet the increased, albeit undefined, capital requirements. The Guidance does not provide for the actions, or the timeframes, that a regulated institution would have to meet should an increased capital requirement be imposed by enforcement of the Guidance. John Dugan Comptroller of the Currency noted in a speech before the NY Bankers Association on 4/6/06 admitted that the "language in the proposal ... is quite general." This may allow for arbitrary and irregular implementation by the Agencies. The Agencies should consider a more flexible alternative that would consider not only the risk presented by a potential CRE concentration but also how the risk has been mitigated and managed. In the midst of an increasingly competitive environment, the proposed increased capital requirements, coupled with the cost of increased underwriting, portfolio management and oversight would further exacerbate the fall in the number of community banks.

We believe that existing regulatory guidelines, periodic examinations and banking practices adequately address the safety and soundness issues surrounding CRE concentration. Additionally, we have a variety of concerns with how the Guidance defines CRE concentration and the lack of specificity as to how such concentrations must be addressed. The regulatory paperwork, the supervisory efforts, the additional capital requirements and the limitations that would be placed on the community bank's current "bread and butter" product line by the Guidance, will cause serious competitive and financial strain on our community banks.

Thank you for consideration of our comments.

Sincerely,



Richard L. Saunders
Chief Credit Officer