REGULATORY CRE GUIDANCE - PART 4

by Steve Brown

Like a leaky faucet that drips, drips, drips, we continue our discussion on the new guidance. Don't worry though, because we have brought in our wrench to make sure tomorrow is the last day of this discussion. Today, we continue to analyze the guidance as we explore how it handles the classification of loans.

The guidance reveals that regulators will not adversely classify renewed or restructured loans that are adequately protected by debt service capacity of the borrower and guarantor; have strong current worth and have good underlying collateral - as long as other key considerations are also covered. These factors would include following prudent underwriting standards and making sure the loan does not have well-defined weaknesses that could jeopardize repayment. In addition, regulators also will not adversely classify renewed or restructured loans, solely because the borrower is associated with a particular industry that is experiencing financial difficulties.

That does not mean bankers get a free pass. Examiners will still be using reasonable judgment to reviewing loans and determine loan classifications. If restructured loans are not supported by adequate analysis and documentation, bankers can expect examiners to request delivery of such information immediately to support management's conclusions and internal loan grades. If such information is not provided, then bankers can expect examiners to exercise more subjectivity.

It is interesting to note that the guidance indicates examiners will not adversely classify or require the recognition of a partial charge-off on a performing loan solely because the value of the underlying collateral has declined to an amount that is less than the loan balance. It goes on to clarify, however, that it would be appropriate to classify a performing loan when well-defined weaknesses exist that will jeopardize repayment.

Part of the classification process should include historical loan performance. Bankers can expect examiners to review loan performance based upon such factors as whether the borrower has been contractually current on all P&I payments, but examiners caution that even loans that are current may carry hidden risk (due to loan structure or liberal use of extensions and renewals) and should be reviewed.

When it comes to restructuring, the guidance indicates short maturity loans maturing in the midst of an economic crisis may have difficulty obtaining refinancing and as such, banks may determine that the most appropriate and prudent course is to restructure or renew such loans.

Regulators recognize that restructured loans typically present an elevated level of credit risk, but indicate assessment of such risk should be based upon the fundamental characteristics affecting the collectibility of the each credit. They even go so far as to say restructured maturing loans to borrowers that have the ability to repay on reasonable terms should not be subject to adverse classification (but should be identified in the internal credit grading system and be closely monitored).

As for loans with well-defined weaknesses, the guidance indicates that when a partial charge-off has been taken, the remaining recorded balance generally should be classified no more severely than "substandard" (unless the loss exposure cannot be reasonably determined). In addition, if the loan facts change after the charge-off has been taken, such that the full amounts contractually due, including the amount charged-off, are expected to be collected and the loan has been brought contractually current, the remaining balance of the loan may be returned to accrual status without having to first receive payment of the charged-off amount.

No matter what is done, the key is documentation and full understanding of this new guidance. This document seems to be saying regulators want banks to restructure loans, but actions speak louder than words and the pain that can be exerted by exam teams can be extreme. Our advice to community bankers is to be cautious, document loan actions/reasoning and tread carefully here until the next exam results are finalized and you can gain first-hand experience.

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BANK NEWS

NOLS & benefits

The Senate unanimously passed HR 3548 extending the NOL carryback period from 2Ys to 5Ys for either 2008 or 2009 NOLs (in addition to some other changes). The change, however, would not include banks that took TARP. In addition, HR 3548 extends the $8k first-time homebuyer credit and lengthens unemployment benefits 14 weeks.

Agency Debt

The Fed will reduce purchases from $200B to $175B through the 1Q due to limited supply.

Communication Nuance

According to a new study by Mintel Compermedia when contacting a bank, 65% of customers favor face-to-face communication at a branch, 43% would like a phone call, 44% the bank's website and 34% via email. On the other hand when it comes to the bank needing to contact the customer, 43% prefer mail, 42% email and 40% in person.

Privacy Concerns

According to a Ponemon Institute Retail Banking Study, customers trust in banks has dropped for a 2nd consecutive year. Those in the top 5 banks, however, showed improved ratings.