FINAL CRE CONCENTRATIONS GUIDE

by Steve Brown

Few would argue banking regulations (or guidance) are sexy, but that doesn't mean bankers don't have to pay attention to them. Consider the just-released interagency guidance on CRE concentrations. While not technically a regulation, this "guidance" reminds institutions that there are "substantial risks" posed by CRE concentrations and banks will need to make sure the risks are "recognized" and "appropriately managed." The guidance leaves little to the imagination that regulators are extremely serious on this subject. In short, regulators want banks to manage concentrations not only on the risk of individual loans, but also on a portfolio basis. Banks will need to identify, measure, monitor and manage CRE concentration risk. The guidance informs banks of the following: 1) The definition of CRE concentrations; 2) Risk management steps that should be taken; 3) Filters the regulators will use to initially identify concentrations; 4) Factors that regulators will consider when evaluating CRE risk management; 5) The need to maintain capital consistent with risk posed by the concentration. The guidance also spells out specific things banks should include in their risk management process including: a) Board and Management Oversight - Banks should establish policy guidelines, approve CRE lending strategies, and periodically review and approve CRE risk exposure limits (or appropriate sub- limits). b) Portfolio Management Â– Banks should develop strategies for managing CRE concentration levels, including having a contingency plan to reduce or mitigate concentrations in the event of adverse CRE market conditions. c) Management Information Systems Â– Banks should provide management with sufficient information to identify, measure, monitor and manage credit risk at a portfolio level. d) Market Analysis Â– Banks will need to provide management and board with information allowing for assessment of whether its CRE lending strategy and policies are appropriate on an ongoing basis, e) Credit Underwriting Standards Â– Bank CRE lending policies will need to address maximum loan amount by type of property, loan terms, pricing structures, collateral valuation, Loan-to-Value (LTV) limits by property type, requirements for feasibility studies and sensitivity analysis or stress testing. Banks will also need to include minimum requirements for initial investment and maintenance of hard equity by the borrower, plus minimum standards for borrower net worth, property cash flow, and debt service coverage for the property. f) Portfolio Stress Testing and Sensitivity Analysis - Banks will need to include portfolio stress testing and sensitivity analysis consistent with the size, complexity and risk characteristics of their CRE loan portfolio. g) Credit Risk Review Function Â– Banks will need to ensure risk ratings are also risk sensitive, objective and appropriate for the types of CRE loans they are originating. Finally, banks with high concentrations may also need to: enhance existing risk management systems; create a specific credit risk function; address the concentration rationale in the strategic plan; periodically sell or participate loans to test the portfolio marketability and ensure this channel of liquidity is viable; evaluate underwriting standards with those of the secondary market and perform credit risk rating migration, among other things. This guidance has been a long time coming and is certainly not sexy, but at the end of the day stands to help bankers get a better understanding of the risks inherent in the loan portfolio. Interested bankers can use the link provided at the bottom of the page to find more info.

Related Links:

CRE Press Release on FDIC Website

BANK NEWS

M&A

LDF Inc., the parent of Labe Bank ($553mm, IL) will acquire BB&T Bancshares (463mm, IL) for $105mm in cash, or about 2.57x book. In related news, LDF also announced that it will change its name to First Chicago Bancorp.

OCC

The regulator announced it will fine accounting firm Grant Thornton $300k for its alleged role in the 1999 failure of First National Bank of Keystone ($1.1B, WV). Grant reportedly "overlooked" about $200mm of assets that did not exist.

Congress

Before the break, legislators were busy approving a spate of bills that will benefit banks. The Tax Extension Bill maintained itemized deductions for private mortgage insurance as well as expands new market tax credits. Further, the legislation expands health savings accounts to allow conversion from flex spending, IRA and other reimbursement-type accounts. Congress also passed a bill that will allow an 18-month exam cycle to banks with less than $500mm in assets and a Camels rating of 2 or higher.

GSEs

FNMA completed its restatement by booking a $7.9B loss for 2001 through 2004, much less than the $10.8B originally anticipated. By the end of the process, FNMA had spent $1.6B on legal, accounting and risk management changes needed to correct earlier accounting problems.

Credit Cards

Chris Dodd (D, CT) will take over as Senate Banking Chair and said he plans to look into excessive interest charges on credit cards and the associated disclosures.