POTENTIAL MIXED MESSAGES: IS GUIDANCE FROM WASHINGTON BEING IMPLEMENTED BY FEDERAL BANK EXAMINERS?

FIELD HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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WITNESSES

TUESDAY, AUGUST 16, 2011

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

POTENTIAL MIXED MESSAGES: IS GUIDANCE FROM WASHINGTON BEING IMPLEMENTED BY FEDERAL BANK EXAMINERS?

Tuesday, August 16, 2011

U.S. House of Representatives,
Subcommittee on Financial Institutions
and Consumer Credit,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:05 a.m., in the Coweta County Performing Arts Center, 1523 Lower Fayetteville Road, Newnan, Georgia, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Westmoreland; and Scott.

Ex officio present: Representative Bachus.

Chairwoman Capito. This hearing will come to order.

First, I would like to thank Mr. Westmoreland for bringing this issue to the attention of the Financial Institutions and Consumer Credit Subcommittee. He has been a tireless advocate in the House—as all of you in the audience know—for his constituents and the financial institutions in his district.

And I would also like to thank our witnesses for traveling to Newnan to testify and answer questions.

For those of you in the audience, we will be maybe a little less formal than we might be in the regular committee hearing room.

I should introduce myself. I'm Shelley Moore Capito, the Chairwoman of the Financial Institutions and Consumer Credit Subcommittee of the Financial Services Committee. Spencer Bachus, from Alabama, is the chairman of the full Financial Services Committee.

Let me just explain the format, so you will all understand what we are going to do. We will do opening statements as Members, and then we will have two panels, which will consist of regulators and then bankers from in and around the region. They will have 5 minutes to give an opening statement and then we will be able to ask them questions. I am going to be pretty lenient on the question-and-answer period because I think that is where we glean the most information. But I do have my handy-dandy gavel that made it through TSA, so we are very happy about that.

I also wanted to thank you for welcoming us to Georgia. By way of information, my grandparents were born in Perry, Georgia, so I have good credentials for Georgia. And I have quite a bit of family over in Columbus. And of course, I do remember the 2006 Sugar Bowl when West Virginia beat Georgia, but we will not talk about that. Sorry, I just had to bring it up.

Anyway, the topic of this field hearing is critical to the overall economic recovery in the United States. Over the past few years, members of this subcommittee have heard accounts about overzealous regulators and bank examiners from small business owners and financial institution executives. The subcommittee has held two hearings this year on the issue of mixed messages from Washington.

In the sense that regulators in Washington are encouraging institutions to lend, while examiners in the field are applying restrictive standards that make it very difficult to lend, this hearing is a continuation of the mixed messages discussion. One of the major hurdles to a true economic recovery for both small businesses and financial institutions is uncertainty.

New regulations created by the Dodd-Frank Act are only furthering the uncertainty for institutions, and subsequently our small businesses. We must work together to closely examine the application of regulations on financial institutions to ensure that the appropriate balance is reached between ensuring safe and sound institutions and providing the certainty necessary for encouraging economic growth.

I want to stress that these concerns are not rooted in an effort to return to the regulatory landscape in the pre-financial crisis levels. There should be a healthy level of regulation of financial institutions. However, there needs to be room for institutions to take calculated risks when lending to spur economic development. Many members of this subcommittee fear that the pendulum has potentially swung too far to one extreme. We will continue to examine the issue of mixed messages from Washington-based regulators throughout this Congress.

Finally, I would like to thank our second panel of witnesses for providing their perspective today. I know that many financial executives are hesitant to come forward publicly with their experiences with financial regulators. But it is important that their accounts be part of the public record.

Again, I would like to thank my very good friend, Mr. Lynn Westmoreland, for graciously hosting the subcommittee in his district this morning.

I look forward to hearing the testimony of all of our witnesses and I hope this continues a productive discussion forward.

Now, I will recognize the chairman of the Financial Services Committee, Mr. Bachus, for 5 minutes for the purpose of making an opening statement.

Chairman BACHUS. I thank the chairwoman of the subcommittee for holding this hearing, and I particularly thank her for holding it outside Washington. I think it is important for Congress and for the regulators to actually visit Main Street, visit really in this case almost ground zero with many of our banks. I would also like to thank Mr. Westmoreland who, along with Mr. Scott, introduced a bill last month that actually came out of the committee on a unanimous vote and passed the Congress 6 days later. You hear a lot about partisanship. That was bipartisanship. And it expressed a concern that I think we all share, and when I say that, I mean the regulators, the bankers, Members of Congress, and business people, that we can do better in addressing the problems in our economy and problems in our community banks.

America is made up really in our diversity and our diversity in our financial system is one of our strengths. One of the biggest strengths is the fact that we have many choices for consumers, and many times those choices are Main Street banks or local banks. People deal with people that they know, they know their reputation, they can—they do not have to bank with an institution where decisions are being made thousands of miles away. They can bank with an institution that is locally owned. And that is something that I know the regulators are committed to preserving.

I was looking at the numbers on Georgia. About 1 out of 6 bank failures in the country have occurred here in Georgia, and in fact, over the last year it looks like it is more like 24 to 25 percent, which is pretty astounding.

The bank regulators—to their credit—on February 10th of last year issued a joint policy statement. They all came together and I really believe that policy statement, which I am sure we will go into a little this morning, if we abide by that policy statement at the local level, we will be successful. And basically one thing it said, it actually specifically permitted reputational loans. It permitted banks to make decisions which did—in fact, all loans incur a certain amount of risk, but it actually enabled banks to make loans based on reputation.

Many of our bankers tell us that they cannot make reputational loans, that the bank examiner simply will not allow that. And of course, a reputational loan has to have certain basic things, the borrower has to have the ability to pay it back, he has to have an income stream. So it is not just based on someone with a good reputation; it is someone who can pay that back.

Let me close by saying two things. One thing is as we have this hearing, I think it is important to distinguish between the word "regulation" and the word "management." I have talked to bankers, regulators, and Members of Congress, and I think we all agree that the regulators are to regulate, the bankers are to manage. Sometimes, the boundary between that line is blurred or difficult. But it is important that we allow, in the final instance, the bankers to make the decisions, as long as those decisions do not violate safety and soundness.

Let me say one last thing. There is also a difference between liquidation and resolution. I have often heard the regulators say, "We have resolved this situation." What actually has been done is they have liquidated the bank. And that is a failure. I think ultimate success would be restoring that institution to health and that ought to always be the priority. Sometimes, that is simply not possible. I can tell you that there have been banks in my hometown of Birmingham, Alabama, which simply could not be restored to health, and the longer they operated, the more exposure to the taxpayer. But I have also on occasions felt as if the message coming from the regulators was, "we have successfully resolved this institution," and that ought to always be a last resort. And sometimes, I fear that it has been done, and actually because of loan loss agreements and sharing agreements, actually the cost has been greater than restoring that institution to health. But at the same time, I do not want to second-guess the regulators.

Thank you, Chairwoman Capito, for allowing me to participate and thank you, Mr. Scott and Mr. Westmoreland, two fine Members of Congress. And Mr. Westmoreland, as we all know, and Mr. Scott, have been bipartisan leaders in this issue. Thank you.

Chairwoman CAPITO. Thank you, Mr. Chairman.

I would like to recognize Mr. Lynn Westmoreland, Third District of the beautiful State of Georgia, for an opening statement.

Mr. WESTMORELAND. Thank you and I want to welcome everybody to Georgia's Third Congressional District and I want to thank Chairwoman Capito and Chairman Bachus and Congressman Scott for coming down. I want to thank all the witnesses for coming.

Madam Chairwoman, will we have 5 days for people to submit—5 business days—

Chairwoman CAPITO. Yes.

Mr. WESTMORELAND. Thank you.

Chairwoman CAPITO. Actually, we will have 30 days. The hearing record will stay open for 30 days to submit statements.

Mr. WESTMORELAND. Thank you.

And again, thank you, Chairman Bachus, for helping us move this bill so quickly and Subcommittee Chair Capito, especially for—Spencer, you did not have that far to come, but Shelley did, so thank you all for coming to listen to this hearing on our bank failures and the mixed messages that the regulators are sending to our community bankers.

I would also like to thank the witnesses for traveling here today and all those in the audience who have made this trip to join us.

In Georgia, bank failures are the major threat to the well-being of our communities. Banks in Georgia, both strong and weak, big and small, are trying to survive in a market where the government is picking winners and losers every day, and especially on Fridays. I know, I wait every Friday for the dreaded email to come from the FDIC that yet another bank in Georgia has failed.

As many of you know, and we have experienced personally, 67 Georgia banks have failed since 2008. That is 25 percent of our banks. Sadly, there are some communities in my district that no longer are served by a community bank. If you ride up and down 34 highway, and I am sure it is a wonderful bank, but you will see the Bank of the Ozarks in our community.

I hear every week from bankers across Georgia that regulators just are not listening, or being able to use any common sense or even wanting to help. And curiously, some of these regulators have never even worked in a bank and never even made a loan.

In the 1980s, the agencies testifying today took much criticism from the handling of the savings and loan crisis. Lax enforcement of the rules created more failures. However, the great community bank crisis of 2008 has seen regulatory swing in a completely opposite direction. Now, strict enforcement has created more failures. Banks that were too-big-to-fail have survived; banks too-small-to-save have been cut loose. I am convinced there must be some middle ground between these two extremes.

Our communities every day are losing generational wealth that the pillars of these communities have put into these banks. That money will never come back.

The main problem I have experienced is there is both too much and too little information to evaluate the job the regulators have been doing. Without a doubt, the FDIC is a wealth of information about the health of banks if you have the time and resources to go through it. However, I felt more analysis was needed. Therefore, myself and Congressman Scott introduced H.R. 2056 to study the underlying fundamentals that continue to cause bank failures across this country. The bill directs the FDIC Inspector General, in consultation with the Treasury and Federal Reserve IGs, to study the FDIC policies and practices with regard to shared-loss agreements, the fair application of regulatory capital standards, appraisals, the FDIC procedures for loan modifications, and the FDIC's handling of consent orders and cease and desist orders. Further, the GAO also has a study in the bill to pursue those questions the FDIC IG is unable to fully explore, such as the causes of the high number of bank failures, the impact of fair value accounting, the analysis of the impact of failures on the community, and the overall effectiveness of shared-loss agreements for resolving banks.

Thanks to Chairman Bachus and Subcommittee Chair Capito, this bipartisan bill moved quickly through the Financial Services Committee and passed the House on July 28th by voice vote.

On the other side of the Capitol, our colleague from Georgia, Senator Saxby Chambliss, took this on and tried to get it passed before the August recess in the same bipartisan spirit in which it passed the House. Unfortunately, the FDIC and the American Institute of Certified Public Accountants have both blocked the study from moving forward. I hope the FDIC and the AICPA will state here for the record that they will reach out to the Senate so all objections will be removed and this bill will pass quickly in early September.

To the bankers and small business owners testifying here today, I appreciate the honest assessment of your experience in this tough business environment. There has been a longstanding struggle from my office to receive an honest assessment of the job the regulators are doing, from the businessmen willing to come forward and share their experience for the record. And I appreciate your courage. We had a number of people who would tell us their story, but were unwilling, because of fear of retaliation, to come testify today. And that is a shame.

To those in the audience, know that while I would like to have everyone testify today, my office is always willing to submit your experience for the record and we have 30 days to do that. And furthermore, I hope the regulators on this first panel will remain in the room for the second panel and listen to what they have to say. Too many times, the first panel of the government officials will come in, testify, and then leave. We are not in D.C., I hope you do not have anywhere to go, and we will make sure you get a good lunch if you will stick around and listen to some of these people that we listen to each and every day.

In closing, Georgia is in a banking crisis. To overcome this crisis, regulators, examiners, and bankers must work together to further investment in our small businesses and create jobs.

With that, Madam Chairwoman, I yield back.

Chairwoman CAPITO. Thank you.

I would like to introduce Congressman David Scott from the 13th District of Georgia. Mr. Scott is a very forceful member of the subcommittee and the full committee and he has been out front with Mr. Westmoreland on this particular issue. Welcome, Mr. Scott, and thank you.

Mr. SCOTT. Thank you, thank you very much. And I certainly want to welcome you, Chairwoman Capito, to Georgia and our chairman, the distinguished chairman who does an extraordinary job on our committee and is a great personal friend to me, Chairman Bachus, thank you for coming. And of course, Lynn, it is always a pleasure working with you. Lynn and I go all the way back to our days in the Georgia legislature, and it has been a pleasure working with you, bringing forward this very important bill.

This is a very, very serious issue and we will never be able to find our way out of this economic doldrum that we are in and get the kind of recovery that we need unless our banks are thriving and they are able to lend money.

Our banks are like the heart of our system. Like the heart pumps out the blood, banks pump out the credit and pump out the cash and pump out the lending to small businesses, to individuals so that our economy can grow.

But when we have a rash of bank failures in one geographic area of the United States which account for over 25 percent of all of the bank closures, and in less than 4 years, over 60 banks in this one State fail, we have to dig deep and find out what happened. And I think that is one of the biggest contributions that we can make today with our distinguished committee and representatives. We have to find out from the FDIC, the Office of the Comptroller of the Currency, and the Fed, all of our examiners and regulators, what went wrong, why did this happen. And if the discovery comes out to be, as many have said, that so many of our banks overleveraged their portfolios into real estate, well if we knew this, why didn't some red flags go up? So, we have some serious questions to ask here.

And then secondly, what can we do now to make sure that we have no more bank closures in this State? Just recently, we had a couple of banks close. So the situation goes on.

I think there have to be some very serious questions asked. I think that we have to examine the impact of mark-to-market accounting, what role that played in it. I think we also have to make sure—and I want to echo what Lynn said, because we have two panels here: we have the regulators; and we have the examiners. It is important that the examiners stay so that you can hear from our banking folks, so they can have an opportunity to put the issues right before them.

We have had many hearings on this issue. We hear from our friends in the banking community who basically say the regulations are too stringent, they are putting too much pressure, particularly pressure in terms of an issue just simply as asset writedowns, which require and put enormous amounts of pressure on banks that go out in a hurry and raise capital. We need to examine this to see if this is the correct procedure. And then we need to come out of this figuring out what, in Washington, are we doing that we need to correct ourselves. And I think if we look very closely and examine each of these questions and really be as frank and as honest as we can today, we will make a great contribution, not just in terms of the banking situation here in Georgia, but this is the epicenter and I think the great contribution we will make here is that we will be able to provide valuable information going forward for our entire country because other parts of the United States are suffering from this as well.

I look forward to this hearing. I also would like to get some opinions from our panelists on the impact of our bill. Is it enough? Can we do more? In the process, as we go and continue to negotiate this bill, are there some more things we need to add to it to make it stronger?

So this is going to be a good hearing, and I am really looking forward to it. And I thank you all for your participation.

Chairwoman CAPITO. Thank you, Mr. Scott.

Now, we will go to the panel. Our first witness is Mr. Christopher J. Spoth, who is the Senior Deputy Director, Division of Risk Management Supervision for the Federal Deposit Insurance Corporation, better known as the FDIC. Welcome, Mr. Spoth.

STATEMENT OF CHRISTOPHER J. SPOTH, SENIOR DEPUTY DIRECTOR, DIVISION OF RISK MANAGEMENT SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. SPOTH. Chairman Bachus, Chairwoman Capito, and members of the subcommittee, Congressman Westmoreland, Congressman Scott—

Chairwoman CAPITO. If I could ask you—I think you have to really lean into the microphone so everybody can hear you.

Mr. SPOTH. I apologize.

Thank you so much for the opportunity to testify here before the committee. As the Senior Deputy Director of the Division of Risk Management, I oversee the FDIC's safety and soundness examination program. Twice in my FDIC career, I lived in Georgia, and it is a pleasure to be back today, and outside of Washington, as you say.

The FDIC is the primary Federal regulator for State-chartered banks that are not members of the Federal Reserve System. We supervise 4,700 banks. Georgia has 261 banks and the FDIC is the primary Federal regulator for 211. We have field offices in Atlanta, Albany, and Savannah, plus a regional office in Atlanta. Our examiners are knowledgeable about the economic challenges confronting banks and their customers. The FDIC works closely with the Georgia Department of Banking & Finance.

Georgia's economy was hit especially hard by the housing market collapse in 2007 and the financial crisis and economic recession that followed. The pace of economic recovery has been slow, and conditions in Georgia remain challenging. The State's unemployment is higher than the national average, and its banks have lost money for 10 consecutive quarters. The non-current rate for construction and development loans in Georgia has been over 20 percent for 2 years. High levels of construction and development lending have been a common characteristic of failed banks, and Georgia had the highest construction rate of any State in 2007.

We are keenly sensitive to the hardship that bank failures pose to communities and borrowers. Our supervisory goal is always to avert a bank failure by initiating timely corrective action. Most problem banks do not fail. In fact, most banks across the country are in sound condition, well-capitalized and profitable, although Georgia has been affected more than most.

Community banks play a vital role in credit creation. While community banks represent only 11 percent of industry assets, they provide 38 percent of bank loans to small businesses and farms. However, surveys of bankers and businesses have identified three primary obstacles to making loans at this time: lack of demand from creditworthy borrowers; market competition; and the slow economy.

In response, the FDIC has adopted policies that can help community banks and their borrowers. Since 2008, the banking agencies have issued statements encouraging banks to lend to creditworthy borrowers, to prudently restructure problem commercial real estate loans, and to meet the credit needs of small business. The FDIC sponsored a small business forum earlier this year. Chairman Bachus attended and spoke at that forum.

The FDIC's examination program strives for a balanced approach. Examiners conduct fact-based reviews of a bank's financial risk, the quality of its loan portfolio, and conformance with banking regulations. In analyzing a loan, our examiners focus on the borrower's cash flow. If the borrower cannot pay the principal and interest, then the examiner will consider any collateral or guarantees. We do not focus on distressed property sales. Loans at risk of non-payment are usually identified by the bank itself. At the conclusion of their examination work on site, FDIC examiners always discuss their preliminary findings with the bank management. This provides an opportunity to express the bank's point of view on findings, recommendations, and the supervisory process. We conduct more than 2,500 on-site examinations annually, and we recognize that questions and disagreements may arise, especially during difficult economic times.

The FDIC has a number of channels available for bankers to appeal examination matters. Care is taken to ensure national consistency. We ensure that examiners follow prescribed procedures and FDIC policy through our national training program and commissioning process, internal quality reviews, and ongoing communication at every level. Members of our board of directors and all of our Washington and regional executives are dedicated and involved in this effort.

The FDIC welcomes feedback and relies on bankers' informed perspectives. We meet regularly with banker groups to discuss the examination process. A significant resource is our advisory committee on community banking established in 2009. This committee, which includes a community banker from Georgia, provides us with advice and guidance on a range of policy issues. Our Atlanta regional office meets regularly with banker groups and has welcomed all opportunities to meet with bankers. The FDIC's Regional Director, Tom Dujenski, is here in the audience today.

I will now turn it over to my colleague, Bret Edwards. I will be pleased to answer any questions, and I heartily accept the invitation to stay and listen to the banker panel.

[The joint prepared statement of Mr. Spoth and Mr. Bret Edwards can be found on page 93 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Spoth.

And now our second witness is Mr. Bret D. Edwards, Director, Division of Resolutions and Receiverships at the FDIC. Welcome, Mr. Edwards.

STATEMENT OF BRET D. EDWARDS, DIRECTOR, DIVISION OF RESOLUTIONS AND RECEIVERSHIPS, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. BRET EDWARDS. Thank you. Chairwoman Capito, Chairman Bachus, and members of the subcommittee, I appreciate the opportunity to testify on how the FDIC resolves failed banks, and in particular on the shared-loss agreements we have employed during the current crisis.

Throughout the financial crisis, the FDIC has worked to maintain financial stability and public confidence in the banking system by giving insured depositors of failed banks quick and easy access to their funds.

When a bank is closed by the Comptroller of the Currency or a State banking commissioner, the law requires the FDIC to use the least costly method of resolving the failed bank in order to minimize the costs of bank failures to the Deposit Insurance Fund or the DIF.

With each bank failure, we use a bidding process to find a bank to take over the performing and non-performing assets of the failed bank, along with the bank's deposits and other liabilities. Such a whole bank resolution has benefits for the failed bank's borrowers and the community, as well as the DIF. The bank's borrowers benefit because the assuming bank is a potential new source of credit. And the community benefits from stabilized asset values. In addition, because the failed bank's assets are managed by the assuming bank, the FDIC's asset-related expenses are significantly less than they would be if the FDIC were to manage and liquidate these assets on its own. Finally, everyone benefits when these assets are managed rather than put into an already strained market at fire sale prices.

During the current financial crisis, turmoil in the economy and significant uncertainty about future loan performance and collateral values have made potential buyers of failed banks reluctant to take on the risk of the failed bank's non-performing loan portfolios. As a result, the FDIC has often been required to use a modified version of the whole bank resolution that includes a shared-loss agreement. This was particularly true during the early stages of the crisis. The FDIC estimates the use of shared-loss agreements has saved the DIF, and the thousands of banks that fund the DIF, almost $40 billion during the current crisis.

Unfortunately, a small percentage of failing banks still do not attract viable bids because they have little or no franchise value, and the quality of their assets is very poor. In those instances, the FDIC pays the depositors the insured amount of their deposits and depositors with uninsured funds and other general creditors are given receivership certificates entitling them to a share of the net proceeds from the liquidation of the failed institution's assets. Typically in a payout like this, there is no new source of credit available for troubled borrowers.

Since the crisis began in 2007, the FDIC has successfully found banks to take over 61 of Georgia's 67 failed banks. Forty-one of the 67 banks were acquired by Georgia-based institutions, while 10 other acquirers are from contiguous States.

Under shared-loss agreements, the assuming bank takes ownership of the failed bank's assets and the FDIC agrees to absorb typically 80 percent of the losses on a specified pool of assets, while the assuming bank is liable for the remaining 20 percent of the losses. Each assuming bank is required to utilize a least loss strategy in managing and disposing of these assets.

Shared-loss agreements soften the effect of bank failures on the local markets by keeping more of the failed bank's borrowers in a banking environment. The assuming bank can more easily work with the borrowers to restructure problem credits and advance additional funding where prudent. And in fact, shared-loss agreements require assuming banks to review qualified loans for modification to minimize the incidences of foreclosure. Because the assuming banks share approximately 20 percent of any losses on covered loans, they are motivated to restructure a loan whenever a modification would produce a greater expected return than a foreclosure or short sale. We also require assuming banks to manage covered assets just like their own portfolio, consistent with prudent business practices and the bank's credit policies. The incentives for pursuing modifications and the requirement for consistent treatment of assets work together to prevent a fire sale strategy.

The FDIC monitors compliance with the shared-loss agreements, including the requirement to consider loan modifications through quarterly reporting by the assuming bank and performing periodic reviews of the assuming bank's adherence to the agreement terms. To enforce compliance with the agreement, the FDIC will delay payment of loss claims until compliance problems are corrected. We can also deny payment of a claim altogether or cancel a shared-loss agreement, if compliance problems continue.

While we believe the shared-loss agreements have significant benefits, as the economy improves, we expect to see fewer resolutions with loss share.

Thank you for allowing me to testify today and I look forward to your questions.

[The joint prepared statement of Mr. Spoth and Mr. Bret Edwards can be found on page 93 of the appendix.]

Chairwoman CAPITO. Thank you.

Our third witness will be Mr. Gil Barker, the Southeast District Deputy Comptroller for the Office of the Comptroller of the Currency. Welcome, Mr. Barker.

STATEMENT OF GIL BARKER, SOUTHERN DISTRICT DEPUTY COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. BARKER. Chairwoman Capito and members of the subcommittee, I appreciate this opportunity to discuss the OCC's supervision of community banks and the steps that we take to ensure that our supervision is balanced, fair, and consistent with OCC policies.

My district supervises more than 650 federally-chartered community banks and thrifts, including 45 national banks and thrifts in the State of Georgia. I have been involved in the direct supervision of community banks for most of my career, so I have a deep appreciation for the challenges that these bankers face.

Community banks play a crucial role in providing consumers and small businesses with essential financial services and credit that is critical to economic growth and job formation. Our goal is to ensure that these banks have the strength and the capacity to meet these credit needs.

I understand that some bankers believe that they are receiving mixed messages from regulators about the need to make loans to creditworthy customers, and I appreciate the opportunity to address these issues today.

The OCC's policies encourage banks to make loans to creditworthy borrowers and to work constructively with borrowers. We have mechanisms to help ensure that our examiners apply these policies in a consistent and balanced manner. We alert our examiners to new policy issuances via weekly updates. When warranted, we supplement these issuances with targeted supervisory memos that provide additional direction for implementing on a consistent basis. We reinforce these messages through periodic national teleconferences and meetings at our local field offices.

We have quality assurance processes to ensure that our examiners are applying our guidance consistently. Every report of examination is reviewed and signed off by an appropriate Assistant Deputy Comptroller before it is finalized. Additional levels of review occur when enforcement actions are involved. Our formal quality assurance processes assess the effectiveness of our supervision and compliance with OCC policies through quarterly randomly selected reviews of the supervisory record. While a bank's supervision policies and procedures establish a consistent framework and expectations, our examiners tailor their supervision to each bank and its individual risk profile and business model.

Our front line managers who are located in the local communities are given considerable decision-making authority, reflecting their on-the-ground knowledge of the institutions that they supervise. To support our local examiners, we have district analysts who monitor and provide information on local markets and conditions. This information allows us to tailor our supervisory activities to unique challenges being faced within local economies and business sectors.

We also have an extensive outreach program with State trade associations and we meet with our State and Federal regulatory counterparts to share information and discuss issues.

OCC examiners assess the quality of the bank's loan portfolio during each examination cycle. The goal of our reviews is to confirm the accuracy of bank management's own assessments of credit quality. If a borrower's ability to repay a loan becomes impaired, we expect the bank to classify the loan to recognize the increased risk.

To provide consistency in the examination process, the OCC and other bank agencies use a uniform risk scale to identify problem credits. Consistent with generally accepted accounting principles, the call reports require that a loan be put on non-accrual status when full repayment of principal and interest is not expected. In making these decisions, each loan must be evaluated based on its own structure, terms, and the borrower's ability to repay under reasonable repayment terms. A loan is not classified simply because a borrower is based in a certain geographic region, when they operate in a certain industry, or because the current market value of the underlying collateral has declined. Our supervision strives to ensure that problems are identified and addressed at an early stage before they threaten the bank's viability. When these efforts are not successful and the bank is not viable, we work closely with the FDIC to effect early and least cost resolution of the bank.

The OCC's supervisory philosophy is to have open and frequent communications with the banks that we supervise. While I believe that OCC examiners are striking the right balance in their decisions, my management team and I encourage any banker who has concerns about a particular examination finding to raise these concerns with their examination team, with the supervisory office, with me directly, with the OCC's independent ombudsman.

Thank you, and I would be happy to answer questions afterwards.

[The prepared statement of Mr. Barker can be found on page 58 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Barker.

And our final witness on this panel is Mr. Kevin Bertsch, Associate Director, The Board of Governors of the Federal Reserve System. Welcome.

STATEMENT OF KEVIN M. BERTSCH, ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERTSCH. Thank you.

Chairwoman Capito, Chairman Bachus, and members of the subcommittee, I appreciate the opportunity to appear before you today to discuss the Federal Reserve's efforts to ensure a consistent approach to the examination of community banking organizations. Community banks play a critical role in their local communities. The Federal Reserve very much values its relationship with community banks and is committed to supervising these banks in a balanced and effective way. Developments over the past few years have been particularly challenging for these institutions, and the Federal Reserve recognizes that, within this context, supervisory actions must be well considered and carefully implemented.

The Federal Reserve conducts its supervisory activities through its 12 Federal Reserve Banks across the country. This means that supervision is guided by policies and procedures established by the Board, but is conducted day-to-day by the Reserve Banks and their examiners, many of whom have lived and worked within the districts they serve for many years. We believe this approach ensures that Federal Reserve supervision of community banks is consistent and disciplined and that it also reflects a local perspective that takes account of differences in regional economic conditions.

There has been much discussion recently about whether examiners are unnecessarily restricting the activities of community banks. The Federal Reserve takes seriously its responsibility to address these concerns, and working with the other agencies, the Board has issued several pieces of examination guidance over the past few years to stress the importance of taking a balanced approach to supervision. The Federal Reserve has complemented these statements with training programs for examiners and outreach efforts to the banking industry. In addition, the Federal Reserve continues to strongly reinforce the importance of these statements with its examiners and has taken steps to evaluate compliance with the guidance as part of its regular monitoring of the examination process.

First, all examination findings must go through a thorough review process before being finalized. Local management teams vet the examination findings at the district Reserve Banks to ensure that problem areas are addressed consistently, findings are fully supported, and supervisory determinations conform with Federal Reserve policies. If these vetting sessions identify policy issues requiring clarification, local Reserve Banks contact the Board in Washington for guidance.

In addition, Board analysts sample recently completed examination reports to assess compliance with policies. Potential deviations from policy requirements that are identified through this process are discussed with Reserve Banks and corrected as needed. Board analysts also review quarterly off-site financial surveillance reports with the Reserve Banks to ensure identified issues are consistently and promptly addressed.

Board staff also conduct periodic reviews of specific examination activities. For example, recently we undertook a focused review of commercial real estate loan classification practices in the districts. We initiated this review to assess whether Federal Reserve examiners were implementing the inter-agency policy statement on commercial real estate loan workouts as it was intended. Based on this review, we concluded that Federal Reserve examiners were appropriately implementing the guidance and were consistently taking a balanced approach in determining loan classifications.

Overall, our monitoring efforts to date suggest that Federal Reserve examiners are following established guidance in evaluating supervised institutions. However, if any banking organizations are concerned about supervisory actions that they believe are inappropriate, we continue to encourage them to contact Reserve Bank or Federal Reserve Board supervisory staff to discuss their concerns.

We at the Federal Reserve are acutely aware of the need for a strong and stable community banking industry that can make credit available to creditworthy borrowers across the country. We want banks to deploy capital and liquidity, but in a responsible way that avoids past mistakes and does not create new ones.

The Federal Reserve is committed to working to promote the concurrent goals of fostering credit availability and maintaining a safe and sound banking system. Through our ongoing communication with Reserve Banks and bankers, the Federal Reserve will continue to strive to ensure our guidance is applied in a fair, balanced, and consistent manner across all institutions.

Thank you again for inviting me to appear before you today on this important subject. I will be pleased to take your questions. Thank you.

[The prepared statement of Mr. Bertsch can be found on page 81 of the appendix.]

Chairwoman CAPITO. Thank you. I appreciate the testimony and we will begin with questioning. Each member will have 5 minutes on the first round, and I am going to begin.

I think the question I am asking could be appropriate to everybody, but it might be most appropriate to the FDIC witnesses. Being a resident of a different State and coming to Georgia and seeing 25 percent of the bank failures occurring in this particular region, my question is, what is different in Georgia? We know that the recession is a national one, we know that half of the houses in Las Vegas are in neighborhoods that are underwater. What is particular to Georgia in the regulatory review that causes it to have the greater share of the bank failures?

Mr. SPOTH. I am happy to start to answer that question, Chairman.

It is a very thoughtful question and one that I think about all the time. What is it that happened in Georgia? And as I said, I lived here, I left in 2002, the second time that I was here living in the Atlanta area. What the numbers show, and what my feeling was at the time, was that Atlanta had, or more generally, the State of Georgia had high economic growth in the run-up to the housing collapse in 2007. Credit was available, readily available, for construction supporting that growing economy, and there were rising real estate prices. Not many expected the collapse of housing. Some of the issues that caused that collapse were masked in the nonbank arena through subprime mortgages and some similar issues. I think that is what happened. Why it affected Georgia more than others was probably, as a principal reason, the high amount of exposure to construction and development lending.

Chairwoman CAPITO. Mr. Edwards, do you have another comment?

Mr. BRET EDWARDS. I would concur with that, that is exactly right, the high level of construction and development loans on the books of the banks, especially as we got to the peak of the market, was a big factor.

Chairwoman CAPITO. So that is different than what is occurring in some of these other high real estate areas—Florida, Arizona, New Mexico, Texas?

Mr. SPOTH. It is somewhat different in scale. All of those States experienced a similar phenomenon with rising real estate prices.

Chairwoman CAPITO. Right, right.

Mr. SPOTH. What was different in Georgia is that it had the highest concentration of construction and development loans relative to the capital base, compared to others.

Chairwoman CAPITO. So then my follow-up question would be during that period of time when you were conducting reviews of these particular banks, that was not a red flag at the time?

Mr. SPOTH. It was a red flag. Maybe some of my other colleagues will talk about it. We issued guidance in 2006 to the industry talking about concentrations and risk management around commercial real estate and acquisition, development and construction lending generally. Would there be lessons learned behind that and mistakes made? Probably so.

Chairwoman CAPITO. In the regulatory reaction, you are talking about?

Mr. SPOTH. Yes. The red flags were not always carried all the way through to the supervisory process.

Chairwoman CAPITO. Mr. Bertsch, in our conversation before we began our testimony, you mentioned that you have sort of ridden through this tide before when you were in Boston as a regulator in the downturn of the real estate market in Boston in the early 1990s, and that you are seeing a lot—a lot of what you are hearing us talk about is a lot of what was talked about in the 1990s. What were the solutions at that time and, I guess, how do we find ourselves back in the same position, understanding that there are economic issues here on a national basis that are sort of more beyond control of community bankers in Georgia and others?

Mr. BERTSCH. I think a lot of what the regulators have been doing has been, to some degree, looking back in history to see what helped the New England crisis sort of slow down and how that was sort of addressed. I think if you look at, for example, the prudent commercial workout, commercial real estate workout guidance that all the agencies issued after the initial guidance that Chris referenced, that is basically designed to encourage banks to work with their borrowers and do formal restructurings of loans because that actually did work fairly well in terms of addressing some of the issues that occurred in New England.

Now neither situation was very good for the banking industry. Just as now Georgia is experiencing a very high level of failures, it was similar in New England back in the late 1980s and early 1990s, and some of these same questions were being asked.

But I think the thing we learned through the New England issue was that we need to give the banks an opportunity to restructure the loans and that if they restructure the loans, they can, some of them, can survive. But that does mean that some of them have to recognize some losses and some problems in some of the transactions before they can move forward and see those transactions come back to a performing asset.

Chairwoman CAPITO. Thank you.

Chairman Bachus is recognized for 5 minutes for questions.

Chairman BACHUS. Thank you.

Let me ask the FDIC this question. Loss sharing agreements, obviously that has been a real focus and area of concern. My first question would be—and these are things we have heard from more than one source—is that banks who come in and take over these loans do not have the incentive to modify those loans when the borrower gets in financial trouble. There is almost maybe an incentive to close those loans out. And that is particularly problematic when there is a participation agreement I guess would be the word, between other banks on those loans. That is sometimes where we hear the complaints.

Do you monitor those and is there a possibility of maybe—or have you changed the way those are structured maybe to address that? Have you heard that before?

Mr. BRET EDWARDS. Yes, we have heard that before and obviously it is a concern to us, because we took a lot of care in crafting those agreements as what we feel is the best solution to dealing with the assets coming out of failing banks.

We do believe that the way the shared-loss agreements work, we share the losses, 80 percent with us, 20 percent with the assuming bank, we believe that gives them a pretty significant incentive, as we call it, skin in the game, to ensure that their behavior, their incentives in these agreements are aligned with ours—which is, we want them to pursue the least loss strategy for each and every asset.

Additionally—and I will get to the monitoring in a second—I just want to make it clear that the agreement basically says they must manage the assets that they take in through a shared-loss agreement the same as their assets that are already on their books. So let us talk about compliance for a second. They do extensive reporting to us, we have compliance management contractors go out and do a thorough review of their compliance with these agreements. The agreement requires them to consider modifications in doing an analysis. So we have a bank credit, we look at all the disposition alternatives. If it is a troubled credit, they are required to do an analysis and demonstrate to us or our contractors as we go in to check with compliance, that they have documented, analyzed, and are following the least loss strategy on every credit.

So we are relatively comfortable that the banks are incented to follow the least loss strategy—and they are also required to—and we also check that they are doing that. So I feel that is—but again, I have heard the same things and that concerns us and what I would say with respect to that is, if there are specific instances where folks feel that they are seeing behavior where that is not occurring, we would want to know about that.

Chairman BACHUS. Okay. Have you heard any complaints from other banks when there are participation agreements?

Mr. BRET EDWARDS. Sure. With participation agreements—and again, generally what happens with those participation agreements is it depends on whether you are the lead participant, in other words you are the manager of that loan, or you are a downstream participant, as we say. Where the assuming institution is under a shared-loss agreement, they take the lead, from our perspective, again, the requirement in the agreement is they should be managing that loan just like any other loan in their portfolio and that includes, with respect to participation agreements, and I am sure my examination colleagues would tell you, they should be regularly and actively communicating with the other participants in that loan about what their disposition strategy is if it is a troubled credit, and follow the terms and conditions of that participation agreement.

Chairman BACHUS. I know that Congressman Westmoreland and Congressman Scott both mentioned mark-to-market. And I know that even in 2008, when we first ran into trouble, mark-to-market came up. Chairman Bernanke actually, within 6 months or a year, said mark-to-market is a problem. In some cases, it is exacerbating the problem. He testified probably on at least two or three occasions that it was a concern to the OCC, which has expressed concerns.

In fact, we actually passed a provision that the SEC would look at the impact of mark-to-market and consult with the banking regulators. And they actually came out and instructed the accounting, the different accounting boards, to address the problem, which they sort of did in what has been called by many in the academic field a superficial addressing, because you had sort of a conflict between investors and the institutions as to what those assets were valued.

Can you update me on any of your thoughts on mark-to-market? In fact, two former OCC Chairmen have testified that had mark-to-market been in effect in earlier recessions, there would have been many more bank failures than they had. And they were quite outspoken about that. I had a conversation with Don Powell—whom you are very familiar with—who headed up the agency, and he said that was a real problem. He had left the agency at that time.

But would you comment on that?

Mr. BARKER. Congressman Bachus, I can tell you that from the examiner's perspective, when they go in and they conduct reviews of a loan portfolio, they are looking to see the ability of the borrower to make repayment. They look at the cash flow, they look at the current status of the loan, they look at the prospects for continued payment. In fact, the only time that mark-to-market would come into play is when the loan is no longer being able to be repaid, and then the valuation of the collateral comes into play. So it is at that point when the examiners would go beyond an assessment of the cash flow and make a determination as to whether there is sufficient collateral, and then apply mark-to-market standards as they exist right now, as part of their examination activity.

Chairman BACHUS. Okay. So you do not always follow mark-to-market in just determining whether a loan needs to be further reserved?

Mr. BARKER. We apply the standards first looking at the cash flow and the borrower's ability to make the payments. As long as those payments are continuing to be made, the assessment of the collateral position is very secondary, much after the cash flow analysis.

Chairman BACHUS. All right. That is good news, thank you very much.

Chairwoman CAPITO. Thank you.

Mr. Westmoreland?

Mr. WESTMORELAND. Thank you, Madam Chairwoman.

Mr. Barker, you mentioned in your testimony that you have a deep appreciation for the challenges of those bankers.

Mr. BARKER. Yes.

Mr. WESTMORELAND. Have you ever been in the banking business?

Mr. BARKER. Only as a regulator, sir.

Mr. WESTMORELAND. Only as a regulator. And how long have you been there with the regulators?

Mr. BARKER. I have been with the Comptroller of the Currency's Office for 33 years.

Mr. WESTMORELAND. So you must have gone straight to work there after you graduated college?

Mr. BARKER. Yes, I did.

Mr. WESTMORELAND. So you have never actually made a loan to anybody?

Mr. BARKER. No, I have not.

Mr. WESTMORELAND. You have never been on the banker's side of the desk making a loan?

Mr. BARKER. No.

Mr. WESTMORELAND. Have any one of you ever—since we have had 67 bank failures, how many times have you all been to Georgia to actually go into some of these banks or communities that have had the large number of failures? I will start with you, Mr. Spoth.

Mr. SPOTH. I have been to our—this microphone again.

Chairman BACHUS. These microphones are not as sensitive as those in Washington, so you might want to pull them pretty close.

Mr. SPOTH. I have been to our offices here in Atlanta.

Mr. WESTMORELAND. No, I mean how many banks have you been to?

Mr. SPOTH. I meet with the bankers when they are in the Washington office.

Mr. WESTMORELAND. How many local banks have you been to here?

Mr. SPOTH. Meet with Georgia banks in Georgia?

Mr. WESTMORELAND. Yes.

Mr. SPOTH. I have not met with any in Georgia in recent years. Regional Director Dujenski meets with them all the time.

Mr. WESTMORELAND. Good. Mr. Edwards?

Mr. BRET EDWARDS. No, I have not. I assumed this position in January of this year.

Mr. WESTMORELAND. Okay. Mr. Barker?

Mr. BARKER. I have met with several community banks in the State of Georgia as part of our supervisory process.

Mr. WESTMORELAND. So you went physically to those that were being audited I guess or whatever?

Mr. BARKER. Yes.

Mr. WESTMORELAND. And how many of those closed?

Mr. BARKER. Three of those banks have closed.

Mr. WESTMORELAND. And so you went to three and all three closed?

Mr. BARKER. Yes.

Mr. WESTMORELAND. Okay. Sir, do you ever get out much? [laughter]

Mr. BERTSCH. When they let me out, periodically I do get out.

Chairman BACHUS. He is out today.

Mr. BERTSCH. I have not been in any of the banks in Georgia. I would refer you back to our testimony that we do our supervision directly through the Reserve Banks and that is typically how our visits are conducted.

Mr. WESTMORELAND. Okay. Now I know that the shared-loss agreements—Mr. Edwards, you spoke about them and I guess their intention, at least from what I am reading, is to soften the blow to the community.

Mr. BRET EDWARDS. Yes, that is correct.

Mr. WESTMORELAND. And I read in your testimony about—I guess it was your testimony, it did not have anybody's name on the front of it, but it talked about loss share, that they were open to modification and that you were willing to work with people and that the reason these shared-loss agreements came in was so the acquiring bank could go in and work with these different people to see if they could not save the loans; is that correct?

Mr. BRET EDWARDS. Yes.

Mr. WESTMORELAND. Okay, you need to get out more. And I hope you will stick around and listen to some of this testimony because that is not what happened. That may be what you all think is going on in Washington, but that is not what is happening here in our local communities, I can promise you that.

You also mentioned, or somebody mentioned, that a large percentage—I guess it was you, sir—that a large percentage of the loans here were A&D and construction. And that is true. And I think Ms. Capito asked a question about how many—because of so many banks in Georgia, and we did have a large part of that. Did you ever take into consideration that because of maybe some type of a uniqueness, that somebody would need to come down here and look at it? And if that was recognized by the FDIC as being a problem, then you cannot manage all problems the same way? And if you recognize this, and I am sure it was much the same in Nevada where 40-something percent of their banks have closed, why wouldn't you come in here and look at maybe some special circumstances of the A&D and the construction loans?

Mr. SPOTH. As you know, we issued guidance from Washington about restructuring troubled real estate loans that was designed to reflect what was going on in Georgia, Florida, and some other States that have been mentioned here. We addressed how to restructure loans on the cash flow from the development or from the commercial property and to try and keep the borrower with that property.

Mr. WESTMORELAND. How often did you inquire to how that process was going and how did you—when you looked at that process, how did you see it going?

Mr. SPOTH. We asked bankers and examiners whether they are able to follow the guidance. The particular guidance that I am talking about is about 19 pages long and has all kinds of examples in it. So we have asked people to go back and look at troubled real estate loans and see if the examiners—

Mr. WESTMORELAND. But from your personal experience, what has been the result of going back and doing these things?

Mr. SPOTH. Bankers tell me that they are more comfortable, and importantly, examiners too tell us that they are more comfortable working on restructured loans than they would have otherwise been without the guidance.

Mr. WESTMORELAND. You need to stick around too.

Mr. SPOTH. I will do that, sir.

Mr. WESTMORELAND. Now let me just—

Chairwoman CAPITO. Sure. We will do another round.

Mr. WESTMORELAND. Okay, if I am going to get another round, I will yield back.

Chairwoman CAPITO. Okay. Mr. Scott?

Mr. SCOTT. Thank you very much, Madam Chairwoman.

One of my favorite actors is Paul Newman and he made a wonderful picture called "Cool Hand Luke" and in there, there was this line that said, "What we've got here is failure to communicate." And I think that—and I want to talk about that for a moment because we have Federal regulators in Washington, field examiners and then the banks. And they have not been on the same page. We have had complaints after complaints. And I think at the core of part of our problem here in Georgia has been just that. What have you all done to correct this, to address the concern that there has been a lack of communication between the Federal bank regulators in Washington and the examiners in the field? And in relationship to what they are doing on a consistent manner with the banks.

Mr. SPOTH. At the FDIC, one of the things that we did, having heard that, Congressman, is we informed our community bank advisory committee and had community bankers come to Washington and try to tell us their experience in their banks, in the field, and how it is with those they are representing, their peers. That has been very helpful; I have met with that committee every time they have been in Washington. That has probably been 7 or 8 times now they have come in.

The other thing that we do—I talked about the commercial real estate loan restructuring guidance—is to have conference calls with bankers and invite them to participate. People like myself and the leadership that I work for participate on those calls with bankers and try to cut through the layers of communication that could break down somewhere.

Mr. SCOTT. Let us just take one of those areas. We have come to the conclusion, I think you talked about the major cause, because I think we need to zero in on that, being that overleverage of bank foreclosures into the real estate and the construction area that caused a lot of what we have down here. So what have we moved or what are we going to put in place to make sure that does not happen again? Have we addressed that? Why didn't the examiners, why were they not able to communicate that as they examined the banks? Why were banks allowed to, if we knew that this would be a problem—some of them I think had 70, more than 70 percent of their portfolios were in this. Wasn't that a red flag going up? Didn't somebody see that? If not, have we moved in to correct that, to put something in place, some kind of triggering mechanism, something that would prevent that?

Mr. SPOTH. I can take an initial stab at that. One of the things that we think about when we see that is to recall—and I referenced earlier—how strong the Georgia economy was, and for the Georgia banks, the high capital ratios that existed at that time, say in 2006 and into 2007, and the high earnings. All this was largely driven by real estate, which masked the levels of exposure that were going on, both to examiners, I think, and to the bankers. So we look at techniques and perhaps go back to our 2006 guidance and see if there is something that we could or should do different there. What we know is that it is not necessarily the level, although we have talked about it some here, it is not necessarily the level of construction and development loans; it is also the management of risk around the loans. So it is a two-part story, and it is complicated, but I think that some of the solution is to look at risk practices.

Mr. SCOTT. Let me just ask one because here in Georgia—I want to bring one incident to illustrate, particularly some of the requirements on what is known as asset writedowns. Let us just take the situation with a bank that was called Buckhead Bank, and it was run by a friend of mine, Charlie Loudermilk, who was the chairman and talked to me about that, to see what we could do.

Is there a consistent procedure in place for asset writedowns in terms of the amount of cash capital that bank has to go and raise and are there too restrictive requirements on where they can go or cannot go to raise that capital? Because I think that is at the core of a lot of the problems with why some of the banks went down. There were very strong, stringent requirements on certain standards that might not—that it seems to me could have been adjusted. I think that some of these banks really had no business failing if we were more on the case and were adapting procedures that fit tough economic times as opposed to just bringing down the hammer. And one of those is the asset writedowns. And if we are going to get a troubled bank to have to go and to raise capital, there ought to have been some elasticity there. I do not know the particulars, but I think there is so much you could get from shareholders, or non-shareholders, there had to be—could you address that?

Mr. SPOTH. I will be happy to touch on that. At the beginning, what we try to do when a bank gets in—

Mr. SCOTT. Specifically, if you could refer to that case. I know somebody here dealt with the Buckhead case because if you did not and did not know about that, that is another part of the problem. Were you familiar with that case or the closing of that bank?

Mr. SPOTH. I am. I cannot recall right now the details of that bank. I would be happy to look into it and get back with you on the specifics of that case. I can talk generally about what we do when a bank's viability is threatened or when its closure is near because of its insolvency. I can talk about that kind of corrective program. I just cannot remember the story behind Buckhead at this moment.

Mr. SCOTT. All right, before you leave, some of our banking friends come and tell us that they fear retaliation. Could each of you respond to that? What is that about? Why is there a fear among the bankers of retaliation just to come forward publicly? Where is this fear coming from and what is this retaliation?

Mr. BARKER. Congressman Scott, let me first address the comment itself, and I think that it is very understandable that examiners have considerable power, and each one of the regulatory agencies have considerable power over the institutions themselves. We have the opportunity to make recommendations to the board of directors, we have the opportunity to assess fines and penalties, to pursue enforcement actions. We have a great deal of authority over the institutions themselves.

I think in recognizing that, there is concern about what will happen if there are disagreements or arguments over different opinions that are expressed during the course of an examination. But I can tell you in the strongest terms—and again, I operate in the Dallas office and supervise this region, that it has been emphasized a great deal that there is no retaliation that will take place in any of our supervisory activities. I am as concerned about that as I am anything else that we do. We have active involvement with the institutions themselves, with the bankers associations, I meet with the institutions, and we are very concerned about any kind of feedback or comments that would suggest any kind of retaliation.

Mr. SCOTT. What would that retaliation be? How would any of our Federal regulators—each of you sitting there are regulators—what would be a retaliation? How would that happen? It is a part of the culture there, we hear it all the time, so we might as well get it out in the open so we can correct it, so we do not deal with it. What are some of the—could you describe an action that would be considered retaliation that our bankers would have to worry about, from an examiner?

Mr. BARKER. Again, I go back to concerns about what actions the regulators could pursue. For example, fines and penalties and violations and weaknesses could all be cited in an examination report. Again, we have a series of checks and balances that take place to make sure that does not happen. And again, I cannot emphasize enough that any kind of retaliation, it is a four-letter word, it is identified as something that we just will not allow to take place in any of the institutions.

Chairwoman CAPITO. Would anybody else like to comment on that?

Mr. BERTSCH. I would just add on the question of retaliation, we take it very seriously too, and would not tolerate it. We have an ombudsman function in Washington that is separate and distinct from our supervisory function that can investigate any specific cases that people identify of retaliation. That ombudsman has the ability to investigate through the Reserve Banks and identify any cases that might rise to that and to take appropriate action if anything of that nature is identified. But as Gil said, and I know my other colleagues from the FDIC share this, we do not expect examiners to retaliate. We understand there are differences of opinion but we do not tolerate retaliation.

Chairwoman CAPITO. Thank you. I am going to take the liberty of having another round. I am going to have one quick question.

All three of you have mentioned guidance as a policy, guidance from Washington to try to spur lending. I know that guidance is different than regulation and this is maybe Washington bureaucratic speak, but it has great impact I think in terms of how it is carried forward. So I would ask you, how do you distinguish guidance from regulation, and then if guidance is a weaker form of regulation, more as an advisory opinion, how do you follow up with that in terms of your quality control to make sure it is consistent across all regions and all types of institutions and lending practices?

So I will start with you, Mr. Bertsch.

Mr. BERTSCH. As I touched on in our testimony, we have done a number of things to try to look specifically at how the examiners are implementing the guidance. So one of the things we have to do is rely on our local reserve banks to monitor the work that the examiners are doing and take into account their knowledge of the local business market, their conversations with bankers, and make sure the examiners are taking a balanced approach to looking at loans.

Beyond that, we have done specific testing to look at the particular area that seems to be raised most frequently, which is concerns about how we are treating commercial real estate loans. And so we took a look at a large sample of those loans across the country to see how our examiners were treating them, compared that to the guidance that we set out and make sure that the examiners were consistently following that.

Chairwoman CAPITO. What did you find?

Mr. BERTSCH. We found that in our opinion, the examiners were carefully following that guidance. And in many instances were giving bankers reasonable and, for good reason, benefit of the doubt on loans that they reviewed when there were pending actions or there was additional collateral that was going to be offered, or things of that nature. So we conclude from that—and we continue to test that—that the examiners are hearing the guidance and that they understand that we need to be careful to consider and listen to what the bankers have to say when we are making our classification determinations. And we think that the guidance is effective, regardless of the fact that it's not regulation, as you mentioned.

Chairwoman CAPITO. Right. Mr. Barker?

Mr. BARKER. Madam Chairwoman, I guess the way I would respond to your comment is the difference between guidance and regulation, that specific point itself, because issuing guidance provides a lot of flexibility for the institutions to be able to take an approach and implement what the intentions and the objectives of the guidance actually is. So it is very much a principles-based rather than rules-based approach, which I think again allows the institutions to go ahead and adopt policies, develop business plans, and it provides them some flexibility in how they comply with the regulatory issuance that is out there. I think that is very important because banking is an innovative, creative process and we see that take place all the time and it is up to the experience of the examiners to make sure that guidance is being followed, that the risks are being identified and that the controls are in place to minimize that risk.

Chairwoman CAPITO. Thank you. And then, anybody at the FDIC on that point?

Mr. SPOTH. I think I can probably comment for both of us there. The guidance does not have the force of law.

Chairwoman CAPITO. Right.

Mr. SPOTH. It is a communication vehicle with the industry and our examiners, and during the tough times that we have here—particularly we are all talking about the same main three pieces of guidance—trying to convey a message to both the bankers and the examiners about what the expectations are. So we expect sound loans to be made.

Chairwoman CAPITO. I expect we will hear from the second panel that in the three guidance areas maybe the guidance is, on the one hand, one thing, and then when the rubber meets the road, so to speak, it ends up converting into something else.

I will just make a quick comment and then go to Mr. Bachus. When I hear bank failures and folks taking over assets, it is consolidation. We just went through too-big-to-fail in a big way in this country and certainly the community banks were not the problem. But I, as chairwoman of the Financial Institutions Subcommittee, am beginning to get very concerned about bank consolidation, because from what we are hearing, the institutions are getting larger and larger. And from a lessons-learned aspect, I am not sure—I need to be assured that is the direction we need to go and that you all as regulators are overseeing this as a potential red flag.

So I just put that out as a comment, a source of concern. I think most of my colleagues share this and certainly some of the controls that were put in place in Dodd-Frank, whether it is the FSOC or some other things to look at, kind of over the horizon, systemic risk areas, are still very unformed and, I don't know, they do not make me sleep all that great at night. And then when you see the markets just going crazy here, particularly with the financial institutions, it is a source of concern.

Chairman Bachus?

Chairman BACHUS. Thank you.

I would say this to the regulators, but also to the audience, it is very difficult here on Main Street, the environment, the demographics, the economy, the loss of jobs. It is also, I think, a very difficult time for regulators and they have many challenges there. You will hear sometimes as a Member of Congress conflicting information even from the bankers or from the borrowers. You talk to a borrower and sometimes he will say that the banks say the regulators don't want me to make that loan. And let me say this, it is not up to a Member of Congress to tell people or encourage people to make loans or not to make loans. That is certainly not our job, ethically. But when we have made inquiries as to just what is the situation here, a lot of times the bankers tell us that they do not want to make the loan and they actually do sort of shift that by saying—and it is an easy answer to say—we are afraid of the regulators. And that is often the case.

I know many bankers will maybe tell you that is not the case, but I have had some of them who have said that is the case. Not that they intentionally do that, and maybe it is someone, a loan officer who is saying that, not someone in management.

Mr. Barker, you, as a District Director, are in the banks quite often. And I think Mr. Westmoreland mentioned something—Mr. Spoth—and Mr. Edward, you have been on the job since January—and you are actually in Washington and you supervise the District Directors, so they are going into the banks. But I think maybe Mr. Westmoreland has hit on something in that I think—I believe it could be beneficial to sometimes go with the District Directors or even the bank examiners and listen. Oftentimes, my staff will meet with constituents and then I will talk to constituents and the staff will think they are getting the message, but I may actually say, I think we can do something.

I would actually encourage you to do that because we sometimes don't—at the Washington level, they say they are sending a message to the bank examiners, the bank examiners on the local level sometimes feel as if it is Washington, that if they do something, they may have a problem with Washington. And it is very difficult for us as Members of Congress or for bankers or for borrowers to know exactly if there is a problem or where there is a problem.

I will close by saying that—and I know for many of the bankers here, this may not be a popular thing for me to say, but I am going to say it anyway, because I do not run in this district.

[laughter]

One of the bankers in my district who was the most critical of the bank regulators, vehemently critical, and was always calling with various examples of overreach, I had been told a year before by other bankers that that bank had done all sorts of imprudent lending and that there was no way they were going to pull out. And they were closed, at a considerable loss to the taxpayer and to some depositors who, during that period of time, came in and deposited money above what their protection rates were. And to the last day, I was being told that this bank was in great shape, by the management. But everyone else realized that was not the case.

That is human nature to say that someone else caused your problem. The bottom line is the regulators may have made mistakes, but I do not think in many cases they forced the failure of banks. They may not have done everything that they could have, they may not have done a perfect job. And I worry going forward the level of regulation and the cost of regulation and Dodd-Frank is going to—the interchange fee on debit cards, of all things, which impacts community banks particularly—is going to be another hurdle for our community banks. And I know the Fed has been outspoken on that and very concerned about it, that it would be a problem.

Credit cards were not addressed on the interchange fee. Those are the seven largest banks. So we have had—that provision that only dealt with debit cards is going to make the—it is not a level playing field between our community banks, regional and community banks, and our largest institutions.

So I would just simply say to you I think more communication always helps. I appreciate the fact that the FDIC sent its top people from Washington. It was good that we had a District Director from the OCC because it is a slightly different point of view, and I think they were both good. But I would encourage you, with Mr. Westmoreland and Mr. Scott, to look at their legislation, offer comments to them, if you have a provision that you think is a problem. But if you can work with them on this, at least sit down and see if you can agree.

I appreciate your attendance today and it is not—we are not one big happy family, we are never going to be, but we are all Americans, we are all concerned about the economy, we all want the financial system and the American people to prosper. So we are all on the same page, we all want the same goals. But as you will probably find out on this second panel, they do not consider you family. But they should not, because you are not there to—you have a duty you have to discharge. It is not always popular, but I do—as I appreciate the challenges with the bankers, I appreciate the challenges you have, too.

I have no further questions.

Chairwoman CAPITO. Thank you.

Mr. Westmoreland?

Mr. WESTMORELAND. Thank you. To the gentlemen from the FDIC, can you both confirm to me for the record that no one on the FDIC asked any Senator in the United States Senate to hold H.R. 2056?

Mr. SPOTH. May I take some liberty with that question, to offer our support. For one, we think it is the right thing to do, to have our Inspector General and anyone else look over the FDIC's operation. We support that initiative and are happy to work with it.

Mr. WESTMORELAND. So if anybody told us that, they were mistaken?

Mr. SPOTH. I would not know about that.

Mr. WESTMORELAND. All right. Mr. Barker, in your testimony, you said, "Thus, a key part of our job is to work with bankers to ensure that they recognize and address problems at the earliest possible stage when remedial action is likely to be most effective. The simple truth is that seriously troubled banks cannot effectively meet the needs of their local communities."

And you testified or spoke that you had gone I think to three banks that eventually went. What prior steps had been done, what remedial actions had been taken to get them back on the road I guess to recovery. And how long back had those remedial actions been put in place before the failure?

Mr. BARKER. I think that in every single case where we have a bank failure, examiners are responsible for conducting examinations on a routine basis, based on the size of the institution. Once we identify problems at an institution—

Mr. WESTMORELAND. But how many of those banks—had there been problems identified with those banks that you visited?

Mr. BARKER. Yes.

Mr. WESTMORELAND. And how far back had those problems been identified?

Mr. BARKER. Varying degrees.

Mr. WESTMORELAND. Okay. Because we have bankers telling us that the OCC comes in and they get an A+ on their report card and then the next report, they not only get an F, they are called everything but a felon.

How often do you do examinations on banks?

Mr. BARKER. Depending on the size, either 12 or 18 months.

Mr. WESTMORELAND. Okay, 12 or 18 months. So, one year, you make all A's and then the next year, you get F's, you are called everything but a felon and you make a D in conduct. Now somewhere, somebody missed those remedial steps I guess, because I don't know how it goes from an A+ to an F in 12 months.

Mr. BARKER. Let me say a couple of things. One is that the uniqueness of the Georgia markets included, as was spoken before, the size of the concentrations in commercial real estate and I think what has not been spoken is the significant economic impact that hit at one particular time. In the past, it was a slow downturn or the economy slowed, but it was just a significant economic event that just completely shut down the markets in Georgia. So it happened very, very quickly.

As part of our supervision, we not only examine banks once every 12 or 18 months, we have quarterly contacts with the institutions. And the purpose is to do those very things, to highlight trends in financial condition, to talk about new products and services—

Mr. WESTMORELAND. I understand. And I am not trying to cut you off, but some of these loans that are now F's were A's. It is just hard for me to believe a loan goes downhill that fast, especially when it is a performing loan.

But I want to get back to the FDIC because I know we are running out of time. How often do you take a performing loan with a failed bank, and when it comes into receivership of the FDIC, how does it become a non-performing loan?

Mr. BRET EDWARDS. Are you talking a bank fails and the loan—

Mr. WESTMORELAND. The FDIC took over as a receivership.

Mr. BRET EDWARDS. Okay. If a performing loan goes into receivership, it would depend on where it gets managed obviously, but you are asking how it would become non-performing?

Mr. WESTMORELAND. No. What do you do with it?

Mr. BRET EDWARDS. With a performing loan?

Mr. WESTMORELAND. When a performing loan comes in.

Mr. BRET EDWARDS. Sure. Again, we have tried to use the whole bank structure as much as possible, so the performing loan would be sold to the acquiring institution and become an asset of that institution.

Mr. WESTMORELAND. The FDIC is the receivership—no?

Mr. BRET EDWARDS. Okay. If there is no acquiring institution, then we would take that onto the receivership's books and we would manage it—either manage it ourselves or package it into a package to sell, or perhaps to put into a limited liability structure to have—

Mr. WESTMORELAND. Okay. But the rules and regs that we are supposed to be, as the chairman said, at least applying consistency, if you go in and put a bank in receivership yourself, you work out these loans or at least you should be following your own guidelines to work out these loans, but isn't it true that most loans that the FDIC wants to modify, they want 50 percent of loan to value?

Mr. BRET EDWARDS. I am not familiar with that requirement.

Mr. WESTMORELAND. Okay, so that is not a requirement?

Mr. BRET EDWARDS. No.

Mr. WESTMORELAND. That it would be 50 percent. So you would be more than willing to help somebody with a loan that the FDIC had, to soften the blow, to do what you are encouraging other banks to do, to have shared-loss agreements, you would be willing to go in and do that?

Mr. BRET EDWARDS. What I described earlier about our expectations on acquiring institutions when they take over these loans under a loss sharing agreement, we follow exactly the same standard. We are going to look at a performing—if a loan becomes non-performing, we are going to look at the alternative disposition strategies and we are going to follow the one that we believe is going to minimize the loss.

Mr. WESTMORELAND. Okay. Let me follow up for just a minute here. With Rialto being a partner of the FDIC, Rialto is a group of people, I think out of Florida, that has partnered with the FDIC, correct? FDIC, 60 percent partner?

Mr. BRET EDWARDS. That is correct.

Mr. WESTMORELAND. They are 40 percent. They purchased $3.2 billion worth of loans I believe from the FDIC—and you are a partner, right?

Mr. BRET EDWARDS. Yes.

Mr. WESTMORELAND. —for about 40 cents on the dollar.

Mr. BRET EDWARDS. Okay, yes.

Mr. WESTMORELAND. And I think the actual money they put in cash, 300 and some million dollars, was about 8 percent of that, right?

Mr. BRET EDWARDS. Okay, yes.

Mr. WESTMORELAND. And you are a partner with them?

Mr. BRET EDWARDS. Right.

Mr. WESTMORELAND. It is zero percent interest for 7 years, is that correct?

Mr. BRET EDWARDS. I believe that's right.

Mr. WESTMORELAND. So the taxpayers—let me get this straight, we are a 60 percent partner and we took on another entity, an LLC. They got the stuff with just cash money for about 8 percent down, right? Would you do that for anybody else out in the audience there who wanted to do that?

Mr. BRET EDWARDS. When we put those LLC structures together, we put—

Mr. WESTMORELAND. No, I am just asking you, would you do that with anybody else out there?

Mr. BRET EDWARDS. Anybody who is qualified to bid on those kind of structures. When we put those—

Mr. WESTMORELAND. So if they had 8 percent of what the deal was, you would take them on as a 40 percent partner?

Mr. BRET EDWARDS. As long as it is the highest bid for the—

Mr. WESTMORELAND. I am sorry?

Mr. BRET EDWARDS. When we put those deals together, we take those assets, put them together in a pool, we bid them out competitively.

Mr. WESTMORELAND. Okay, so your 40 percent partner was just lucky to get the bid?

Mr. BRET EDWARDS. We think we do an excellent job of marketing these things—

Mr. WESTMORELAND. I know, but I am just asking you.

Mr. BRET EDWARDS. Yes.

Mr. WESTMORELAND. Because it sounds like a sweetheart deal, and all these people may want to get involved with you to be able to do that.

[applause]

Mr. WESTMORELAND. And let me ask you this—

Chairman BACHUS. It was bid, though.

Mr. BRET EDWARDS. Correct, that is absolutely right.

Mr. WESTMORELAND. I don't care. With all due respect, Mr. Chairman.

Chairman BACHUS. I know.

Mr. WESTMORELAND. When you go and buy other people's loans that are supposed to be in the constant consistency of what we are doing, that is supposed to soften the effect on the community and work them out, now they are auctioning them off. And let me go one step further. Typically, you would foreclose on a property if it was a non-performing loan?

Mr. BRET EDWARDS. If that is the best disposition alternative after we have done the analysis.

Mr. WESTMORELAND. Okay. Would the best dispositional thing to do be to go immediately to court and file for a judgment and let the borrower continue to accrue interest and let the borrower be responsible for the taxes, rather than foreclosing and taking the property over and putting it back out and selling it. Would it be the FDIC's decision, since you are a 60 percent partner, to go to court first and go after these people personally, because we are wanting to do a consistency of the regulations? So it is the FDIC's position that their managing partner go to court first, sue these people personally, try to get control of the property and even though they have control of the property, the borrower is still responsible for the taxes and the interest? Is that what I am hearing from you?

Mr. BRET EDWARDS. It sounds like this is a fact-specific situation. I would be happy to talk to you about that.

Mr. WESTMORELAND. You know the situation, I mean it is Rialto.

Mr. BRET EDWARDS. Right. I will tell you that the LLC structure has served the FDIC well. We take the loans—

Mr. WESTMORELAND. You are a 60 percent partner.

Mr. BRET EDWARDS. —we put them out for bid.

Mr. WESTMORELAND. You put them out for bid and then do you tell them to go straight to court? I am not going to argue with you here, but we are going to look further into this because I am telling you, there is something that is not right with it.

[applause]

Mr. WESTMORELAND. And we are going to continue to pursue it.

Chairwoman CAPITO. Mr. Scott?

Chairman BACHUS. Mr. Edwards may want some time to explain. I know he was kind of—

Chairwoman CAPITO. Mr. Edwards, did you have another response?

Mr. BRET EDWARDS. Again, let me just explain. Our LLC program is essentially designed to keep as many of the assets in the private sector, just like the shared-loss program is. If we are incapable of getting a loss share deal or a whole bank deal first of all and then a shared-loss deal, we then take those assets back onto the books of the receivership. Rather than manage those assets ourselves with our own employees, we put these assets into an LLC structure. These equity partners bid competitively to get a piece of that deal and then they have their own capital at risk. Again, they are putting up substantial amounts of capital, these are not—these are some of the most poor quality assets we have and they are incented to follow the same disposition strategies that we would or our loss share partners would. It is their money at risk, they are going to follow the disposition strategy that has the highest net present value for that asset.

Chairwoman CAPITO. Thank you.

Mr. Scott?

Mr. SCOTT. Thank you.

Let me ask you, are there any banks now currently, in your opinion, or your understanding, that are in trouble or close to closing now that are under review?

Mr. SPOTH. Yes.

Mr. SCOTT. And how many would that be?

Mr. SPOTH. The problem bank list has 888 on it, it has been trending down some. Not nearly all of those do we expect would fail. There is a subset of those, there is a possibility that some of those could fail, not all of them will.

Mr. SCOTT. But relative just to Georgia, how many?

Mr. SPOTH. I do not have that information.

Mr. SCOTT. But there are some?

Mr. SPOTH. There are banks struggling in Georgia, yes.

Mr. SCOTT. And if you had to put your hand on one basic area that was a causal effect, what would that be? Why?

Mr. SPOTH. This is still the workout of the overhang in the real estate markets.

Mr. SCOTT. One of the problems that we have that I would like for you to address is that we get to hear from our friends in the banking community when we ask them to lend more. We faced it most recently, a lot of closing of car dealerships, for example, and their biggest problem was we would go to the bank, we could not get the money, we would go to the bank and when we get to the bank, the bank would say, we are not lending, we cannot lend because of the overly restrictive standards and application of regulations that the FDIC, the Office of the Comptroller, the Fed, all the regulators, examiners, are putting on us. Do you agree with that? Is that a fact?

Mr. SPOTH. No. I do not doubt that it is a fact that you are hearing it, but I do not think that it is a fact that it could be occurring that way.

Mr. SCOTT. You mean you do not feel that what you are doing is hindering the banks from lending money?

Mr. SPOTH. That is correct.

Mr. SCOTT. Why would they say that it is then? That is what I mean; there is this disconnect. We cannot get the banks to lend because they say you are putting so much pressure on with these restrictions that they cannot lend and then you say these restrictions can. So something has to give, we have to get the money out into these small businesses.

Mr. SPOTH. I think this may go back to the chairman's point about the guidance and the like. This is why, along with the other regulators, we would put out guidance that we are encouraging loans to creditworthy borrowers, and that goes right to, if it is a car dealership, do they have the ability to cash flow whatever kind of loan that they are applying for. We are happy to see those kinds of credits made.

Mr. SCOTT. But let me just ask you, what are these restrictive standards? What would they be? What are the bankers talking about? I do not think they are just making this up. There has to be something that you are doing. What is it—I am trying to get at a point, not sort of he said-she said, but what in your opinion are they talking about in terms of these restrictive standards?

Mr. SPOTH. I will try to work with you on that. It is a communication piece, I think. The only banks that are restricted on the amount of lending that they can do, unless it would be State law, there are limits on how much you can lend to any borrower, but setting that aside, the only restrictions that are on banks are banks that are in serious trouble, and we usually have a formal or informal agreement with them about how they plan to work out their problems. Even then, you would not usually see the kind of restrictions that you may be hearing about.

Mr. SCOTT. Let me ask one for you to respond to. There have been complaints about the consistency of procedures used by examiners for appraising collateral values. Is that, in your opinion, legitimate? Is there a problem of not being consistent in applying those procedures?

Mr. SPOTH. Our procedures at the FDIC, and I think the other regulators as well, are to review the appraisals that the bank itself has gotten. So you would not be expecting, and you would not see, a bank examiner conducting appraisals. We may ask about an appraisal or an evaluation that a bank has in its files, but—

Mr. SCOTT. And so you do not see, there is no legitimacy to the concern that there is inconsistency in the procedures?

Mr. SPOTH. I don't think there is inconsistency in the procedures, but I do hear the concern. It is certainly true that there is a concern about that. We put out guidance specifically on this issue. I think it was in December of 2010 that we reissued appraisal guidance.

Mr. SCOTT. What about the factors that the examiners consider when assessing capital adequacies?

Mr. SPOTH. The assessment of capital adequacy is a case-specific situation, according to the risk profile of the institution, unless they are not meeting the absolute minimum standards of the regulation. So there is a minimum standard, as you know, and there may be a requirement above that, depending on the risk profile.

Mr. SCOTT. What about the impact of the cease and desist orders?

Mr. SPOTH. This is one that we do hear a lot about when banks are in troubled condition. We try to work with the bank management to reach a bilateral agreement, which would include, if we agree, that an increase in capital is necessary, and we try to agree with the bank on what that number should be. And we think what that leads to is a consistency of approach. If the bank has to talk to their existing shareholders or new shareholders, what exactly is the road map forward. So if we can agree on an order, which we do substantially all of the time, everybody knows what the road map is to avert that failure.

Mr. SCOTT. Okay. And so what would you say, because the bankers are going to come up here and speak in the next panel, I would like to give you an opportunity, what would you say—we have asked questions here, and there are two thoughts of opinion here. There are areas of disagreement. I think you saw and heard some of the reaction from the audience with their applause in making a point, but there seems to be some difference here. You are the examiners, you are the regulators, they are the banks. What would you say to the bankers, what do they need to do that they are not doing, and where are some of the miscommunications that are taking place, because there obviously is miscommunication here? How would you address that?

Mr. SPOTH. I would just stipulate that these are the very toughest conversations that a regulator and a banker can have, if the bank is in a seriously threatened condition. Investors could lose money, borrowers, communities could potentially lose their local community bank. These are the very toughest conversations you can have and you would expect that informed people on both sides of the table would be trying to come to a solution. And I believe that is the case substantially all of the time. So it is getting around to just what you are asking, what needs to be done. Usually if capital has been depleted, it will need to be replaced at some level so that the institution has time to work out its issues.

Mr. SCOTT. Yes?

Mr. BARKER. I would like to make a couple of comments. In my experience over the years, we have difficult times like this, but there are institutions that not only survive, but those that thrive. And there are two elements in those two individual cases. One is a management team that recognizes the issues and is prepared to address them. The second issue is having access to capital in order to have them last through the difficult periods. The access to capital is really a key.

But I think what I would pass along to the bankers who are coming up next is as examiners, our window into the bank, our window into their borrowers is through the credit files and through the discussions of management. So the best they can do is to help us understand what the situation is, help us to see the things that they see, have that dialogue, and the communication is critically important to us making accurate assessments.

Mr. SCOTT. Finally, I don't want to take up too much time, but Congressman Westmoreland and I are working on this bill and in the legislative process, you are always looking for vehicles. And while the paramount purpose of this bill is to really get a good study and get some answers to questions, and we can also use this—as a result of this hearing, there may be some things that come about where we can improve the situation and that is why I really asked those questions about some of the points and some of the concerns that have been raised. And I would hope that you all would have an open mind here that as we get back, the bill gets over to the Senate, that we might be able to add one or two items into this bill that can be executed to help with one or two of these problems. Would you all be amenable to that?

Mr. SPOTH. Yes.

Mr. SCOTT. Okay, thank you.

Chairwoman CAPITO. All right, thank you. I want to thank the first panel. I think we have had a very good discussion. I want to thank you for traveling to Georgia and I want to thank you for—

Mr. WESTMORELAND. May I make one comment? It will take 5 seconds.

Chairwoman CAPITO. He said 5 seconds.

Mr. WESTMORELAND. Mr. Edwards, could you just get me a list of every entity that the FDIC is in partnerships with?

Mr. BRET EDWARDS. Absolutely.

Mr. WESTMORELAND. Thank you.

Mr. BRET EDWARDS. Absolutely.

Chairwoman CAPITO. And also, I would like to echo the chairman's comments in terms of thanking you for your service in the financial sector, I know sometimes it is not easy work, and we appreciate that. You have certainly had lengthy service there.

My final comment before I call the second panel up would be that one of the big solutions to a lot of the issues that we have heard today is a roaring and vibrant economy. And this is something that we are all four here tasked with, but so is everybody in this audience. So I look forward to those days in other such hearings.

Thank you all very much. I will dismiss the first panel and I would like to call up our second panel of witnesses.

We will go ahead and get started. If everyone could take your seat quickly, we will go ahead and start the second panel. They have been very patiently waiting. I know the chairman will be back in the room—there he is.

Chairman BACHUS. Madam Chairwoman, Mac Collins, who was a colleague of mine, we came into Congress in 1992 together—Mac, would you stand up? You represented this district?

Mr. COLLINS. I had the pleasure of representing this district for 12 years. It is in good hands now with Lynn Westmoreland. We appreciate you all being here; this is an issue that really needs to be addressed. There are a lot of problems around the country with our community banking system and I do think a lot of it has come from the regulators. In fact, I know it has. And I appreciate you all being here, and I appreciate them being here and facing up to the issue, too.

You all take care and have a good day. I hate to beg off, but I have to go to Forsyth for a conference.

Chairwoman CAPITO. Thank you, Mac.

Our colleague, Mr. Scott, probably will be coming in here shortly. So with your permission, I am going to go ahead and start. I will introduce each panelist individually for the purpose of giving a 5-minute opening statement and then we will get to the question portion.

Our first witness is Mr. Chuck Copeland, who is the CEO of the First National Bank of Griffin. Welcome.

STATEMENT OF CHUCK COPELAND, CEO, FIRST NATIONAL BANK OF GRIFFIN

Mr. COPELAND. Committee Chairman Bachus, Subcommittee Chairwoman Capito, and Representative Westmoreland and Representative Scott in absentia, welcome to my congressional district and thank you for affording me the opportunity to provide my comments during these times which have been so detrimental to our communities.

First National Bank of Griffin is a 78-year old community bank chartered in Griffin, Georgia, in 1933, literally rising from the ashes of the 1929 financial collapse, to serve the citizens and merchants of our community. For all of these 78 years, service to and access to credit for our citizens and merchants have been our principal tenets of business.

Being located less than 50 miles from downtown Atlanta, our community has served as a long-time bedroom community for those commuting daily into Atlanta for work. As such, as the metro Atlanta economy prospered in the 1990s and early 2000s, the demand for housing in our banking markets blossomed. Being a community bank, we responded to this by providing both construction and development financing to many of the builders and developers. We provided responsible conventional long-term mortgage financing to many of the home buyers through our longstanding, direct-delegated authority through Freddie Mac. We did not knowingly participate in the subprime game of hybrid loan structures and perilously relaxed mortgage underwriting standards and we often questioned the soundness and appropriateness of those activities. What we failed to anticipate in our risk management practices at that time was the degree to which this subprime activity was propping up the unprecedented demand for new housing our market was experiencing. We also failed to understand the degree to which misrepresentation and manipulation were masking huge fundamental flaws in the mortgage securitization market.

We monitored our concentration risk in the areas of residential construction and development, comparing our levels against the regulatory guidelines, and against the levels of our market peers. Due to our 7 decades of retained earnings and careful and prudent past dividend policies, our higher than peer capital levels helped mitigate our risks, and our concentrations in these loans as a percentage of capital generally came in at the lower end of our market peers, which was not substantially out of line with regulatory guidance. Regardless of these circumstances, no amount of forward analysis or stress testing anticipated the depth and length of the real estate housing collapse we were about to face in the closing months of 2007.

We were early to recognize our problems, mainly due to the fact that we had used loan structures which were more stringent than many of our peers. We commonly required hard equity and monthly payment of interest on our construction lines. In addition, it was the exception where we permitted borrowers to draw funded interest reserve to carry their development loans. Because of these practices, in many cases, we knew our problems the first time a monthly payment was missed as opposed to not discovering the depth of the problem until loan maturity. In spite of these efforts, the pace and magnitude of the residential collapse quickly overwhelmed our early warning devices.

We are a core-funded community bank. As we entered the recessionary cycle, we enjoyed the number one deposit market share position in our home market and had no wholesale or brokered deposit funding on our balance sheet. In spite of the significant credit stresses we have endured over the past 4 years, we continue to demonstrate an underlying core earnings stream. In other words, once the cloak of this real estate collapse is finally lifted, our bank can not only survive, but prosper for another 78 years.

I recognize that the title of this hearing is, "Potential Mixed Messages." My frustration is not so much one of mixed messages, but one of changing messages. As this cycle began, we sensed a reaction from our regulator of supportive cooperation. They knew our bank. Many of the field examiners had been in our bank through multiple exam cycles for as long as 25 years. The general message coming from examiner comments in 2008 was one of acknowledging that the same core fundamentals which had sustained our bank for decades were still evident, but that we had become victims of an unprecedented real estate market collapse. The beginning of the shifting message became evident when we received our written reports of examination, and many times the narrative seemed more harsh than the discussions. Unfortunately, it is the written narrative which becomes the written record, and the document by which we will all be judged in history. Did we have a role in setting ourselves up to become victims? No doubt. But did we recklessly pursue growth and earnings at all cost with no regard to the other elements of our mission? Never.

Fast forward to subsequent exam cycles and we have found the field examiners less willing to disclose conclusions and very guarded in acknowledging progress in those areas where we had been performing well. These are many times the same examiners we have worked with for years. We understand that this is not a personal affront; it is simply this environment of second-guessing and weariness in which we are all operating. But as the field examiners have become less comfortable in making casual assessments of progress or acknowledgement of bright spots within our banks, such as our extreme customer loyalty and core funding, the written reports of examination have taken on a clear pattern of excessive criticism and legal edification. So much so that one can find nearly contradictory statements within the same paragraph or section of a current report.

We understand our shortcomings, and you can rest assured that we are working diligently to improve our banks in the areas we can control and influence. But, the inflammatory and demoralizing tone found in many of the examination reports only tends to send us clamoring for cover. We are trying to improve our banks and preserve our chances of survival, not because of heightened rhetoric or threat of repercussion, but because for most of us, our banks are a substantial part of our being. We are the ones leading our community's economic development activities and trying to attract jobs for our citizens. We carry the daily weight of knowing the importance of a paycheck to the roughly 100 people we employ in our bank. This is bigger than pride, deflection of responsibility, or self-preservation.

I have observed some of the testimony of the regulators and the academic experts in earlier hearings on the subject of regulatory practices or behavior. A recurring theme seemed to be the position that forbearance in regulation is inappropriate and would only lead to greater potential losses to the fund. I would argue that forbearance is a necessary and logical part of any healing process. And that is exactly what is taking place in our banks; we are attempting to heal our banks, our local economies, and where salvageable, our borrowers. That is why I support the flexibility being offered in some of the proposed legislation such as smoothing out the effects of loan and asset impairments resulting from declining real estate values. The current methods of write-down being employed today have the potential to wipe out all of the capital in our banks with no chance of living to see the eventual real estate market recovery. Unfortunately, by that point, our community will have been stripped of a valued commodity. My bank and its resources will have been extinguished and the beneficiary will be a faceless, opportunist investor with no ties to my community.

Chairwoman CAPITO. Mr. Copeland, could you kind of summarize the end there? Sorry. I'm trying to keep it in a reasonable timeframe.

Mr. COPELAND. Certainly.

In spite of the imperfections and the public's general distaste for it, I was an early proponent of the TARP program. Unfortunately, our bank was not allowed to participate in that. This has created a system of two different classes of banks: those that can afford to and are motivated to dump problem assets at substantial discounts; and those of us who are clinging to our remaining capital like a shipwreck survivor clinging to debris.

Theoretically, had we received the TARP funding which the funding formula indicated we were eligible for, our current leverage ratio would still be at a respectable 8.25 percent and our total risk-based capital at 15 percent.

And with that theoretical capital level, I am sure it would be much easier for my bank to attract additional shareholder investment to bring us into compliance with the regulatory order my bank entered into with the OCC almost 2 years ago. The capital cushion would add badly needed flexibility as we consider loan requests from borrowers and we would find ourselves in a position to operate our bank for the benefit of our community, its employees, and the broader economy, as opposed to the regulatory paralysis which we suffer from today.

Cycles eventually come to an end. We have endured this one for 4 years. We realize that much of what has been done cannot be changed or its effect reversed. We kindly ask that through forbearance and flexibility, our regulators give us time and support us as we try to lead our communities to recovery.

Thank you for your time.

[The prepared statement of Mr. Copeland can be found on page 89 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Michael Rossetti, who is president of Ravin Homes. Welcome.

STATEMENT OF V. MICHAEL ROSSETTI, PRESIDENT, RAVIN HOMES

Mr. ROSSETTI. Thank you, Chairwoman Capito. I would like to welcome you and Chairman Bachus to Georgia. And Lynn Westmoreland, David Scott, it is good to see you guys again. I sincerely appreciate the honor and the opportunity to testify before you on this subject. It is my opinion that our Representatives genuinely want to foster and promote a healthy banking environment so that citizens and businesses can prosper.

I have been directly involved in the banking business as a director since 1999. And my primary business, as Chairwoman Capito mentioned, is homebuilding. I have owned and operated Ravin Homes for 30 years.

In your letter inviting me to testify, the first two bullet points request comments on the policies and procedures of the FDIC and whether they are being applied uniformly across the country.

Although I have read about certain banks getting favorable treatment from regulators, I can say that my experience has generally been that they have acted reasonably with our bank. The problem is with the regulations and the lack of common business sense used in the interpretation of these regulations. We are being regulated so heavily that we cannot function as a facilitator in the community.

When Sarbanes-Oxley was implemented, our bank decided to go private so we would be exempt from the duplication of regulatory reporting. We were already performing the regulatory requirements of the FDIC. The costs and manpower required to do redundant reporting under Sarbanes would have been crippling to our institution.

Now, we have Dodd Frank to contend with. This a 2000+ page bill that will have 10 times the regulations attached to it after bureaucrats get through with writing all the rules. I see more of an issue with the amount of regulations rather than the regulators. We are being regulated to death in all of our personal and business lives.

Your next point of interest concerns regional economic conditions and adjusting exam standards.

In my banking world, as well as most banks in Georgia, real estate loans, which we call AD&C loans, were and still are a large part of our portfolios. In accumulating these large portfolios, the bank's customers were simply supplying the product that the Federal Government, through Fannie Mae and Freddie Mac, were giving away money to buy.

The current huge overhang that this created in all levels of housing development is going to take years to work down. If the regulators were able to adjust to this fact and be less onerous on banks to write down loans, I believe that the liquidation of assets would be more orderly and more lucrative and create considerably less stress on our banks. I will have more on this when I discuss loss share.

The second to last point of discussion concerns safe and sound operation of banks while promoting economic growth. In my mind, there are two entities that need to be considered in the economic growth equation for this topic—the banks and their customers. At the present time, we are restricted from doing any new AD&C lending, no matter how secure it is, due to the concentration limitations imposed by the regulators. We cannot take advantage of doing a good loan and the customer cannot find a bank to do that same loan. Both get hurt and the economy loses jobs and suffers.

My grandfather told me when I was younger that there were only two ways to get out of debt: stop spending; and start making. If banks are going to survive, we need to make a profit. And the only way that banks make money is to lend it. Right now, we are prevented from doing that.

Banks that are in this position, basically community banks, are completely defensive in this arena. As of this date, we do not lend unless it benefits the bank in the disposal of foreclosed property. New loans to new or existing customers do not exist at our bank.

I would respectfully request that you investigate H.R. 1755, the Home Construction Lending Regulatory Improvement Act. It addresses this issue and several other regulatory issues that are very germane to our discussions here today.

Now we have the last point in your letter, and my favorite—winding down failed institutions and the liquidation of assets by the acquiring institutions, which we will call loss share.

This shared-loss agreement allows banks to operate completely outside of normal banking policies because they are guaranteed to make money, no matter what they sell the asset for. The same banks operate completely differently—and I have found this directly and heard this from other people—they operate completely differently under a loan that was originated in their original bank. To add insult to injury to our bank and the community, they will dump the assets acquired at a rock-bottom price, thereby destroying local property values. In my opinion, loss share has done more to destroy property values than any other economic factor in this downturn.

Concerning troubled and failed institutions, from what I have seen, the FDIC declares that anywhere from 25 to 35 percent of the failed institution's assets are declared as a loss when they close that bank.

Using our bank as an example, we are a $380 million bank, the Bank of Georgia. If we were closed, the loss to the FDIC Insurance Fund would be between $95 million and $133 million. If our bank could borrow, or be supplied through TARP like Chuck mentioned, $6 million to $10 million to use as capital, we would return to being well-capitalized and we would be profitable. In addition, we would be able to pay this back over a period of time in the future.

My point is that many banks could survive with a minimal—compared to closing the bank—capital injection. This is what should have been done with TARP funds instead of forcing them on healthy institutions and telling them that they were too big to fail.

I also want to mention—it is not in my testimony, but Lynn brought up this Rialto/FDIC partnership. In my opinion, these public/private partnerships are terribly—they are perverted. That just leaves the door open for a private company to make a ton of money. And from what I have heard recently over the past 2 weeks of investigating this, that Rialto/FDIC partnership is bad news. And I would highly recommend that you investigate that.

It is my sincere hope that my testimony today has given you a constructive view of these items of interest. Again, I would like to thank you for your time today and I look forward to answering any questions that you may have.

[The prepared statement of Mr. Rossetti can be found on page 142 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Jim Edwards, the CEO of United Bank. Welcome.

STATEMENT OF JIM EDWARDS, CEO UNITED BANK

Mr. JIM EDWARDS. Good morning. Chairman Bachus, Subcommittee Chairwoman Capito, Representative Lynn Westmoreland, Representative Scott, I am delighted to be here today.

My name is Jim Edwards, and I am CEO of United Bank which is based in Zebulon, Georgia. I appreciate the opportunity to speak to you today concerning the state of banking in Georgia and our bank's experience working with the FDIC's shared-loss agreements.

I want to tell you a little bit about our bank. United Bank's corporate office is located 50 miles south of Atlanta and 40 miles east of where we are today in Newnan. I joined United Bank in 1993 and I became CEO in 2002. I am proud to say that I represent the third generation of my family to work with United Bank and the banks from which it was created. I am active in both State and national bank trade associations and currently serve as chair-elect of the GBA or the Georgia Bankers Association, and also serve as a member of the American Bankers Association Community Bankers Council.

United Bank traces its roots back to the founding of its predecessor, The Bank of Zebulon, in 1905. Over 100 years later, more than 90 percent of our company's stock continues to be owned by our employees and our directors who live in and care very deeply about the local communities that we serve. We operate 21 banking offices in 11 contiguous counties ranging from 35 to 65 miles southwest, south and east of Atlanta. Our total assets are just over $1 billion and we offer traditional banking services along with mortgage, trust and investment products. We are pleased that we have been able to grow our employee base through this economic downturn and we now provide jobs and benefits to nearly 400 people and their families.

The economic downturn which Georgia and our entire Nation have endured over the last several years has created the most challenging operating environment for banks that I have ever experienced. United Bank has historically maintained above-average capital levels and worked to make sure that our loan portfolio was well-diversified among different types of lending. This conservative philosophy has served our company well during the past century of operations. This same cautious approach encouraged our board to make the decision to apply for the Capital Purchase Program funds, more commonly known now as TARP, from the U.S. Treasury in late 2008. After a rigorous application process, we were approved for a little over $14 million in funding. Even though we were already well-capitalized at the time, the new capital has provided an additional buffer in what has certainly been a worsening economy, and has allowed us to maintain our employment and continue to make loans to qualified borrowers in the communities that we serve.

Since accepting this funding in 2009, United Bank has paid just over $2.6 million in quarterly interest payments at an approximate rate of 8 percent to the Treasury. Our current plans are to begin repaying our TARP funding in May of 2012, assuming the economy begins to improve by then.

United Bank has acquired 3 failed banks from the FDIC during the last 3 years. We purchased the deposits in all these transactions and loans in two of the transactions. In the early stages of the recession, the FDIC liquidated failed banks primarily by auctioning off the deposits to another financial institution and then retaining the loans themselves for disposition at a later time.

In December of 2008, United Bank purchased the deposits of First Georgia Community Bank in Jackson, Georgia, using this "clean bank" type transaction without a shared-loss agreement. A group of FDIC contractors stayed onsite and managed the failed bank's loan portfolio for over a year, but they had little authority to make decisions or to offer options to work with customers experiencing financial difficulties. Ultimately, the FDIC bundled all the failed bank's loans into several groups and bulk sold them through an internet-based auction. The winning bidders were mostly located several States away; therefore, they knew very little about the local community. And as a result, they had minimal incentive, in my opinion, to try to take any long-term approaches to working with troubled borrowers.

In August of 2009, United Bank entered into its first shared-loss agreement with the FDIC for the purchase of deposits and loans of First Coweta Bank here in Newnan. In contrast to our earlier acquisition in Jackson, we are fully responsible for managing this loan portfolio. In return, the FDIC reimburses us for essentially 80 percent of the credit losses we experience in the loan portfolio. This reimbursement is effective for the first 5 years for commercial loans and for 10 years for one-to-four family residential loans. The shared-loss agreement does not reimburse United Bank, however, for the expenses associated with funding these loans, nor does it cover the considerable overhead needed to manage this loan portfolio and remain in compliance with what are very extensive requirements involved with the shared-loss agreement.

In the fall of last year, the FDIC informed us that First National Bank in my home town of Barnesville, Georgia, soon would fail and they asked us to consider submitting a bid, along with other banks. Although we were competitors, this was shocking and very sad news. Our employees in Barnesville had always enjoyed a very good relationship with First National's employees and we historically had worked together to improve the local community for decades. Our board ultimately decided not to submit a bid for First National due to our recent growth and due to the fact that we felt like the economy was continuing to turn down. However, shortly after the bid deadline, the FDIC contacted us and explained that they had received no qualifying bids from any financial institutions and that they were preparing to close the doors of First National, terminate all the employees, and simply send checks to all the depositors. They also communicated that unfortunately it appeared some customers might exceed deposit coverage limits and so there could be depositor losses from some of the First National Bank accounts. After considering how devastating this would be to one of our most important communities, our management team and board decided to submit a bid to prevent the bank payout. And I am pleased to share with you today that we were able to hire a majority of First National Bank's employees and continue banking services without any disruption to customers in Barnesville.

Through these experiences, I have seen the advantages of how a loss share arrangement works, as compared to the FDIC's earlier practice of using outside contractors to manage a failed bank's loan portfolio. When a local community bank, such as United Bank, manages a loan portfolio, in my opinion, it has a very strong vested interest in trying to take a long-term approach and work with customers to overcome their financial challenges. The primary reason for this is so that we can make the borrower a life-long bank customer. The secondary reason, and you heard the regulators talk about this earlier today, is that because the bank participates in any future loan loss, we do have skin in the game and we work hard to try to minimize any future losses. We have worked very hard here in Newnan and in Barnesville to find solutions for struggling loan customers and have offered modifications and forbearance agreements. And we have had a number of successes with this type of approach.

Under our agreement with the FDIC, United Bank is essentially required to manage the loss share loan portfolio in essentially the same manner as we handle our non-loss share portfolio. The FDIC has encouraged us to work with customers whenever possible. The FDIC also audits our bank regularly to make sure that we remain in compliance with all the elements of the shared-loss agreement. This enhanced scrutiny has necessitated us having to hire a number of new employees, just to make sure that we are in compliance with the shared-loss agreement.

No, there is absolutely nothing good about any bank failure. We all know that. Customers, bankers, businesses, and in effect, entire communities, suffer in a variety of ways. However, as I mentioned, in our experience, the current system of utilizing a shared-loss agreement is preferable to the others used earlier in this economic cycle by the FDIC. In general, the resolution process works to keep the transition organized, it provides maximum depositor protection, encourages confidence in the safety of deposits at a critical time, and it minimizes more broad-based market disruptions.

Thank you again for the opportunity to share our perspective and our experience in working with the FDIC in these shared-loss agreements, and I look forward to answering your questions.

[The prepared statement of Mr. Jim Edwards can be found on page 113 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Edwards.

And our final witness is Mr. Gary Fox, former CEO, Bartow County Bank. Welcome, Mr. Fox.

STATEMENT OF GARY L. FOX, FORMER CEO, BARTOW COUNTY BANK

Mr. FOX. Thank you. Chairwoman Capito and members of the committee, thank you for inviting me to participate in your hearing today. My name is Gary Fox and I was in the banking business in Georgia from January 1981 until April 2011, when our bank was closed by the Georgia Department of Banking & Finance and sold with a shared-loss agreement to Hamilton State Bank. I started my career as a bank examiner with the State of Georgia and began working at the Bartow County Bank in May of 1983. I am also a certified public accountant and am now in private practice.

I divided my remarks into three categories. First, how we got here, to give you some historical perspective. Second, what made it worse, where I will mention issues such as appraisal policies, market disruptions caused by unprecedented government involvement, and the application of certain regulatory and accounting policies. And third, I will mention some real concerns I have with how the loss share is playing out in the market.

Included in my testimony are slides that I will be referring to that were furnished to me by John Hunt of Smart Numbers, which would be a good resource for you going forward.

I saw a lot of changes in our industry in 30 years and had the pleasure to meet and know a lot of great community bankers during that time. I have a depth of knowledge about the community banking industry in Georgia that few other people have.

The biggest change that I saw over the years, other than regulatory, was the ease of entry. When I first got into the business, it was quite difficult to get a bank charter. In fact, it was quite a chore to even get a branch application approved. At that time, you had to convince the chartering authority of convenience and need. Sometime in the mid-1990s, that went out the window and it seemed to me the only requirement became whether or not you had enough initial capital to meet the chartering authority's requirement. As a result, we had an overabundance of banks. Many banks relied heavily on brokered deposits since there really was not a need for the bank in that particular community in the first place. It was also a reason why so many banks did out-of-market lending and participation lending since there was not enough demand in the community they operated in. On top of that, in 1996, Georgia passed statewide branching. Previously, Georgia had been a State that only allowed a bank to operate in the county in which it was chartered unless it formed a bank holding company and entered a new market by buying another bank in a whole bank transaction. So as a result, many of the banks in markets that were not as robust branched into the metro Atlanta area to take advance of metro Atlanta's growth. This only compounded the problem. After all, it only takes a couple of folks polluting the pool to ruin the swimming for everyone.

Another thing that got us here was prompt corrective action, which was put into law in 1991 as a result of the S&L crisis. While in theory, it sounded reasonable to mandate FDIC to take progressively punitive action against a bank as its initial capital falls towards 2 percent, in this environment, it was and is a bank killer. It immediately put you in a death spiral that you could not escape. Capital dried up, liquidity dried up, customers lost confidence, employees left, and regulators no longer were allowed to exercise judgment, as they were required to follow a set of draconian guidelines.

And you cannot talk about how we got here without mentioning two government programs that have created market disruptions—the Troubled Asset Relief Program and the FDIC selling failed banks with shared-loss agreements given to the acquiring bank.

Most banks in Georgia that have failed have been appraised out of business. To give a specific example of the appraisal problem, in the metro Atlanta area, historically the cost of a lot is 20 percent of the overall cost of a home. That means if you had a new home that cost $200,000, the lot cost would be $40,000. Today, the cost of a lot is 5 percent of the overall cost of a home, meaning that in the same $200,000 home, that lot cost is now $10,000. We have gone from a cost norm of 5-to-1 to an abnormal TARP and loss share induced 20-to-1. This is visually demonstrated by slide 13, which is part of the set of slides that I have included in my testimony.

There is another slide, number 20, that shows real estate asset disposals by TARP and loss share banks. The size of the yellow dot represents the number of lots liquidated, and they were all sold at less than $10,000 per lot. Unless you were one of the fortunate ones who received the government assistance, you had no chance to avoid significant charges against your capital due to undue influence of government money in the marketplace.

Another example specific to my community was a subdivision where the lots had sold in the $90,000 to $120,000 range in 2007. The loan amount was around $43,000 per lot, which at the time seemed to be a safe margin. Most recently, those lots were sold for $9,500 apiece by a loss share bank. That is a decline of 89 percent at the minimum. This was a fully developed subdivision in a highly desirable area with a first class amenities package.

Additionally, these types of appraisal-driven declines permeate throughout the local economy. You would think that what it costs to create something would have some relevance to its value, but not in today's world. Under new appraisal standards, many appraisers will tell you that cost is not relevant. All that matters is the market approach, and to a lesser extent, the income approach. Therefore, since the market approach is the most heavily favored approach and you have federally-funded asset disposal by TARP and loss share banks, we have an incredible disruption in our real estate markets here in metro Atlanta and Georgia in general.

Think about how this affects the general public. Consumers cannot refinance their homes to a lower payment because their home will not appraise. The municipalities that rely on real estate taxes can no longer fund schools or police and fire protection. And to make matters worse, many bankers are telling me that new appraisals are coming in 40 percent less than last year.

In Georgia, until recently, building and building-related businesses had made up 20 to 25 percent of our economy. Referring back to the Smart Numbers slides, notice slide number 15, which shows permits issued since 1996. The norm appears to be 3,500 to 4,000 per year. The current number is around 500, which is a drop of about 86 percent. In Georgia, we have had an industry that represented 20 to 25 percent of our economy not just slow down, but literally cease to exist.

Another side that demonstrates the same point is slide number 3. Normally, new homes make up about 50 percent of the home sales, but most recently, they represent less than 10 percent of that total. The decline is not only a result of lack of inventory from lack of funding, but it is also because of the undue influence of TARP and loss share money in the real estate market. If you take a look at slide number 8, you will see that the average new home in the first quarter of this year sold for around $225,000 while the average resale was $97,000, primarily due to foreclosures. A lot of asset devaluation has to do with a regulatory system trying to flush out the overall system as quickly as possible. As a result, the economy in general is being significantly hindered.

A couple of other accounting-related issues of great importance are loan loss reserves and the deferred tax asset. Historically, banks use the experience method, called FAS–5, to fund their loss reserve. In May of 1993, an additional loss measure called FAS–114 was put into place, which I will not discuss today. Under the experience method, banks looked back at their average 5-year loan losses and set aside an amount that would cover those same losses as if they were going to happen again. In the 5-year look back, some years were better than others and the reserve balanced out. Over the last few years, banks have been required to shorten their look-back period to anywhere from 2 quarters to 5 quarters. This basically has the effect of capturing your worst historical loss periods and having to fund your loss reserve as if it were going to happen again. This has a direct effect on reducing capital, since only part of your loss reserve is allowed to be counted toward risk-based capital, and none of it counts towards tangible equity, which is the ultimate measure under prompt corrective action.

Also of importance is the deferred tax asset. The deferred tax asset is a balance sheet account that is the result of timing differences between financial accounting and tax accounting. A deferred tax asset is a benefit you stand to gain in the future and in our current environment, this is primarily a loss carryforward. So if you had a couple of years of net losses, those losses would carry forward to reduce future tax liability when you have net income. Unfortunately, regulatory requirements state that you must disallow the amount of your deferred tax asset that you cannot demonstrate you can recoup in net income within the upcoming 12 months. When the entire amount becomes disallowed, it must be subtracted from tangible equity. In this environment, a 12-month look forward for the deferred tax asset should be reconsidered and a longer look put in place.

In my home county, Bartow County, there are three loss share banks. The fact that there are so many loss share banks in this area has only exacerbated the asset value problem. It is clear to me that loss share banks stand to make more money by forcing the issue rather than working with the customer. In Georgia, community banks generally do balloon notes on commercial properties. This is done as an interest rate risk management tool. So at the end of 18, 24, 36 months, the entire balance of the loan is due. The commercial loss share part of the acquiring bank's agreement, which is 4.15B, is for 5 years. I fear that as the fifth year anniversary of the shared-loss agreements comes closer, rather than losing the protection of the loss share, many of these loss share banks will pursue judgments and foreclose so as to maximize financial gains, regardless of the borrower's past performance or capacity to pay.

Another loss share issue is home equity lines of credit. While they generally fall within the provisions of the single family shared-loss agreement, which is 4.15A, which has a 10-year duration, they are specifically separated from the mandatory loss mitigation provisions required for single family loans. Instead, they fall within the other shared loss loans category, which simply requires the acquiring bank to try to mitigate loss consistent with its own policies. Since this product became popular in the early 2000s and originally had a 15-year maturity, later a 10-year maturity, many will be coming due in the next 4 to 8 years. What could easily happen is the loss share bank will get an updated appraisal, which will probably be valued down and then it will have to mitigate loss consistent with its own policies. Basically, this means there will be a whole lot more pressure on an already stressed consumer. And since there is no incentive to allow those loans to get outside of the loss share period, we could see another round of judgments and foreclosures. As a result, I think we will be mired in this real estate mess for quite a long time.

Another problem I see with the loss share is it does not allow the loss share bank any judgment in its collection practices. Several months ago, one of these loss share banks in our community filed suit against a borrower. This particular borrower had had a debilitating stroke and would never be able to work again, and had lost everything. In prior years, the bank would have written the loan off and gone on down the road. I called someone I knew who worked at the loss share bank and asked, "Considering the circumstances, why are you suing this person?" He simply replied, "That is the only way we can collect on the shared-loss agreement." I cannot imagine that is our government's intent.

In closing, I also want to point out that the regulators I dealt with at all levels were both courteous and professional. I do not believe they take any joy in closing banks. I also want to point out that, particularly during the prompt corrective action process, I was told many times by the regulators that their hands were tied, they had no choice but to follow the requirements of prompt corrective action. Therefore, it is clear to me it is not an issue of regulators; it is an issue of regulations. So if this committee truly wants to make a positive change, it is going to have to come on a legislative level, not a regulatory level, to deal with these particular issues.

Again, I want to thank you for inviting me to be part of this hearing and I hope that something positive comes from it.

[The prepared statement of Mr. Fox can be found on page 116 of the appendix.]

Chairwoman CAPITO. Thank you.

I want to just ask a quick question, and then a follow up, and then we will move on.

Mr. Copeland, each one of you, will you tell me who your regulators are?

Mr. COPELAND. The Office of the Comptroller of the Currency.

Mr. ROSSETTI. FDIC.

Mr. JIM EDWARDS. State-chartered bank, also regulated by the FDIC.

Chairwoman CAPITO. And you were?

Mr. FOX. State and FDIC.

Chairwoman CAPITO. FDIC, okay. Now, you have made your statements and they are all very, very good. But you had the benefit of being the second panel, so you also heard the regulators. What, in your mind, Mr. Copeland—and Mr. Scott talked about this a lot in the first panel, the sort of talking past each other, lack of communication—if there was something glaring that came out of some of the statements the regulators made that did not fit with what you see in practice in your bank, what would that be?

Mr. COPELAND. I was not at great disagreement with any of the statements made by the regulators. However, because this is not a personal issue, I do not believe—

Chairwoman CAPITO. Right.

Mr. COPELAND. —there are no personal attacks involved. But I will say we have seen a clear difference in the tone of particularly the written reports of exams that we have received, as we have moved further out, that risk compendium in the eyes of our regulator. Whereas the initial reports of examination that we got had a very clear tone of understanding with regard to what got us here in this unforeseen catastrophic collapse, I believe it was Mr. Barker, my own regulator, who talked about this was not a steady slowing market, but literally we fell off the cliff. And what we have seen is a change in those reports, with an understanding that is what got us here and this is still a competent management team, for example, running this bank. And we do see positive aspects to this bank with regard to liquidity for funding and so forth. You see a change in tone in the reports of examination that clearly show what I would describe as legal edification where you are seeing verbiage come into these reports that is designed to bring it into step with prompt corrective action and other regulatory tools that are out there. And that is not for our benefit, I feel. It is for the benefit of being able to look back and kind of self-justify why particular actions may have been taken with the bank or might be taken in the future. So that is a tough thing to articulate and it should not come across as, for lack of a better word, whining, "they are picking on me on the playground" sort of thing. So we try to be careful as we say those things, because again, I do not believe it is personal.

Chairwoman CAPITO. Right. Mr. Rossetti, do you have a comment?

Mr. ROSSETTI. Yes, ma'am. There are two things. The first is when the regulators come in to regulate us, one of the first questions that the directors ask is what is the regulator like, what is the personality, how are they going to be on us. And that should not be a concern if they are dealing equally with all of the regulations. But a lot of the time it comes down to personality and that is something that I think the guys up in Washington do not understand, that it does depend a lot on who the regulator is and what they are like as to how that exam is going to come out.

The second thing is their misunderstanding I believe of the loss share and how effective it is. I think you need to look at the two types of banks out there—a community bank under the loss share who has a stake in that community is going to administer the loss share differently than a large bank where you are just a number. And it has been my feelings with those large banks that they are very onerous and very stiff with their dealings with the loss share. They want that out of the bank, they do not care if it is performing, non-performing, whatever. They want it out of that bank and they want to get their money off the loss share. So those two things.

Chairwoman CAPITO. Thank you. Mr. Edwards?

Mr. JIM EDWARDS. Being a State-chartered bank, we are regulated one year—we will have the State Department of Banking & Finance in one year and the FDIC will come in the following year. And we have not—we are now due, although I probably should not remind my regulators of this, but I am sure we will have an FDIC exam before long. I hope I do not say anything today that causes that to be any sooner.

But in terms of what they said, I think we have found certainly maybe a more challenging time with regulators but I think we all have to understand the backdrop here, how difficult these economic times are. The way you could structure something maybe in better times is not the way you can do it today unfortunately. And I look forward to those days when things will be better.

I think in our discussions with regulators, obviously there are new requirements that come out, but we have felt like there has at least been a dialogue with them about that. And certainly I do not know a banker working today who believes or agrees with the regulators about everything they say. But I think in general terms, we have felt that they are trying to work through this situation too, in most cases.

Chairwoman CAPITO. Mr. Fox?

Mr. FOX. I think the loss share is having a far greater effect on local communities than maybe what they feel like right here. And it is a difference. There are some banks, while they may be locally chartered in the State of Georgia, they are funded by huge dollars from Wall Street or wherever, by venture capitalists. And those guys did not get into banking because they want to make 2 percent on assets, I promise.

Chairwoman CAPITO. Thank you.

Chairman Bachus?

Chairman BACHUS. Thank you.

I want to commend all you gentlemen for the tone of your testimony and for the specificity. I think you have actually given us some real meat.

Mr. Fox, I especially appreciate you being here. As a former banker, you could just walk away, but you are still obviously concerned about your colleagues and the business, and I think that speaks well of your character.

Mr. FOX. Thank you.

Chairman BACHUS. I commend you for that.

We mentioned shared-loss agreements, that keeps coming up. I think there is a problem there and I think it is something that needs to be looked at again. I think particularly—not particularly, but also when you have participation agreements, it can be a problem for those institutions.

One thing that came up that I do not think we talked about on the first panel was writing down a performing loan, which at least two of you mentioned. We have often used the words "paper profit" or "paper loss" where you write down performing loans and you have to raise capital and then an institution has restrictions or challenges because of, not actual losses but just the write downs of performing loans. And I think that is particularly frustrating and bears more watching.

So I appreciate what you said about the prompt corrective action, that it may be the regulation, it may not be the regulators in those cases. They are following the law. And then that becomes our duty to review.

And finally, Dodd Frank—2,400 pages—and I can tell you the regulators appreciate that you are concerned about them because they are pretty much struggling with it on a daily basis, they are overwhelmed by that regulation. So the regulators are even overwhelmed by the regulations. And when it gets to that point, you know you have a problem.

I know one Georgian, Newt Gingrich, has actually said we need to repeal Dodd-Frank.

We seriously need to take a strong look at it, I will tell you that. We are going to have a hearing on that in October, as to how the economy is going to swallow that massive undertaking.

I will yield the balance of my time to Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

Before we close, I want to thank Mr. Don Mixon for allowing us to use this Performing Arts Center. It is a beautiful building. Thank you for allowing us to use the facility.

And I also want to thank Chief Deputy Mr. Riggs for being here today and for the whole staff of the Newnan Police Department for being here and providing the security. So thank you all for what you do.

Let me say just for the benefit of maybe everybody in the audience, I think most of you are familiar, but to some of these gentlemen who have great careers with the FDIC and the OCC and with the Federal Reserve, and I want to thank you all for your 30+ years of service or whatever you have been there. But you need to talk to some of these guys on a regular basis, some of these guys who are out there actually making the loans. Not your regulators, but talk to some of the people making the loans, talk to some of the people who are being punished by some of your regulations. And believe it or not, until the construction business comes back, our unemployment is going to stay high and this economy is not going to get going again. That is just a fact.

Now let me say, what happened is a lot of these TARP banks, and we had some come into our communities that had gotten a lot of money and they fire sold, they did public auctions and sold these properties. And that brought the value down. So then some of our community banks were demanded to write down these loans immediately. Is that not true? And so they wrote down the loans immediately and had to have more—a loss of I guess reserve, grow their capital, were told to reduce their real estate portfolios in many cases.

Then after that wave, we had the shared-loss agreements. Now Jim Edwards—if everybody who came into a community was like Jim Edwards, especially down in Barnesville and the relationship he had with that bank across the street, we would not have a problem. But when you have banks coming in here from California—and I am not picking on them—or Arkansas or others—I know we had testimony that said that these other banks were 10 banks adjoining Georgia. That is not true. So they do not know the community and so with their loss share, I think as Mr. Fox pointed out, the quicker they flushed these things, the better off they were.

So we had another round with our community banks. And now we have communities that do not even have a community bank. And why people who have been regulating for 30+ years at the FDIC and the OCC could not see that this ball was going downhill, it was going downhill. We were losing thousands of jobs, generational wealth was being sucked out of our communities. People were losing their investments. We were losing our community banks, pillars of the community lost everything they had. Why could we not recognize that and see if we could not come in to see a Chuck Copeland or a Michael Rossetti or Jim Edwards or Mr. Fox and say, what we might need is some advice on how to do this because I have been in Washington for 30 years?

Is what I have described basically what happened to our economy, especially here in the Third Congressional District?

Mr. COPELAND. There is no doubt, it is the massive devaluation of real estate that has impacted all of our banks. And there are many reasons for that.

Mr. WESTMORELAND. Right. And Mr. Fox, you mentioned that we do not need to do anything with the regulators, we need to do something with the regulation. I could not agree with you more. But say you do something legislatively, what would you propose that we could do legislatively that would help?

Mr. FOX. It seems to me—and this is a double-edged sword, probably the reason we have prompt corrective action is you all wanted to take judgment away from the regulators. I think they need to be given some amount of judgment. And of course, if they are given that judgment, they need to use it wisely. Because when you look at the way real estate values have collapsed in Georgia, a non-assisted community bank, it is going to be a struggle. If this does not correct itself within the next 4 or 5 years, I do not know what is going to be left. But we cannot survive such an asset devaluation. And I think you would just have to give these banks some time through some kind of regulatory—I mean legislative—leeway for them to have.

Mr. WESTMORELAND. So how about if there was a 5-year period to write down some of these loans, that some of them are even performing, where people are paying their interest, they are meeting their takedown schedules, and they are still being made to write these loans down because somebody is saying that it will not ever be worth that much money or they cannot pay it. Would it be of any assistance if there was some room to where they would write this down for a certain period of time, maybe even go back 24 months and go forward say 36 months, or whatever, if they were still in business, to be able to adjust some of these loans?

Mr. FOX. Sure, it would be helpful, yes. I think that approach may have been tried back in the S&L days, and that has been brought up. I know another banker, Chris Maddox, brought it up to the FDIC.

Mr. WESTMORELAND. Chuck, would that have hurt you?

Mr. COPELAND. Oh, there is no doubt it could make a difference. I do think there is this whole issue of transparency though and someone being able to pick up a call report or a financial statement and truly be able to assess the condition of a bank that is using some of these smoothing techniques with regard to funding writedowns, but I would think that that could be handled through memorandums to call reports or whatever, as a way to capture how much a bank does have in this pool of asset writedowns that it is accreting onto its books, and a process for how you re-evaluate values there and you adjust that pool, so that someone can pick up my call report and know exactly what sort of hangover effects I am still dealing with from the real estate meltdown versus say Jim's bank, who might be in a different situation.

Mr. WESTMORELAND. You would be glad to work with any of these folks to give them an idea, wouldn't you?

Mr. COPELAND. Oh, no doubt about it. And you have to cut through some of the rhetoric too, because when you talk about writedowns on performing loans, I think there is a bit too much anecdotal jargon getting thrown in there. And for example, I know our experience with our regulator, I cannot say I have ever experienced having to write down a performing loan. But there is a point at which the regulator—

Mr. WESTMORELAND. Even if the appraisal had come back for half the price of the loan?

Mr. COPELAND. Again, there is a difference between being forced by a regulator to write it down and having to reserve. The nuance in that, though, is the effect on my capital is the same. I have had to remove it from earnings and either put it into my loan loss reserve as a specific earmark against that credit or I have had to take the writedown. So the impact on my capital ratio is the same.

I think we have to remove some of this rhetoric and anecdote from some of this if we are going to get to real solutions.

Mr. WESTMORELAND. I will go ahead and close because I know we are running out of time. But let me just thank all of you for coming and thank all of you for doing this. I would hate for the FDIC to get the same reputation as the IRS.

Chairman BACHUS. I think you have your own time now.

Mr. WESTMORELAND. Oh, I do.

Chairman BACHUS. You can start the timer again.

Mr. WESTMORELAND. That is Ellen, and she has just given me five more—I will take just a couple more minutes then. I know lunch is getting near.

But it is amazing that the FDIC when they come in and actually be the receiver does not want to work with a lot of these people. I have had a number of them call and tell me that they had loans that they offered to buy or whatever and then they were put up for auction. And then, they are sued personally by a partner with the FDIC. That just does not sit well with me. In a non-recourse loan for 7 years, interest free, there is something wrong with that. Really and truly, there is something wrong with that. When we put out banks and we suck this money out of the community and we are in business. It would be a little bit different if this company, Rialto, was not—I think most of them are from a home building company and I think 5,100 of the 5,500 loans were actually residential loans. So there is just something weird with that. But I know there are a lot of new partners for the FDIC out there right now just waiting to put together their money and call them and say, look, we want to be in business.

But thank you all very much for coming and I hope we all learned something today. I hope we will take it back to Washington—Chairman Bachus, Chairwoman Capito, and Congressman Scott—so that we can write some legislation that will help out here in the real world. Maybe not in Washington, but out here in the real world with people who sit across the desk from these folks who have to make a decision on whether to loan money or not.

I do think we need to look at some of those regulations that Mr. Fox mentioned about having to sue somebody to be able to get your loss share part of it. So there are a lot of different things that we can look at. I know that Chairman Bachus has been great about looking at this, about having the hearings and I want to push forward with it.

So with that, I will yield back the balance of my time. And again, I thank everybody for coming.

Chairwoman CAPITO. Thank you.

Mr. Scott?

Mr. SCOTT. Thank you.

I would just like to start off by commending each of you for excellent testimony, very thorough, very informative, and providing us with a lot of good information.

I would like for my line of questioning to kind of zero in on this area of conflicting communications—the banks and the regulators. I think you all were probably here when I asked the regulators if they felt that their standards were so restrictive that it was inhibiting lending, and their basic response was that they did not feel it was.

And I would like for you to address that. Do you feel so? If I remember, I think, Mr. Copeland, you said they were sending shifting messages and the examiners were making contradictory statements that sent you clamoring for cover.

Mr. COPELAND. Correct.

Mr. SCOTT. That is certainly a stark difference from what the regulators said.

Mr. COPELAND. I can tell you there is a marked difference between how we feel and how we maneuver through our normal day-to-day in the management of our banks during times when we do not feel the cloak of the regulator. And that cloak of the regulatory being most present during periods of exam, where you truly do feel almost paralyzed in terms of dealing with the day-to-day running of your bank.

With regard to the contradiction, there are two things there that I would point to. One is—and this is somewhat of a selfish statement—one of the tenets of the CAMELS rating is the management component. We have the same management team and same board of directors in our bank that was there in the period of the early 2000s when our bank was generating record earnings and receiving nothing but the highest of regard from our regulator.

My reports of examination today have a very indictful tone towards management and the board of the bank. But it is the very same people.

Mr. SCOTT. Did you say indictful?

Mr. COPELAND. Indictful, yes. So it tends to put you in a very guarded position. The other thing with regard to contradiction; again, in our report of examination, we never had any significant reliance upon wholesale funding, brokered deposits or those things, we were always a core funded community bank. And that gets a brief acknowledgement in a passage in a report, but then it will go on to say in the same paragraph, "but due to the bank's high level of non-performing assets and its elevated risk profile, liquidity is insufficient" and it may even go in some passage to take it a step further and say, "and this constitutes an unsafe and unsound banking practice." Back to prompt corrective action. The trump card that has to be there before they can play prompt corrective action is they need to be able to assert these unsafe and unsound banking practices.

Mr. SCOTT. So with the regulators here in the audience listening to what you have to say, what two major recommended changes would you like to see in their procedures?

Mr. COPELAND. I would like to see patience exerted in how verbiage and terminology finds its way into the report of examination. I want a report of examination that 20 years from now my 5-year old child would not be embarrassed and ashamed to read about his dad.

Mr. SCOTT. Okay.

Mr. COPELAND. In simple terms.

Mr. SCOTT. Right.

Mr. COPELAND. But in addition to this patience, forbearance. And an example of that would be we are under a public regulatory order, so I am not disclosing anything that is not out there in the world to see, which requires that we achieve and maintain 9 percent tier 1 leverage and 13 percent total risk-based capital. We were in excess of those levels by and away during good times because that is the way we ran our bank. We understand the core principle of capital being your cushion against bad things that can happen in a risk-associated industry. Bad things happened to us, our capital has eroded. We need forbearance to work with our regulator on how we get back to that 9 and 13 over a reasonable period of time. There is no capital out there to a community bank in a community of my demographics, 13 percent unemployment, 30-odd percent of my population not being high school graduates, housing prices in the tank. There is no—outside of perhaps maybe with the beauty of a nice FDIC 80/20 loss share, some venture capitalist from New York who might like to take a bite out of our bank.

So we do not disavow the importance of the capital, but to have an expectation and a demeanor in how that expectation is communicated that we be able to restore those capital levels to that 9 and 13 in an environment that just for all practical purposes and common sensical analysis will not support that.

Mr. SCOTT. Okay.

Mr. COPELAND. The tools are already there with regard to what is defined as adequately capitalized. The trigger is there within prompt corrective action with regard to the forced dissolution of a bank. We understand the need to abide by those and will continue to do our dead level best to do it. But it is indeed crippling to realize that is not enough.

Mr. SCOTT. Okay. They are sitting out there, they are listening. So we hope that they hear what you are saying and we can move to correct.

But going a little bit further, of course, lending—we have been touching upon that, that is a great concern, it is really at the core of this field hearing, the whole issue, of course lending is the key. Banks cannot make money if they do not lend, and we cannot recover our economy if they are not lending.

Mr. Rossetti, you came right out in your statement and said in fact it is preventing you from lending. How is that?

Mr. ROSSETTI. Our lending guidelines for AD&C lending, the FDIC has written them down to 100 percent of capital. We are at 450 percent of capital. We will not get down there in 30 years.

Mr. SCOTT. Repeat that again.

Mr. ROSSETTI. They have put such an onerous guideline on us to lend money for AD&C lending, acquisition, development and construction lending, that—they put a guideline on us that we cannot achieve. And we are just prevented from bringing in any new business to lend money to people doing AD&C lending.

Mr. SCOTT. And what would you recommend that formula be?

Mr. ROSSETTI. It gets back to what Chuck says, common sense, if you get a loan, say a builder comes in, he has a presale home to build on somebody else's lot and the customer that he is building for is completely qualified. It is a commonsense loan. We cannot do that. We could not lend money in that situation because it is outside of our guideline.

Mr. SCOTT. And have you presented this particular issue to the examiner or to the regulator in any way?

Mr. ROSSETTI. I am sure it has been discussed.

Mr. SCOTT. But have you yourself discussed it?

Mr. ROSSETTI. Not myself, no. No, I have not, but I know what the guidelines are and I know the revised guidelines that they put us under to do that kind of lending, and it is just going to be impossible for us to get there for a long period of time.

Mr. SCOTT. And you had some things to say about the shared-loss agreement, which you felt was the most onerous. And I think it might have been you, Mr. Edwards, I wonder if you might—you said that, if I understand you correctly, that there is a requirement that you hire new people in order to be in compliance with the shared-loss agreement.

Mr. JIM EDWARDS. Yes, sir. They did not require that we hire new people per se in the contract, they just—we entered into a contract and it has a number of obligations and we have to make sure that we comply with all different things in the contract.

Mr. SCOTT. And when you say "they," you are talking about the FDIC?

Mr. JIM EDWARDS. Yes.

Mr. SCOTT. Okay. Do you believe—do each of you believe that there ought to be some restructuring in Washington regarding the regulation of our financial institutions to fit these economic times, that would be different? And if so, what would those be?

Mr. COPELAND. I think without a doubt. And honestly, it had not occurred to me until Mr. Fox's testimony just what a hurdle prompt corrective action creates for the regulator, and that perhaps it is not so much the regulator, but the regulation. And I understand the 2 percent capital minimum and the time in which that came from, but I would assert that there are banks out there that have a strong enough core element to their DNA that they could survive with negative capital. Now, you could not survive indefinitely, but you could certainly survive at less than a 2 percent capital level.

Mr. SCOTT. Okay. And just a final question. If you could zero in on and categorize—we have discussed many issues here, what would be the single deterrent to banks lending more now? What would that be?

Mr. FOX. Most banks, or a lot of banks in Georgia, a high number, are under a regulatory order of some sort. And usually in those orders, there is a limitation on your lending, there is a limitation on how much you can grow. So by virtue of that, you have to meet a minimum capital standard and every time you make a loan, it usually goes, based on risk-based capital, that is going to reduce your capital ratio. So basically, once you come under order, all you are managing from that point forward is liquidity in capital, that is all you can really do.

Mr. SCOTT. Just one last question, if I may, Mr. Chairman, this will be my last one. But it just intrigues me that you, Mr. Fox—I think you mentioned that you were once an examiner, is that correct?

Mr. FOX. Yes.

Mr. SCOTT. So that puts you in a pretty unique position here, to be able to add some perspective. And I really want to try to get to this, because as I mentioned before, Lynn and I find ourselves in a pretty good position with our bill having passed the House, and over in the Senate, and we have a pretty good bipartisan approach to this bill. That, unfortunately, does not happen very often. So we have a very live vehicle here and I am wondering—you remember I asked the regulators when they were here what they were doing that was so restrictive that stopped the lending, and they basically said, it is not our fault. But you hear from the bankers here that yes, some of this is their fault.

What is the true story here? You have sat in both seats here. Who is telling the truth?

Mr. FOX. I am not going to call anybody a—

[laughter]

Mr. SCOTT. Let us put it this way, who is more accurate? I did not say it correctly; who is more accurate? We really have to get to—

Mr. FOX. Mike made probably one of the best points I have heard today about the fact that if someone comes to his bank right now, because they are restricted from increasing their concentrations in real estate—construction lending, it is a presale, it probably has a mortgage takeout—he cannot make the loan. That does not make sense. So that's a great example. You really need to be able to use some common sense like he is saying. Does this credit stand on its own and if it does, then we ought to be able to make it.

Mr. SCOTT. Okay. So there is some truth to that statement and we will just say that we will work with our regulators to see what we can do here.

Thank you very much, it has been a very good session. Thank you.

Chairwoman CAPITO. Thank you. Before I dismiss the panel, I would like to thank them for their very great comments and answers to questions and their statements. We will be taking this back to Washington, working with this bill and others to try to strengthen the possibility of a faster rebound for everybody.

I would like to thank the audience for being a great audience and being so attentive and sticking with us. This has been a very lengthy hearing. I would also like to thank panel one, the four regulators, they are all in the audience, so I would like to thank you all for staying and listening as we requested, and that is duly noted. Right, Lynn?

Mr. WESTMORELAND. Yes.

Chairwoman CAPITO. And I would like to also thank Mr. Westmoreland's staff for putting this together and at such a beautiful facility and I think creating two panels that have been very enlightening.

So with that, the Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

With that, this hearing is adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

A P P E N D I X

August 16, 2011

For Release Upon Delivery
9:00 a.m., August 16, 2011

TESTIMONY OF

GIL BARKER

DEPUTY COMPTROLLER

SOUTHERN DISTRICT

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON FINANCIAL SERVICES

U. S. HOUSE OF REPRESENTATIVES

August 16, 2011

Statement Required by 12 U.S.C. § 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Capito and members of the Subcommittee, my name is Gil Barker and I am the Deputy Comptroller for the Southern District of the Office of the Comptroller of the Currency (OCC). In this position, I oversee the supervision of more than 550 national community banks – including 29 of the 244 banks chartered in Georgia. I am also responsible for supervising 109 federal savings associations, including 16 in Georgia. I appreciate the opportunity to appear today to discuss the OCC's supervision of national banks and federal savings associations (herein after referred to as "banks"), including the steps we take to ensure that our supervision is balanced, fair, and consistent with OCC policies and guidance.

I have been a commissioned national bank examiner for 29 years. For almost my entire career, I have been involved in the direct supervision of community banks, so I have a deep appreciation for the challenges that those bankers face.

Community banks play a crucial role in providing consumers and small businesses in communities across the nation with essential financial services as well as the credit that is critical to economic growth and job creation. A primary goal of our supervision is to ensure that community banks have the strength and capacity to meet the credit needs of their customers and communities. Fundamentally, the best way to ensure that banks are making credit available in their communities is to assure that they are safe and sound and have sufficient capital available to support lending to creditworthy borrowers. Thus, a key part of our job is to work with bankers to ensure that they recognize and address problems at the earliest possible stage when remedial action is likely to be most effective. The simple truth is that seriously troubled banks cannot effectively meet the needs of their local communities.

I understand that some bankers believe they are receiving mixed messages from regulators about the need to make loans to creditworthy customers while at the same time being subject to what some have termed as "overzealous" regulatory examinations. In particular, some bankers have stated that their ability to meet the needs of their communities is being constrained by what they regard as overly aggressive regulatory loan classifications and the substitution of examiner judgment for that of bank management. I appreciate this opportunity to address these concerns and to explain the OCC's policies, and how examiners apply those policies, when assessing a bank's loan portfolio. These assessments are a core component of our examinations, and we strive to make sure that they are fair, balanced, and consistent over time and across institutions. I believe that the OCC examiners I supervise are striking the right balance in encouraging bankers to make loans to creditworthy borrowers, but to also identify and address problem credits.

My testimony discusses the OCC's examination policies and procedures and our recent supervisory guidance to encourage bankers to make prudent loans and to work constructively with troubled borrowers. I then discuss how we structure and carry out our examinations at the local level to ensure consistency and balance in examiners' assessments. With this background, I then describe our supervisory approach to assessing loan quality and performance, and address some of the common issues we hear from bankers about examiners' actions. I close with a short discussion of the process we use when a bank's condition becomes so impaired that we must work with the FDIC to find a least cost resolution of the bank, consistent with the Prompt Corrective Action (PCA) provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991, or "FDICIA."

Let me begin, however, by acknowledging the challenging environment that community bankers are facing. Although community bank profitability, as measured by return on equity, has improved in recent quarters after precipitous declines in 2008 and 2009, returns remain sharply below historical averages. For example, only 52 percent of the national community banks and 50 percent of the federally chartered savings associations in Georgia were profitable in 2010. A major factor contributing to the decline in profitability is the continued pressure on community banks' net interest margins. Tepid loan demand and the low interest rate environment are contributing to the decline in these margins: as loans and investments mature, banks are forced to replace them with lower yielding assets. While the rates banks pay for certificates of deposit and other funding sources have also declined, many core deposits are already at extremely low rates, leaving little room for further declines. Lending activity – the primary revenue source for community banks – has been hampered by the overall economic climate. Although it is true that many bankers have adjusted and tightened some of their credit underwriting standards, most of the community bankers I talk to reiterate that lending is the backbone of their business and that they are seeking to make loans to creditworthy borrowers. We continue to encourage bankers to lend to such borrowers, but in many areas and sectors, loan demand remains weak. For example, the NFIB Research Foundation's recent report, "*Financing Small Business – Small Business and Credit Access*," noted that while small business financing conditions have deteriorated over the last two to three years, the small business problem has been, and remains, weak sales, followed by continued problems in the housing and real estate sectors.[1]

The strains in the economy and most notably in the real estate sector resulted in a substantial increase in the number of problem institutions and bank failures in recent years. For example, since the current down cycle began at the end of 2007, 67 insured-depository institutions have failed in Georgia. Of these, 10 were federally chartered by the OCC or OTS, and 57 were chartered by the state of Georgia. While there are signs that the number and severity of new problem institutions is abating, there remain banks whose condition has been severely affected by the combination of high levels of problem loans and impaired capital. Some of these institutions will be able to find strong buyers – in some instances with our assistance – that will enable them to avoid failure and resolution by the FDIC. But that will not always be possible. In that circumstance, our goal, consistent with the provisions of FDICIA, is to facilitate the FDIC's early and least cost resolution of the bank with a minimum disruption to its customers and community.

In this environment, some have talked about the need for regulatory "forbearance," where supervisors allow troubled banks to ignore credit problems in the hope they will go away over time. This is not permissible under generally accepted accounting principles. Nor would it be advisable. As the savings and loan crisis of the 1980s demonstrated, regulatory forbearance, by delaying the recognition of problems, can ultimately make those problems and their cost of resolution far worse.[2] The savings

[1] *See:* NFIB Research Foundation, "Financing Small Business – Small Business and Access to Credit," January 2011, page 5.
[2] The Congressional Budget Office staff memorandum, "The Cost of Forbearance During the Thrift Crisis," 1991, estimated that regulatory forbearance increased the cost of resolving the thrift crisis by $66 billion.

and loan experience caused Congress to enact the PCA regulatory regime in FDICIA that expressly rejects regulatory forbearance.

OCC's Examination Policies, Procedures, and Supervisory Guidance

The OCC has a consistent examination philosophy and structure that is used at all banks. We will be applying this same philosophy at the thrifts that we supervise. This approach includes a uniform risk assessment system that evaluates each bank's risk profile across eight risk areas – compliance, credit, interest rate, liquidity, operational, price, reputation, and strategic – and assigns an overall composite and component ratings on a bank's capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risks using the interagency Uniform Financial Institution Rating System (CAMELS).

As we develop regulations, supervisory policies, and examination standards, we strive to provide sufficient flexibility in the application of those standards to reflect the size and complexity of the institution. In other words, while the OCC generally holds all of the banks it regulates to the same set of standards and regulations, the methods and controls banks use to implement those standards may vary, based on their size and complexity. As the complexity and scope of a bank's activities increase, so do our expectations for their internal controls and risk management systems. To reflect these differences in expectations, we have two sets of core examination procedures – one for community banks and one for larger, more complex banks.

The OCC has worked with the other federal banking agencies to encourage bankers to work with and extend credit to creditworthy borrowers. In November 2008, we and the other federal banking agencies issued the *Interagency Statement on Meeting* *the Needs of Creditworthy Borrowers*[3] that underscored the crucial role that prudent bank lending practices play in promoting our nation's economic welfare and the importance of bankers and regulators working together to meet the needs of creditworthy borrowers.

Given the concerns expressed about how examiners were assessing troubled commercial real estate loans, we and the other banking regulators issued guidance in October 2009 to provide greater clarity and certainty to the industry and examiners on our policies and expectations for commercial real estate (CRE) loan workouts.[4] The guidance provided real world examples that our examiners were confronting to help promote consistency in how examiners apply key supervisory principles. We followed that guidance with interagency conference calls with the industry and discussed its implementation in a nationwide call with our examiners. To help assess the effectiveness of this guidance, the federal banking agencies and the Conference of State Bank Supervisors conducted a survey in 2010 to gain a better understanding of how institutions were working with creditworthy CRE borrowers affected by economic and market difficulties. Approximately 97 percent of the survey respondents indicated that the CRE policy statement had been helpful, and nearly 88 percent indicated there were not any specific regulatory policies that were impeding their ability to work constructively with troubled CRE borrowers.

In February 2010, the OCC and other agencies issued the *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers,*[5] which

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[3] *See:* OCC News Release 2008-131 at: http://occ.gov/news-issuances/news-releases/2008/nr-ia-2008-131.html.
[4] *See:* "Policy Statement on Commercial Real Estate Loan Workouts," at: http://www.occ.treas.gov/ftp/release/2009-128a.pdf.
[5] *See:* OCC Bulletin 2010-6, "*Small Business Lending: Meeting the Credit Needs of Creditworthy Small Business Borrowers,*" available at: http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-6.html.

encourages prudent small business lending and emphasizes that examiners apply a balanced approach in evaluating loans.

OCC's Supervisory Structure to Ensure Consistency and Balance

The OCC's community bank supervision program is built around our local field offices located throughout the United States. In the Southern District, we have 21 offices in nine states. The primary responsibility for the supervision of individual community banks is delegated to the local Assistant Deputy Comptrollers (ADCs) who manage those field offices. We have two ADCs in Atlanta who oversee the supervision of national banks and federal savings associations operating in Georgia. These ADCs report to an Associate Deputy Comptroller, who reports directly to me. Each individual bank is assigned to an examiner who monitors the bank's condition on an on-going basis and who serves as the focal point for communications with the bank.

Our structure ensures that community banks receive the benefits of highly-trained bank examiners with local knowledge and experience, along with the resources and specialized expertise that a nationwide organization can provide. While our bank supervision policies and procedures establish a common framework and set of expectations, our examiners are taught to tailor their supervision of each community bank to its individual risk profile, business model, and management strategies. As a result, our ADCs are given considerable decision-making authority, reflecting their experience, expertise, and their "on-the-ground" knowledge of the institutions they supervise.

To support our local examiners, we have district analysts who monitor and provide information on local markets and conditions within each district. This information, along with various databases and other analytical tools we use, allows us to tailor our supervisory activities to unique challenges being faced within local economies and business sectors. For example, as the housing market began to deteriorate in Georgia, we adjusted our examination schedules to focus more attention on the banks that our analysis indicated had the greatest potential exposure to the downturn. We also redeployed our most experienced examiners to those institutions. Our goal in taking these actions was to identify potential problems at an early stage so that bank management would have time to take appropriate remedial actions.

The OCC has mechanisms in place to help ensure that our supervisory policies are applied to community banks in a consistent and balanced manner. Our examiners are alerted to new policy issuances via weekly updates. When warranted, we supplement these issuances with targeted supervisory memos that provide additional direction on how examiners should implement those policies or guidelines on a consistent basis across the country. These messages are reinforced and clarified through periodic national teleconferences with our field staff. Every report of examination is reviewed and signed off by an appropriate OCC manager before it is finalized. In those cases where significant issues are identified and an enforcement action is already in place, or is being contemplated, additional levels of review occur prior to finalizing the examination conclusions. We apply these same additional levels of review to a sample of institutions that are not subject to enforcement action in order to ensure our ADCs apply our standards consistently. We also have formal quality assurance processes that assess the effectiveness of our supervision and compliance with OCC policies through quarterly, randomly selected reviews of the supervisory record. The Enterprise Governance unit that reports directly to the Comptroller oversees this process. Finally, we have an active outreach program in place that includes regular interaction with state banking associations and periodic interagency meetings with state and federal regulators. These sessions provide the opportunity for industry feedback on our supervision efforts and a chance to discuss common issues with other regulators.

OCC's Approach to Assessing Loan Quality and Performance

Given the central role that asset quality plays in a bank's overall safety and soundness, we expend considerable time and resources in providing training and guidance to our examiners on evaluating credit. Loan review and analysis, and the application of appropriate accounting principles, are focal points of every new examiner's classroom and on-the-job training. Topical booklets in *The Comptroller's Handbook* provide detailed examination procedures on various aspects of credit review and lending practices and are available on the OCC's Web site. Twice a year the Southern District conducts commercial credit roundtable meetings. These sessions include senior credit examiners from each of our field offices and focus on topical commercial credit issues throughout the district. After each meeting, the information and materials from these roundtables are shared and discussed with our examiners at each of our local field offices. We also offer a variety of continuing educational opportunities for more experienced examiners to ensure that their skills remain current and to keep them abreast of current supervisory policies and expectations and accounting standards. These include various interagency classroom and on-line training opportunities offered through the Federal Financial Institutions Examination Council and topical seminars and conferences.

OCC examiners review and assess a bank's loan portfolio during each examination cycle. The primary objectives of these reviews are threefold. First, examiners assess whether the bank has adequate systems to identify, measure, monitor, and control the amount of credit risk in its loan portfolios. A key component of such systems is the process that the bank uses to monitor and rate the relative risk of its loans. Second, examiners assess whether the bank's financial statements accurately reflect the condition of its loan portfolios and conform to generally accepted accounting principles (GAAP) with regard to loan loss reserves, the accrual of interest income, and the reporting of troubled debt restructurings. Third, examiners assess whether the bank has adequate capital cushions to support the bank's lending activities and credit risk exposures.

When making these assessments, examiners first consider the adequacy of the bank's policies, procedures, and practices to ascertain the degree of reliance that we can place on the bank's own evaluations and assessments. Our goal is to review and confirm bank management's assessments, not to "second guess" or supplant their judgments with ours. Examiners confirm management's assessment through transaction testing of specific loans or loan portfolios. Where weaknesses or deviations from sound practices are found, examiners will direct bank management to take corrective action to ensure that the bank's lending practices are conducted in a safe and sound manner.

The OCC expects banks to have credit risk management systems that produce accurate and timely risk ratings. Well-managed credit risk rating systems promote bank safety and soundness by facilitating informed decision making on matters such as loan selection and underwriting standards, loan pricing, and maintaining adequate loan loss reserves and capital levels. Such systems also serve as important "early warning" indicators for bank management of when a borrower's or loan facility's performance may be deteriorating and warrant additional action to improve the likelihood of continued performance. Such action may include a variety of measures, including modification of loan terms and obtaining additional collateral or other forms of support.

Bankers use a variety of systems to "grade" and risk-rate their loan portfolios. To provide consistency in the examination process, the OCC and other banking agencies use a common, uniform risk rating scale to identify problem credits. This regulatory classification system, which has been in use in some form since it was first established in 1938, consists of four levels of designations that identify different degrees of credit weakness, ranging from a potential problem to a more serious actual one.

Credit risk rating and loan classification are focused on ensuring that the credit risk of a bank's loan portfolios is properly identified. Ensuring that those risks are properly reflected in the bank's financial statements and asset valuations is the function of the bank's loan accounting policies and procedures. Accurate and transparent financial statements are essential to allow investors, creditors, and regulators to evaluate a bank's overall financial condition. Congress recognized and underscored the importance of ensuring that banks' regulatory reports are accurate when it passed FDICIA in 1991. Section 121 of FDICIA requires that the accounting principles used for regulatory reporting should be no less stringent than GAAP.

When a loan or borrower shows signs of trouble, there are generally three key accounting concepts that bankers and examiners must consider: 1) whether the loan, for financial reporting statements, should continue to accrue interest or, conversely, be put on nonaccrual status; 2) whether, if the loan is subsequently modified, it should be reported as a "troubled debt restructuring" (TDR); and 3) whether the bank has properly and adequately set aside loan loss reserves for any loan impairment.[6] The OCC and other banking agencies' standards for applying these concepts are governed by GAAP and are contained in the instructions that banks must follow when filing their quarterly Consolidated Reports of Income and Condition (Call Reports).[7]

First, consistent with GAAP, Call Report instructions require that a loan be put on nonaccrual status when: 1) payment in full of principal or interest is not expected; or 2) principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection. As a general rule, a nonaccrual loan may be restored to accrual status when: 1) none of its principal and interest is due and unpaid, and the bank can reasonably expect repayment of the remaining contractual principal and interest; or 2) when it otherwise becomes well secured and in the process of collection.

Second, under GAAP, a modification of a loan's terms constitutes a TDR if the bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that the bank would not otherwise consider.[8] Likewise, designating a loan as a TDR does not, by itself, mean that the loan must be placed on nonaccrual. If the borrower has demonstrated performance under the previous terms and shows the capacity to continue to perform under the restructured terms, the loan will likely remain on accrual. If the borrower was materially delinquent on payments prior to the restructure, but shows potential capacity to meet the restructured terms, the loan

[6] This discussion assumes that a bank's loan portfolio is accounted for on amortized or historical cost basis. There are some loans or portfolios that are reported at fair value, but the vast majority of loans, especially for community banks, are held at amortized cost.
[7] The Thrift Financial Reports (TFRs) that savings associations currently file are also governed by GAAP. Beginning in the first quarter of 2012, savings associations will begin filing their financial reports using the same reports and instructions as commercial banks.
[8] *See:* Accounting Standards Codification (ASC) 310-40, Receivables – Troubled Debt Restructurings by Creditors.

would likely remain on nonaccrual until the borrower has demonstrated a reasonable period of performance – generally at least six months.

Third, consistent with GAAP, the OCC expects banks to maintain an appropriate allowance for loan and lease losses (ALLL). An appropriate ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio. Estimated credit losses mean an estimate of the current amount of loans that it is probable the bank will be unable to collect given facts and circumstances as of the evaluation date. When available information confirms that specific loans, or portions thereof, are uncollectable, those amounts should be promptly charged off against the ALLL.

Decisions about the proper classification, accrual, and TDR treatment of a loan is fact specific. The examples provided in the 2009 CRE policy statement were designed to provide greater transparency to bankers in how changes in underlying facts or assumptions may affect examiners' assessments. The OCC's Bank Accounting Advisory Series, available on our Web site, provides similar guidance to bankers and examiners by illustrating how various fact patterns will affect accrual, TDR, and ALLL determinations. These examples and fact patterns draw upon frequent issues that examiners encounter and are updated on a regular basis to reflect current situations and accounting standards.

Banker Concerns About Examiner Classification and Accrual Decisions

As we work through the current problems in the industry, our messages to examiners continue to be these: Take a balanced approach; communicate concerns and expectations clearly and consistently; and encourage bankers to work with troubled borrowers in a prudent manner and to extend new credit to creditworthy borrowers. This does not mean that bankers can ignore or delay recognition of their credit problems. If a banker is unwilling or unable to take appropriate action to identify and manage the risks in the bank's credit portfolio as required by GAAP and established supervisory standards, examiners will then direct bank management to take corrective action. At institutions where bank management has not sufficiently identified or addressed their loan problems, our reviews may result in a bank needing to make additional loan loss provisions; to charge off loans that are deemed loss; or to place loans on nonaccrual where full collection of principal and interest is in doubt. Depending on the specific circumstances, the bank may also be directed to strengthen its credit underwriting or risk identification and management practices.

With this background, let me address some of the specific concerns we are hearing about examiners' actions.

- *Examiners are barring loans to certain borrowers or industries, or are criticizing loans simply because they are located in a state with a high mortgage foreclosure rate or to an industry experiencing problems.*

We expect banks to have robust credit underwriting and risk management processes which, among other things, monitor and control the bank's overall exposure to a particular borrower and industry segment. We also expect bankers to assess how borrowers, and their industries, may perform in stressed economic environments to ensure they will continue to have the capacity to perform under the terms of their loan obligations. However, examiners should not criticize loans simply because a borrower is located in a certain geographic region or operates in a certain industry. Each loan must be evaluated based on its own structure, terms, and the borrower's willingness and ability to repay the loan under reasonable terms. Market conditions, however, can influence a borrower's repayment prospects and the cash flow potential of the business operations or underlying collateral, and these are factors that we expect bank management to consider when evaluating a loan.

- *The bank can no longer work with a borrower because the examiner has classified the borrower's loan.*

When a borrower's ability to repay its loan deteriorates or becomes impaired, we expect the bank to "classify" the loan to recognize the increased risk. This means that they move the borrower from a "pass" designation into one of three categories set forth in the agencies' uniform credit classification system based on the weaknesses in the credit and likelihood of the bank incurring some degree of loss. Although some bankers may infer that they are no longer allowed to extend credit to borrowers whose loans have been classified, this is simply not the OCC's position. We expect and, in fact, encourage bankers to continue working with "classified" borrowers who are viable. An increase in classified loans does not automatically trigger supervisory action – we expect banks to have higher classified loan ratios during economic downturns – provided that bank management is being realistic in its assessments, has reasonable workout plans, and is maintaining adequate loan loss reserves and capital ratios.

- *Examiners are classifying loans to borrowers who are current and can meet their debt obligation – what has sometimes been referred to as "performing non-performing" loans.*

The OCC does not direct banks to classify borrowers that have the demonstrated ability to service both interest and principal under reasonable payment schedules. There are instances, however, where liberal underwriting structures can mask credit weaknesses that jeopardize repayment of the loan. The agencies' October 2009 policy statement on CRE loan workouts addresses these situations and provides examples of when classification would and would not be appropriate. One common example is bank-funded interest reserves on CRE projects, where the interest reserves are being used to keep the loan current, and expected leases or sales have not occurred as projected and property values have declined. In these cases, examiners will not just accept that the loan is good quality because it is current; instead, they will also evaluate the borrower's ability to make future payments required by the terms of the loan. While interest reserves on CRE loans are one common issue, there may be other examples, such as terms that require interest-only payments for extended periods, or the use of proceeds from other credit facilities to keep troubled loans current. Again, in these cases, examiners will consider the totality of the borrower's credit exposure and debt service obligations.

- *Examiners are criticizing loans or borrowers simply because the current market value of their collateral has declined and are forcing bankers to write down loans to current distressed market values.*

Examiners will not classify or write down loans solely because the value of the underlying collateral has declined to an amount that is less than the loan balance – a point that we reiterated in the October 2009 CRE policy statement and the 2010 interagency statement on small business lending. For many CRE projects, however, the value of the collateral and the repayment of the loan are both dependent on the cash flows that the underlying project is expected to generate. Because of this linkage, current collateral values can be an important indicator of the project's viability and can signal changes that will adversely affect the cash flow available to service or repay the loan.

In making loan classification or write-down decisions, examiners first focus on the adequacy of cash flow available to service the debt, including cash flow from the operation of the collateral, support from financially responsible guarantors, or other bona fide repayment sources. However, if these sources do not exist, and the only likely repayment source is sale of the collateral, then examiners will direct the bank to write down the loan balances to the value of the collateral, less estimated costs to sell.

- *Examiners are unduly overreaching and are second guessing bankers and professional independent appraisers.*

One of the areas of greatest controversy during the last significant real estate downturn in the late 80's and early 90's was the practice of examiners making adjustments to real estate appraisals. We have taken steps to minimize the need for such adjustments during the current cycle. In 2008, in a nationwide teleconference and supervisory memo, we reiterated to examiners that it is management's responsibility to have updated borrower information and current real estate appraisals. We also noted that a new appraisal may not be necessary in instances where an internal evaluation by the bank appropriately updates the original appraisal assumptions to reflect current market conditions and provides an estimate of the collateral's fair value for impairment analysis. As noted in the October 2009 CRE policy statement, appropriately supported assumptions are to be given a reasonable degree of deference by examiners. The policy statement also provides guidance on the factors that examiners are to consider when assessing the reasonableness of those assumptions used for an appraisal or evaluation

Provided that the appraisal is reasonable, our examiners will not make adjustments or apply an additional haircut to the collateral.

- *Examiners are penalizing loan modifications by aggressively placing loans on nonaccrual status following a modification, even though the borrower has demonstrated a pattern of making contractual principal and interest payments under the loan's modified terms.*

As previously noted, determinations about a loan's accrual status are based on interest income recognition criteria in GAAP. For a loan that has been modified, if the borrower has demonstrated performance under the previous terms and shows the capacity to continue to perform under the restructured terms, the loan will likely remain on accrual. If the borrower was materially delinquent on payments prior to the restructure, but shows potential capacity to meet the restructured terms, the loan would likely remain on nonaccrual until the borrower has demonstrated a reasonable period of performance.

- *Examiners are arbitrarily applying de facto higher regulatory capital requirements, constraining banks' ability to lend.*

The recent financial crisis has underscored the importance of strong capital buffers in protecting a bank from unforeseen losses and stress events. It is the OCC's long-standing policy that regulatory capital requirements represent minimum capital levels, and that most banks will need to maintain capital levels above these minimums to support their banking activities. When assessing a bank's capital adequacy, examiners consider the bank's internal capital planning and allocation process and risk factors that are not explicitly captured by the agencies' risk-based capital regime. One critical factor is the degree and nature of concentrations that may exist in the bank's loan portfolio.

Concentrations of credit exposures that have a high degree of correlation with cyclical changes or economic events can accentuate a bank's risk exposure and therefore generally will require additional capital buffers.

In anticipation of rising credit losses, over the last two years the OCC has urged banks to build loan loss reserves and strengthen capital. Indeed, if a bank simply maintained its capital at the minimum level defined by regulation and then incurred unexpected losses, the resulting decline in its capital ratios could immediately trigger the provisions of PCA that would constrain the bank's activities. Thus, there are instances where we have directed, and will direct, bank management to maintain higher capital buffers if they choose to have significant risk concentrations. Such decisions, however, are not made unilaterally by a field examiner. Any such directive is reviewed and approved by our district supervision management teams.

OCC's Resolution of Problem Banks

At the OCC, the supervision of problem banks – those banks with a composite CAMELS[9] rating of 3, 4, or 5 – is divided between experienced examiners in our districts and our Special Supervision Division located in Washington, D.C. Banks supervised from Washington include all 5-rated banks, 4-rated banks with total assets over $1 billion, and any bank that our management team believes should be supervised by Special Supervision. All other problem banks are supervised by the district in which they are geographically located. The Special Supervision Division works to resolve critical problem banks, first through rehabilitation, or if that is not successful, through orderly

[9] The CAMELS rating system is an interagency bank-rating system for bank supervisors to rate an institution's Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. Insured depository institutions are assigned a rating from 1 to 5 on each of these elements (with "1" being the highest or best rating), as well as an overall composite rating.

failure management. The Special Supervision Division monitors and consults with our district offices on the supervision of problem banks, and supports OCC supervisory objectives as an advisor and liaison to OCC management and field staff on emerging problem bank issues.

As a bank's condition becomes more troubled, or when we find weaknesses in its management processes, we use a variety of enforcement tools to achieve the corrective action needed to restore the bank's condition. The intent of enforcement action is to address problems or weaknesses at an early stage, before they develop into more serious supervisory issues or adversely affect the bank's performance and viability. This may mean taking action well before problems or weaknesses are reflected in a bank's financial condition. With respect to problem banks, our Enforcement Action Policy[10] describes factors to be considered when assessing the situation and what action to take. The policy also describes formal and informal enforcement action options and the typical use of those actions based upon indicated factors. Formal enforcement action is often used if a bank has less than satisfactory management, or if there is uncertainty surrounding management and the board's ability or willingness to take corrective measures.

Each enforcement action is specifically tailored to the institution, and is designed to correct deficiencies and return the bank to a safe and sound condition as soon as possible. Once an enforcement action is taken, it is our policy to incorporate into the supervisory strategy an early assessment of the bank's efforts to comply with the action. This monitoring is critical to helping management and the board address the requirements of the action and achieve timely compliance. Where rehabilitation is unsuccessful,

[10] OCC's Enforcement Action Policy describes the OCC's policy for taking appropriate enforcement action in response to violations of laws, rules, regulations, final agency orders, and/or unsafe and unsound practices or conditions and was publicly released as OCC Bulletin 2002-38.

consistent with the FDICIA, our goal is to effect early and "least cost" resolution of the institution.

The OCC has the authority to place a bank into receivership on the basis of capital inadequacy, specified unsafe and unsound practices, illiquidity, and other grounds specified in the Federal Deposit Insurance Act. The decision to place a bank into receivership is made with great care and must be approved by senior management at the OCC. We consider the overall viability of the bank including the status of efforts to recapitalize; earnings and liquidity trends; competence of the board and management; and the existence of other factors such as fraud or insider abuse, where delay in closing the bank would increase the cost to the FDIC Deposit Insurance Fund. Our decision to place a bank in receivership is supported by a fully developed administrative record that includes a supervisory analysis of the bank's condition, history, and the applicable grounds for closing, along with a legal analysis of the sufficiency of the supervisory record to support the grounds for closing.

While we work closely with other regulators during all phases of problem bank resolution, our interaction is virtually continuous when a bank's condition is deteriorating. When we have determined that a problem bank has exhausted all options, has no reasonable prospect for raising capital, is facing insurmountable liquidity problems, or for other reasons is no longer viable, the FDIC's Division of Resolution and Receivership (DRR) joins our examiners on-site in the bank to begin preparing for receivership. The OCC's goal is to provide DRR with the maximum amount of time possible to prepare for the closing in order to minimize both the disruption to the depositors and customers of the failed bank and the FDIC's cost to resolve the bank.

Conclusion

The OCC's supervisory philosophy is to have open and frequent communication with the banks we supervise. My management team and I encourage any banker that has concerns about a particular examination finding to raise those concerns with his or her examination team. Should a banker not want to pursue those chains of communication, our Ombudsman's office provides a venue for bankers to discuss their concerns informally or to formally request an appeal of examination findings. The OCC's Ombudsman is fully independent of the supervisory process, and he reports directly to the Comptroller.

The OCC agrees that access to credit plays a vital role in restoring economic growth and jobs to our communities, and that banks should not be unduly constrained from meeting these credit needs. We are committed to supporting these goals with supervision that is balanced and fair and that does not cause bankers to become too conservative in their lending decisions. At the same time, however, we must avoid forbearance strategies that defer recognition of loss. History has demonstrated that forbearance is not a viable solution during times of economic stress because it leads to larger future losses and more severely troubled banks.

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Statement of

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Division of Banking Supervision and Regulation

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

U.S. House of Representatives

Field Hearing

Newnan, Georgia

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Chairwoman Capito, Chairman Bachus, Ranking Member Maloney, and members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the Federal Reserve's efforts to ensure a consistent approach to the examination of community banking organizations.[1] Developments over the past few years have been particularly challenging for these institutions, and the Federal Reserve recognizes that within this context supervisory actions must be well considered and carefully implemented.

Currently, the Federal Reserve supervises more than 5,000 bank holding companies and 825 state-chartered banks that are members of the Federal Reserve System (state member banks). As of July 21, the Federal Reserve also assumed responsibility for the supervision of more than 430 savings and loan holding companies. Although these supervised institutions include some of the largest diversified financial firms in the world, most are small community banking organizations focused on traditional banking activities.

In my remarks, I will start with a brief overview of the examination and enforcement policies that guide the Federal Reserve's supervisory activities for these institutions. I will then touch briefly on the recent performance of community banking organizations, highlighting the main sources of recent problems for these companies. In concluding, I will describe the steps that the Federal Reserve is taking to help ensure a consistent and balanced examination process across all of its Reserve Banks.

Examination and Enforcement Policies and Procedures

The Federal Reserve conducts its supervisory activities through its 12 Federal Reserve Banks across the country. This means that supervision is guided by policies and procedures established by the Board, but is conducted day-to-day by the Reserve Banks and their examiners, many of whom have lived and worked within the districts they serve for many years. We believe

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[1] For supervisory purposes, the Federal Reserve defines banking organizations with assets of $10 billion or less as community banking organizations.

this approach ensures that Federal Reserve supervision of community banks is consistent and disciplined, and that it also reflects a local perspective that takes account of differences in regional economic conditions. For example, in the Midwest, where many community banks specialize in agricultural lending, Federal Reserve examiners maintain a special expertise in agricultural markets and associated lending practices. They also draw frequently on the expertise of regional and agricultural economists in the districts to maintain an up-to-date understanding of local conditions. This helps ensure that examiners are familiar with the unique features of their local economies and that they apply examination policies in a manner that is sensitive to local conditions or business practices.

Examination and enforcement policies followed by Federal Reserve examiners are set forth in supervision manuals published by the Board.[2] In addition, the Board regularly publishes supervisory letters to address emerging supervisory issues and provide guidance to examiners and banking organizations.[3] Many recent supervisory letters, for example, have addressed commercial real estate--an area of concern for many community banks. To promote consistency in examination practices across federal banking agencies, the Federal Reserve also participates in the interagency Federal Financial Institutions Examination Council, which has long-established task forces that address supervision, regulatory reporting, surveillance, and other common regulatory activities.

Safety and soundness bank-examination guidance covers a broad range of issues, but it focuses primarily on providing examiners with the guidance and procedures necessary to assess capital adequacy, asset quality, management and board oversight, earnings, liquidity, and sensitivity to market risk. Examiners use this guidance to assign a supervisory CAMELS rating

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[2] The Board's supervision manuals are available at www.federalreserve.gov/boarddocs/supmanual.
[3] Active supervision and regulation letters are available on the Board's website at www.federalreserve.gov/boarddocs/srletters.

at on-site examinations, which are required at least once every 18 months.[4] The examination guidance outlines procedures for conducting a thorough review of a bank's loan and investment portfolio, a comprehensive assessment of funds-management practices, an evaluation of the quality and level of capital, the adequacy of internal controls, and the accuracy of regulatory reporting. In addition, examiners are directed to review various bank policies, board of directors' activities, and compliance with laws and regulations.

Guidance governing inspections of bank holding companies addresses issues similar to those highlighted for bank examinations, but also focuses on specific issues related to the parent company and its nonbank affiliates. These include the extent to which leverage is used to support bank subsidiary activities, intercompany transactions and their impact on bank subsidiaries, nonbank activities and their effect on the consolidated financial condition of the organization, and the parent company's ability to serve as a source of strength to its insured depository institutions.

The Federal Reserve has a broad range of enforcement powers over financial institutions and the individuals associated with them. Formal actions, which are used to address significant issues, are governed by statute and administered from the Board in consultation with the Reserve Banks. These include written agreements and cease-and-desist orders. Informal actions, which are used to address less severe issues, are administered by the Reserve Banks and include board resolutions and memorandums of understanding.

Bank Performance in the Current Financial Market

In recent quarters, earnings for community banks have improved notably, and asset quality has largely stabilized and begun to improve. However, earnings remain quite weak by

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[4] To assess the bank's performance and summarize its overall condition, examiners use the Uniform Financial Institutions Rating System (UFIRS), which is commonly referred to as the CAMELS rating system. The acronym CAMELS is derived from six key areas of examination focus: Capital Adequacy, Asset Quality, Management and board oversight, Earning, Liquidity, and Sensitivity to market risk.

historical standards, and high levels of problem loans and charge-offs continue to strain bank resources. Revenue growth has also been held back, as loan balances at community banks have declined for 11 consecutive quarters.

Most of the asset quality and earnings problems in community banks stem from relatively high concentrations in construction and other commercial real estate loans that were built up during the real estate boom that started in the early part of the last decade. As real estate markets began weakening in 2007, cash flows supporting commercial real estate loans fell, and banks experienced a significant increase in weak and impaired assets. Community banks in all regions of the country have experienced problems stemming from the weakened real estate market, but those operating in regions that experienced the greatest run-ups in real estate prices--the Southeast, Southwest, and West Coast--have been most significantly affected.

Consistent with this, of the 388 failures of insured banks and thrifts since early 2007, 140--or nearly 40 percent--occurred in the Southeastern states, with many failures here in Georgia. A significant number of Georgia banks that failed held large concentrations of loans related to land acquisition, development, and construction--many tied to the region's housing boom in the years leading up to the economic downturn. When real estate markets softened, the level of problem loans increased rapidly for these banks and ultimately overwhelmed their available capital.

The commercial banks that continue to operate in the Georgia market generally have an elevated level of non-current real estate loans, which in turn have reduced earnings and strained capital levels. Through the second quarter of 2011, 41 percent of Georgia's insured commercial banks were unprofitable. Though an improvement over last year, this contrasts significantly with results for the nation as a whole, where only 15 percent were unprofitable. Similarly, the aggregate Return on Assets for Georgia's banks was 0.07 percent, well below the 0.87 percent nationally.

Achieving Consistency in the Supervisory Process

There has been much discussion recently about whether examiners are unnecessarily restricting the activities of community banks. The Federal Reserve takes seriously its responsibility to address these concerns, and working with the other agencies, the Board has issued several pieces of examination guidance over the past years to stress the importance of taking a balanced approach to supervision. More recently, examples of such guidance include the November 12, 2008, "Interagency Statement on Meeting the Needs of Creditworthy Borrowers,"[5] and an October 30, 2009, interagency statement designed to encourage prudent workouts of commercial real estate loans and to facilitate a balanced approach by field staff to evaluating commercial real estate credits.[6] On February 5, 2010, the Federal Reserve and other regulatory agencies issued a joint statement on lending to creditworthy small businesses.[7] The Federal Reserve has complemented these statements with training programs for examiners and outreach to the banking industry to underscore the importance of sound lending practices. In addition, the Federal Reserve continues to strongly reinforce the importance of these interagency statements with its examiners and has taken several steps to evaluate compliance with the guidance as part of its regular monitoring of the examination process.

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[5] Board of Governors of the Federal Reserve System (2008), "Interagency Statement on Meeting the Needs of Creditworthy Borrowers," press release, November 12, www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm.

[6] Board of Governors of the Federal Reserve System (2009), "Federal Reserve Adopts a Policy Statement Supporting Prudent Commercial Real Estate (CRE) Loan Workouts," press release, October 30, www.federalreserve.gov/newsevents/press/bcreg/20091030a.htm.

[7] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and Conference of State Bank Supervisors (2010), "Regulators Issue Statement on Lending to Creditworthy Small Businesses," joint press release, February 5, www.federalreserve.gov/newsevents/press/bcreg/20100205a.htm.

First, all examination findings must go through a thorough review process before being finalized. Local management teams vet the examination findings at the district Reserve Banks to ensure that common issues are addressed consistently, findings are fully supported, and supervisory determinations conform with Federal Reserve policies. If these vetting sessions identify policy issues requiring clarification, Reserve Banks contact the Board staff in Washington for guidance. Vettings for complex or problem banks often include participation from Board staff.

In addition, Board analysts assigned to monitor community bank supervision activities in the districts sample recently completed examination reports to assess compliance with policies. Potential deviations from policy requirements that are identified through this process are discussed with the Reserve Banks and corrected as needed. Board analysts also review quarterly off-site financial surveillance reports with the Reserve Banks to ensure identified issues are consistently and promptly addressed.

Board staff also conduct periodic reviews of specific examination activities. For example, recently we undertook a focused review of commercial real estate loan-classification practices in the districts. We initiated this review to assess whether Federal Reserve examiners were implementing the interagency policy statement on commercial real estate loan workouts as intended. As part of this effort, we reviewed documentation for more than 300 commercial real estate loans with identified weaknesses in six Federal Reserve districts. Based on this review, we concluded that Federal Reserve examiners were appropriately implementing the guidance and were consistently taking a balanced approach in determining loan classifications. We further noted that the documentation indicated that examiners were carefully considering the full range of information provided by bankers when evaluating these loans. In this regard, workpapers often indicated that examiners were taking into account mitigating factors noted by bankers, where appropriate, in determining the regulatory treatment for the loans.

Overall, our monitoring efforts to date suggest that Federal Reserve examiners are following established guidance in evaluating supervised institutions. However, if any banking organizations are concerned about supervisory actions that they believe are inappropriate, we continue to encourage them to contact Reserve Bank or Federal Reserve Board supervisory staff to discuss their concerns. Any specific instances of possible undue regulatory constraints are evaluated by both Reserve Bank and Board staff. In addition, the Board maintains an Ombudsman, independent of the supervisory process, who handles any such concerns on a confidential basis.[8]

Conclusion

We at the Federal Reserve are acutely aware of the need for a strong and stable community banking industry that can make credit available to creditworthy borrowers across the country. We want banks to deploy capital and liquidity, but in a responsible way that avoids past mistakes and does not create new ones. The Federal Reserve is committed to working to promote the concurrent goals of fostering credit availability and maintaining a safe and sound banking system. Through our ongoing communication with Reserve Banks and bankers, the Federal Reserve will continue to strive to ensure our guidance is applied in a fair, balanced, and consistent manner across all institutions. I would be pleased to take your questions.

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[8] For more information and for contact information for the Ombudsman, see www.federalreserve.gov/aboutthefed/ombudsman.htm.

Committee Chairman Bachus, Sub-Committee Chairman Capito, Representative Westmoreland, and other committee members welcome to my congressional district and thank you for affording me the opportunity to provide my comments during these times which have been so detrimental to our communities.

First National Bank of Griffin is a 78 year old community bank, chartered in Griffin, Georgia in 1933, literally rising from the ashes of the 1929 financial collapse to serve the citizens and merchants of our community.

For all of these 78 years, service to, and access to credit for, our citizens and merchants have been our principal tenets of business.

Being located less than 50 miles from downtown Atlanta, our community has served as a longtime bedroom community for those commuting daily into Atlanta for work. As such, as the metro Atlanta economy prospered in the 1990's and early 2000's the demand for housing in our banking markets blossomed. Being a community bank we responded to this by providing both construction and development financing to many of the builders and developers. We provided responsible conventional long-term mortgage financing to many of the homebuyers through our longstanding, direct-delegated, authority through Freddie Mac. We did not knowingly participate in the sub-prime game of hybrid loan structures and perilously relaxed mortgage underwriting standards, and we often questioned the soundness and appropriateness of those activities. What we failed to anticipate in our risk management practices at that time, was the degree to which this sub-prime activity was propping up the unprecedented demand for new housing our market was experiencing. We also failed to understand the degree to which misrepresentation and manipulation were masking huge fundamental flaws in the mortgage securitization market.

We monitored our concentration risks in the areas of residential construction and development, comparing our levels against the regulatory guidelines, and against the levels of our market peers. Due to our seven decades of retained earnings and careful and prudent past dividend policies, our higher than peer capital levels helped mitigate our risks, and our concentrations in these loans as a percentage of capital generally came in at the lower end of our market peers, which was not substantially out of line with regulatory guidance. Regardless of these circumstances, no amount of forward analysis or stress testing anticipated the depth and length of the real estate housing collapse we were all about to face in the closing months of 2007.

We were early to recognize our problems, mainly due to the fact that we had used loan structures which were more stringent than many of our peers. We commonly required hard equity and monthly payment of interest on our construction lines. In addition it was the exception where we permitted borrowers to draw from a loan funded interest reserve to carry their development loans. Because of these practices, in many cases we knew our problems the first time a monthly payment was missed, as opposed to not discovering the depth of a problem until loan maturity. In spite of these efforts, the pace and magnitude of the residential collapse quickly overwhelmed our early warning devices.

We are a core-funded, community bank. As we entered the recessionary cycle we enjoyed the number one deposit market share position in our home market and had no wholesale or brokered deposit funding on our balance sheet. In spite of the significant credit stresses we have endured over the past four years, we continue to demonstrate an underlying core earnings stream. In other words, once the cloak of this real estate collapse is finally lifted, our bank can not only survive, but prosper for another 78 years.

I recognize that the title of this hearing is "Potential Mixed Messages…"; my frustration is not so much one of mixed messages, but one of changing messages. As this cycle began, we sensed a reaction from our regulator of supportive cooperation. They knew our bank. Many of the field examiners had been in our bank through multiple exam cycles for as long as 25 years. The general message coming from examiner comments in 2008 was one of acknowledging that the same core fundamentals which had sustained our bank for decades were still evident, but that we had become victims of an unprecedented real estate market collapse. The beginnings of the shifting message became evident when we received our written Reports of Examination, and many times the narrative seemed more harsh than the discussions. Unfortunately, it is the written narrative which becomes the written record, and the document by which we will all be judged in history. Did we have a role setting ourselves up to become victims? No doubt. But did we recklessly pursue growth and earnings at all cost with no regard to the other elements of our mission? Never!

Fast forward to subsequent examination cycles and we have found the field examiners less willing to disclose conclusions and very guarded in acknowledging progress in those areas where we may have been performing well. These are many times the same examiners we have worked with for years. We understand that it is not a personal affront; it is simply this environment of second guessing and weariness in which we are all operating. But as the field examiners have become less comfortable in making casual assessments of progress, or acknowledgement of bright spots within our banks, such as our extreme customer loyalty and core funding, the written Reports of Examination have taken on a clear pattern of excessive criticism and legal edification. So much so that one can find nearly contradictory statements within the same paragraph or section of a current report. We understand our shortcomings, and you can rest assured that we are working diligently to improve our banks in the areas we can control and influence. But, the inflammatory and demoralizing tone found in many of the examination reports only tend to send us clamoring for cover. We are trying to improve our banks and preserve our chances of survival, not because of heightened rhetoric or threat of repercussion, but because for most of us, our banks are a substantial part of our personal being. We are the ones leading our community's economic development activities and trying to attract jobs for our citizens. We carry the daily weight of knowing the importance of a pay check to the roughly 100 people we employ. This is bigger than pride, deflection of responsibility, or self-preservation.

I have observed some of the testimony of the regulators and the academic experts in earlier hearings on the subject of regulatory practices or behavior. A recurring theme seemed to be the position that forbearance in regulation is inappropriate and would only lead to greater potential losses to the fund. I would argue that forbearance is a necessary and logical part of any healing process. And that is exactly what is taking place in our banks; we are attempting to heal our banks, our local economies, and where salvageable, our borrowers. That is why I support the flexibility being offered in some of the proposed legislation such as smoothing out the effects of loan and asset impairments resulting from declining real estate values. The current methods of write down being employed today have the potential to wipe out all of the capital in our banks with no chance of living to see the eventual real estate market recovery. Unfortunately, by that point, our community will have been stripped of a valued commodity. My bank, and it's resources will have been extinguished, and the beneficiary will be a faceless, opportunist, investor, with no ties to my community.

The changing regulatory landscape has already led pundits to begin to opine that community banks of less than $500 million to $1 billion in assets are doomed to disappear from our landscape. Without some relief from the effect of downward spiraling real estate evaluations this fate could be sooner than later.

In spite of its imperfections and the public's general distaste for it, I was an early proponent of the TARP program and continued to be so, even after learning that our bank would likely not be allowed to participate, and as the public's distaste for it grew. I could elaborate on where I feel many of the shortcomings were in the evaluation process for who would be eligible, but that is water under the bridge. What I can say is it has created two classes of banks, those that can afford to and are motivated to dump problem assets at substantial discounts, and those of us who must cling to our precious remaining capital like a shipwreck survivor clinging to debris. Add to that mix a publicly traded institution who was able to leverage up its TARP "seal of approval" and access the public markets, and you have a bank which can now really flush some problems. And, to throw another wrinkle into the game, add a bank which has TARP and the good fortune to acquire assets through an FDIC-assisted transaction with loss-share, and they are now super-motivated to clear the system.

I hope that one thing that can come out of the studies being proposed in our congressman's legislation, H.R. 2056 that recently passed the House, is a forensic analysis of the bank failures in my area to determine how many would still be with us today, but for having received their proportionate share of TARP.

Theoretically, had we received the TARP funding which the funding formula indicated we were eligible, our June 30, 2011 Leverage Ratio would have still been at a respectable 8.25%, while our Total Risk Based Capital ratio would have been approximately 15%.

With the above capital ratios that TARP could have theoretically helped support, I am sure that it would have been much easier for my bank to attract additional shareholder investment to bring us into compliance with the regulatory order my bank entered into with the Comptroller of the Currency almost two years ago. The capital cushion would have added badly needed flexibility as we consider loan requests from qualified borrowers. We would find ourselves in a position to be able to operate our bank for the benefit of our community, employees, and the broader economy, as opposed to the regulatory paralysis we suffer from today.

Cycles eventually come to an end. We have endured this one for four years. We realize that much of what has been done cannot be changed or the effects reversed. What we kindly ask is that through forbearance and flexibility our regulators give us time and support us in trying to lead our communities to recovery.

Thank you for your time today and your interest in our communities.

STATEMENT OF

THE FEDERAL DEPOSIT INSURANCE CORPORATION

on

**POTENTIAL MIXED MESSAGES:
IS GUIDANCE FROM WASHINGTON BEING
IMPLEMENTED BY FEDERAL BANK EXAMINERS?**

before the

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
HOUSE OF REPRESENTATIVES**

**August 16, 2011
Newnan, Georgia**

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, we appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) about banking conditions across the nation and specifically in Georgia, actions taken to ensure fair and consistent bank examinations, and guidance issued to encourage banks to originate and, when appropriate, restructure loans. In addition, our testimony discusses the FDIC's role as receiver for insured depository institutions that fail and the shared-loss agreements that are used to handle some loans resulting from failed institutions.

The Challenging Environment for FDIC-Insured Institutions

As the Subcommittee has discussed in previous oversight hearings, the collapse of the U.S. housing market in 2007 led to a financial crisis and economic recession that has adversely affected banks and their borrowers in Georgia and nationwide. Georgia's economy was hit especially hard following years of strong economic growth characterized by rising real estate prices, abundant credit availability, and robust job creation. The pace of economic recovery has been slow. In addition, heavy loan losses have weakened some banks' capacity to lend.

Financial institutions, whose performance is closely linked to economic and real estate market conditions, have been significantly affected by a rise in the number of borrowers who are unable to make payments. This has led to elevated numbers of unprofitable and "problem" financial institutions. As of March 31, 2011, there were 888 FDIC-insured institutions nationwide on the FDIC's problem bank list, representing approximately 12 percent of all FDIC-insured institutions. This is the highest volume of problem institutions in nearly 20 years.

The economic downturn has also resulted in a significant increase in bank failures. Nationally, there have been 386 bank failures since the beginning of 2008, 326 of which have been community banks – those with total assets less than $1 billion. While still high, the current pace of failures is slowing. There have been 64 failures so far in 2011 through August 12th compared to 110 failures at this same point in 2010. In Georgia, there have been 67 bank failures since the beginning of 2008 through today, the highest number of any state. Thus far in 2011, 16 banks in Georgia have failed, compared to a total of 21 failures in 2010 and 25 in 2009. The FDIC is keenly aware of the significant hardship of bank failures on communities in Georgia and across the country. The FDIC's supervisory goal is to avoid bank failures whenever possible by initiating timely corrective measures. As a result, most problem banks do not fail and can continue to serve their communities. In fact, most banks across the country are in sound condition, well capitalized and profitable.

One factor contributing to Georgia's bank failures was the sharp deterioration in the residential real estate market which weakened the state's banks, particularly in the Atlanta metropolitan area. Bank failures in Georgia rose sharply in 2009 when real estate values declined, the supply of housing increased, and unemployment rose to 10.4 percent. At the time, banks were contending with rapid increases in loan delinquencies, defaults, and resultant losses. A common characteristic of Georgia banks that failed was significant volumes of construction and development (C&D) and commercial real estate (CRE) loans, sometimes supported by non-core funding sources as opposed to local deposits. Georgia's insured institutions had the nation's highest median concentration of C&D loans to total capital at year-end 2007 -- 170 percent -- not long after home prices peaked.

Georgia's economic, real estate, and banking conditions remain challenging. The state's unemployment was high at 9.9 percent in June 2011 (compared to 9.1 percent nationally in July) with some sectors, such as construction, continuing to lose jobs. Historically, Georgia has experienced a strong net population migration into the state that powered the local economy and especially the housing market. Net migration into Georgia averaged almost 74,000 per year between 2000 and 2010, with a peak of almost 144,000 in 2006. But net migration into Georgia declined to under 3,000 in 2010.[1] Since peaking in April 2007, home prices in Atlanta fell by almost 24 percent through May 2011. However, prices may be approaching a bottom. Since May 2010, prices have declined by almost 5 percent, and since April 2011, prices have declined only 0.2 percent.[2] In Atlanta, housing starts are off by over 80 percent since the peak in 2006,[3] yet data suggest that the Atlanta region still has a large inventory of available housing. According to the U.S. Census Bureau, from 2000 to 2010 the supply of new housing units outpaced demand by 50 percent in the four largest metro Atlanta counties (Fulton, Gwinnett, DeKalb and Cobb). In those four counties, more than 143,000 houses, condos, apartments and other units were vacant in 2010.[4] More than 300 suburban neighborhoods throughout metro Atlanta have a concentration of vacant housing that exceeds 10 percent - a level that raises red flags. A commonly accepted benchmark, in a

[1] Census Bureau; Moody's Analytics
[2] S&P / Case-Shiller Home Price Index.
[3] Census Bureau; Moody's Analytics
[4] "Economy Creates 'a renter's nation'," Derek Kravitz, Associated Press, June 1, 2011

healthy neighborhood, is no more than 5 percent or 6 percent of properties vacant at any given time.[5]

This economic backdrop has resulted in a weakened aggregate financial profile for Georgia's banks, which have lost money for 10 consecutive quarters. As of March 31, 2011, 38 percent of Georgia banks were unprofitable, compared to 15 percent nationally. Georgia's banks also reported a noncurrent loan ratio[6] of 5.19 percent in March 2011, up from 4.10 percent at year-end 2009. Deterioration has been most severe among C&D loans, as the percentage of noncurrent C&D loans has exceeded 20 percent for the past two years. These and other conditions will likely cause the number of problem institutions in Georgia, and in other states with similar economic conditions, to remain elevated for some time. Importantly, most troubled banks remediate their financial weaknesses over time and regain their ability to provide essential financial services, including making loans to creditworthy borrowers.

The Economic Downturn's Negative Effect on Lending

Community banks, which comprise the vast majority of FDIC-supervised banks, play a vital role in credit creation across the country, especially for small businesses. While community banks represent only 11 percent of industry assets, they provide a significant 38 percent of the industry's small loans to businesses and farms.[7] However, the lingering effects of the economic recession have resulted in reduced demand for new loans. Recent surveys, such as the Federal Reserve *Senior Loan Officers' Opinion*

[5] "Surge in Vacant Houses Sweeps Neighborhoods," Craig Schneider and Victoria Loe Hicks, *Atlanta Journal-Constitution*, March 30, 2011.
[6] The noncurrent loan ratio is the total of nonaccrual loans plus loans more than 90 days past due, divided by total loans.
[7] Small loans to businesses and farms are (1) commercial and industrial loans of less than $1 million; (2) loans of less than $1 million secured by nonfarm, nonresidential real estate; (3) agricultural production loans of less than $500,000; and (4) loans of less than $500,000 secured by farmland.

Survey and the National Federation of Independent Businesses *Survey on Small Business Economic Trends*, indicate that demand for new loans from creditworthy borrowers remains sluggish. These findings are consistent with recent anecdotal information that our bank examiners have gathered. Bankers have identified three primary obstacles that they face in making loans: lack of demand from creditworthy borrowers, market competition, and the slow economy.

In response to the real estate and economic downturn, the FDIC has adopted policies that can help community banks and their customers. We have joined several interagency efforts that encourage banks to originate and restructure loans to creditworthy borrowers. For example, the federal bank regulatory agencies issued the *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* on November 12, 2008, which encourages banks to prudently make loans available in their markets. On October 30, 2009, the FDIC joined in issuing the interagency *Policy Statement on Prudent Commercial Real Estate Workouts*, which encourages banks to restructure loans for commercial real estate mortgage customers experiencing difficulties in making payments. This guidance reinforces long-standing supervisory principles in a manner which recognizes that pragmatic actions by lenders and small business borrowers are necessary to weather this difficult economic period. The banking agencies also issued the *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* on February 12, 2010, which encourages prudent small business lending and emphasizes that examiners apply a reasonable approach in evaluating loans. The clarification provided by these interagency statements has helped community banks become more comfortable extending and restructuring soundly underwritten loans. In turn, we expect that borrowers will benefit from more flexible credit structures that banks may offer.

The FDIC also broadened its dialogue with the small business community by sponsoring a Small Business Forum earlier this year. The Forum focused on economic and credit conditions facing small businesses, and included a discussion from participating government and business leaders on possible solutions for overcoming any obstacles to credit availability. As a part of this Forum, the FDIC invited small businesses to provide the Corporation with feedback on their current business challenges, credit needs, and relationships with financial institutions. The FDIC will continue its strong support of prudent small business lending to fulfill the financial needs of creditworthy entrepreneurs.

The FDIC's Supervisory Approach

The FDIC serves as primary federal regulator for state-chartered institutions that are not members of the Federal Reserve System. The FDIC supervises 4,664 of our nation's 7,574 insured institutions, representing 62 percent of all institutions. Of the 261 insured institutions in Georgia, the FDIC serves as primary federal regulator for 211 or 81 percent of institutions. In Georgia we have field offices in Atlanta, Albany, and Savannah in addition to our Atlanta Regional Office. Our examiners, who are familiar with the community banks and local conditions in their areas, are knowledgeable about the economic challenges confronting banks and their customers. In fulfilling our supervisory responsibilities, the FDIC works closely with the Georgia Department of Banking and Finance which charters and supervises banks in this state.

The FDIC strives for a balanced approach to supervision that relies significantly on the validation of banks' own risk management processes and adherence to generally accepted accounting principles. Banks have flexibility, within prudential safety and soundness standards, to manage their loan portfolios and individual credit relationships. During each on-site examination, FDIC examiners engage in a fact-based, objective review of an institution's financial risk, the quality of its loan portfolio, and conformance with banking regulations. In analyzing the quality of a loan, our examiners focus on the borrower's cash flow and capacity to repay the loan according to its terms. If the borrower cannot pay as promised, we consider any secondary sources of repayment to support the loan, such as pledged collateral or personal/corporate guarantees. Importantly, our examiners do not focus on the price of properties from distressed sales. Instead, we evaluate the borrower's cash flow, financial position, and overall ability to repay the debt.

Real estate downturns, such as the current situation, result in an increase in problem loans and related losses when borrowers are unable to make contractual payments. Such conditions necessitate close oversight by bank management to monitor credit performance, manage loan workouts, apply effective loan grading and review processes, and ensure accurate accounting for problem loans. Loans that present a heightened risk of non-payment are usually identified by the bank itself and receive increased attention from loan officers to mitigate potential loss exposure. During their loan review process, examiners assess the accuracy and reliability of management's internal grading systems and, in the majority of cases, examiners confirm banks' own internal ratings.

Examinations also assess the appropriateness of an institution's allowance for loan and lease losses (ALLL) within the framework of U.S. generally accepted accounting principles (GAAP). At the end of each quarter, financial institutions estimate loan portfolio credit losses so that an appropriate ALLL is maintained and recorded on regulatory Reports of Condition and Income. GAAP requires that the ALLL reflect losses which are probable and estimable; therefore, bank management must determine an appropriate ALLL level that is supported by reasonable assumptions and objective data. When available information confirms that specific individual loans, or portions thereof, are uncollectible, GAAP requires these amounts to be charged off against the ALLL. If the ALLL is found to be insufficient during an FDIC examination, we may recommend that management increase the allowance or improve its ALLL calculation methodology for adhering to GAAP to ensure accurate financial reporting. Replenishment of the ALLL, if necessary, comes from bank earnings.

The FDIC takes great care to ensure national consistency in our examinations. Through our formal examiner training and commissioning process, to internal work product reviews and ongoing communication at every level, we strive to ensure that examiners follow prescribed examination procedures and FDIC policy. As a matter of practice, the FDIC's executive management team responsible for bank supervision maintains an on-going dialogue with examiners to make certain that consistent examination procedures are followed. Before the final Report of Examination is issued to a bank, our regions and our Washington office (in cases involving deteriorating banks), perform a secondary review to ensure consistency with outstanding guidance and accuracy of our assessment of the institution's risk profile.

The FDIC Chairman and members of the Board of Directors also meet with our examiners through personal visits to regional and field offices, as well as regular national teleconferences involving all employees. At the more local level, our Regional Directors meet with their examiners to reinforce FDIC policies and ensure that an even-handed approach to supervision is maintained. The FDIC's examiners are expected to adhere to the FDIC's Manual of Examination Policies, procedural directives, guidance issued to the industry, and prudential bank supervision tenets. The Corporation promptly follows-up on any concerns about deviations from FDIC policy, and we address these matters immediately.

<u>The FDIC's Examination Program is a Transparent, Two-Way Process</u>

At the conclusion of on-site examination work, FDIC examiners always discuss their preliminary findings with bank management and the board of directors. Such communication provides bankers with an opportunity to discuss the FDIC's conclusions and express the bank's viewpoint on findings, recommendations, and the supervisory process in general. The FDIC follows an open, two-way communication process with financial institutions, and we consider banks' comments about our conclusions in the shared interest of accurately assessing the bank's risk profile, understanding its strategic goals, and serving the local community. We conduct more than 2,500 on-site examinations annually, and recognize that questions about and even disagreements with our findings may sometimes arise, especially in difficult economic times. The FDIC has a number of outlets for bankers to express their concerns when this occurs. When banks disagree or are uncomfortable with examination findings, they are advised to discuss such concerns with us.

On March 1, 2011, the FDIC issued Financial Institution Letter-13-2011, *Reminder on FDIC Examination Findings*, which reinforces the Corporation's policy that encourages banks to express any concerns about an FDIC examination or supervisory determination through informal or formal channels. We have found that the most effective method for understanding FDIC supervisory conclusions is to raise concerns with the examiner-in-charge or the appropriate field or regional office. Banks can informally contact FDIC offices by telephone or email, or request a meeting in-person. If an institution is unable to resolve its concerns or believes that our regional office is not carrying out FDIC policies, the institution is encouraged to contact our Washington office. We have set up a dedicated email-box and provided contact names and phone numbers to facilitate this process. Most follow-up discussions are successful in resolving the issue; however, if these informal channels do not resolve concerns, a formal appeals process is available. An institution may also contact the FDIC Ombudsman to facilitate the resolution of problems and complaints in a fair, impartial, and confidential manner. The FDIC strictly prohibits any retaliation or retribution by any examiner or employee against any institution.

We are aware of concerns expressed by some bankers that examinations are being conducted in an overly conservative manner during this challenging economic time. To address these perceptions, we have expanded our outreach at the national, regional, and state level to broaden our communication with both individual banks and trade associations. The FDIC welcomes feedback from the industry and relies on bankers' informed perspective as we consider refinements to our supervisory process. We also use our outreach channels to clarify supervisory expectations and explain our approach to handling emerging risks. A primary outreach resource for the FDIC was the establishment of the FDIC Advisory Committee on Community Banking in 2009. This Committee, which includes a community banker from Georgia, provides us with advice and guidance on a range of policy issues impacting community banks nationally, as well as the local communities they serve. The Advisory Committee has provided valuable input on examination policies and procedures, credit conditions, regulatory compliance matters, and obstacles to the continued growth and ability to extend financial services in their local markets. Our Atlanta Regional Office has also pursued an active dialogue with the banks it supervises and has welcomed all opportunities to meet with institutions to discuss their business plans and any concerns they may have about our supervisory program. The Region's staff regularly participates in and hosts roundtables, meetings with trade associations, and outreach events such as our Directors' Colleges.

Resolution of Failing Banks

Throughout the financial crisis, the FDIC has worked to maintain financial stability and public confidence in the banking system by giving insured depositors of failed banks quick and easy access to their funds. In fulfilling our statutory obligations to depositors and the Deposit Insurance Fund (DIF), we strive to resolve failing banks in the manner that is the least disruptive to depositors, borrowers and communities while minimizing the cost to the DIF. When the Comptroller of the Currency or a state banking regulator closes an FDIC-insured institution, the law requires the FDIC to use the least costly method of resolving the failing institution. The least costly method minimizes the cost of bank failures not only to the DIF but also to the thousands of banks and thrifts that fund the DIF through insurance premiums.

In resolving failing banks consistent with the least cost mandate, the FDIC's goal is to keep as many of the bank's assets and liabilities in the private sector as possible. Hence, we strive to effect a purchase and assumption agreement for the whole bank that includes the acquisition of the performing and non-performing assets at a competitive price, along with the assumption of the deposits and other liabilities. A whole bank agreement minimizes the FDIC's asset disposition costs and is better for the borrowers since it gives them a potential source of new credit from the assuming bank. Whole bank purchase and assumption agreements are entered into after a competitive bidding process among interested and qualified banks.

Unfortunately, we are not always successful at resolving banks in this manner. Often, failing banks with little or no franchise value and poor asset quality do not attract sufficient interest from viable bidders to warrant a sale. In those instances, depositors with insured funds are paid the full amount of their insured deposits. Depositors with uninsured funds and other general creditors of the failed institution are given receivership certificates entitling them to a share of the net proceeds from the sale and liquidation of the failed institution's assets. The FDIC as receiver for the failed bank assumes ownership of all the failed bank assets and must manage, market and sell the assets. Because the FDIC, as manager of failed bank receiverships, is neither a long-term investor nor lender, we generally do not extend additional credit on such assets. The impact of this type of resolution is the most disruptive for borrowers, failed bank employees, and the surrounding community. Additionally, the loans may be sold to private investors outside the banking system, who may have little interest in extending additional credit to troubled borrowers.

Shared-Loss Agreements

During the current financial crisis, the FDIC reintroduced whole bank purchase and assumption agreements with loss share coverage in order to maximize the return to the DIF and effect as many whole bank transactions as possible. The FDIC had initially utilized these arrangements during the banking crisis of the early 1990s. Turmoil in the economy and significant uncertainty about future loan performance and collateral values necessitated utilizing this technique -- especially early in the current crisis -- since potential buyers of these failing banks have been unwilling to take on the credit risk associated with a failed bank's non-performing loan portfolio. The goals of shared-loss arrangements are to allow as many assets as possible to be kept in the private sector with a lending institution and to have the assets managed by the assuming bank through incentives that closely align the interests of the bank with the interests of the FDIC. Under loss share, the FDIC agrees to absorb a significant portion of the losses -- typically 80 percent -- on a specified pool of assets while the assuming bank is liable for the remaining 20 percent. It is important to note that because an assuming bank has significant financial exposure to the losses on assets purchased under this arrangement, it has every incentive to utilize a "least loss" strategy in managing and disposing of these assets.

Shared-loss agreements also soften the effect of bank failures on the local market by keeping more of the failed bank's borrowers in a banking environment. The assuming bank can more easily work with the borrowers to restructure problem credits or to advance additional funding when prudent, helping to avoid a further decline in collateral values in a failed bank's market. And most importantly for the borrowers, the shared-loss agreements require assuming banks to review qualified loans for modification to minimize the incidences of foreclosure.

Without shared-loss agreements to attract potential acquirers of failing banks, the FDIC would have had to take ownership of and liquidate the assets of many of the banks that failed over the last three years. As mentioned earlier, this would have resulted in larger losses on these assets, greater losses to the DIF and more disruption for borrowers and surrounding communities. Almost 70 percent of the bank failures since the beginning of 2008 were resolved through purchase and assumption transactions with shared-loss agreements. As of August 5, 2011, the estimated savings of utilizing whole bank agreements with loss share is approximately \$39.7 billion, compared to liquidation of those institutions. Since the beginning of 2008, there have been 67 banks in Georgia that have failed with total assets of \$31 billion; 41 of the 67 banks were acquired by other Georgia institutions; and, 76 percent were resolved through purchase and assumption transactions with shared-loss agreements.

Prospective bidders for failed institutions have the option to bid with (or without) loss share. We expect the number of failing bank resolution transactions where loss share is included will decrease as the economy recovers and real estate markets stabilize.

Term of Shared-Loss Agreements

There are two primary types of shared-loss agreements, which are based on the underlying covered assets: single family mortgage loan (one to four units) shared-loss agreements and commercial real estate loan shared-loss agreements. Single family shared-loss agreements have a term of ten years. Commercial real estate shared-loss agreements have a term of five years with an additional three years to allow for recoveries on the assets for which a shared-loss claim was paid. The long term nature of the agreements are intended to allow for the assuming bank to work with distressed loans to reach a mutually beneficial modification with the borrowers and also allow time for economic conditions to improve. The expiration of the term of the agreements does not change the underlying incentives for the assuming bank to develop new customer relationships and maximize its return on assets.

Management of Acquired Assets

The assuming bank is required to manage and administer each loan covered under the shared-loss agreement in accordance with prudent business and banking practices and the assuming bank's written internal credit policies and usual practices. In addition, assuming banks must administer and undertake loss mitigation efforts prior to taking any foreclosure action.

Loss mitigation alternatives are encouraged in order to improve borrower affordability, increase the probability of loan performance, preserve communities, and increase the value of the loans - thereby increasing the bank's incentive to hold and service the loans. Because the assuming banks share approximately 20 percent of any losses, they are motivated to pursue loss mitigation alternatives to foreclosure or short sale whenever a modification or restructuring produces a greater expected return than a foreclosure or short sale. For borrowers, modified loans can preserve their investments in their homes and businesses.

Requiring the assuming bank to maximize the return on assets helps support collateral values in the failed bank's market. The evaluation of loss mitigation options ensures that sustainable and affordable loan modifications are available to the failed bank's troubled borrowers. The FDIC believes that mortgage loans that are managed well, and held for a period of time, will perform significantly better with the improvement in the overall economy, resulting in a better return on the loans than foreclosures in the current real estate market.

Commercial Real Estate Loan Restructuring Requirements

Commercial loan restructurings are designed to convert a non-performing loan, or a loan that is on the verge of becoming non-performing, to performing status consistent with the ability of the borrower to repay the debt. Loan restructurings can include an extension of the term of the loan, interest rate reduction, and principal forbearance or forgiveness. The FDIC requires the assuming bank to limit losses on commercial real estate loans. In addition, assuming banks may want to develop and expand business relationships with commercial borrowers in these communities. Restructuring loans at risk can turn these loans into interest earning assets while keeping the protection of loss share coverage during the five-year coverage period. It also provides an opportunity for borrowers to improve their business conditions. Nonetheless, both borrowers and lenders must recognize the near term challenges posed by an over supply of construction and development projects in many communities.

On December 17, 2010, the FDIC issued *Commercial Loss Mitigation Guidance on Commercial Real Estate (CRE) Loans* to assuming banks to encourage disposition strategies other than foreclosure. For commercial loans, the assuming bank is reimbursed for claims based on a loan or portion of a loan that is categorized as a loss under supervisory examination criteria. Therefore, an assuming bank may file a shared-loss claim on a commercial loan restructure as a result of a principal reduction, as well as a result of a foreclosure.

Residential Mortgage Modification Requirements

Single family shared-loss agreements require the assuming bank to implement a loan modification program, such as HAMP or the FDIC Loan Modification Program, to modify loans that improve borrower affordability, increase the probability of performance, and allow borrowers to remain in their homes.

For single family mortgage loans, the assuming bank is required to perform and document a least loss evaluation when assessing the feasibility of modifying a single family mortgage loan. If a qualified borrower accepts the modification offer, the bank can submit a shared-loss claim to the FDIC. The other option for submitting a claim for a residential mortgage loan occurs after all loss mitigation options have been pursued and the real estate owned property is sold after a foreclosure. Depending on the state the property is located in, this process can take 500 days or more. Hence, the bank has every incentive to consider and engage in single family mortgage loan modifications where that alternative is viable.

Monitoring of Shared-Loss Agreements

The FDIC monitors compliance with the shared-loss agreements through quarterly reporting by the assuming bank and performing periodic reviews of the assuming bank's adherence to the agreement terms. If the FDIC determines that the assuming bank has not complied with the terms of the shared-loss agreement, including the requirement to consider loan modifications, the FDIC will delay payment of loss claims until compliance problems are corrected. We can deny payment of a claim all together or cancel a shared-loss agreement, if compliance problems continue.

The periodic reviews of the assuming bank are completed on-site and include verifying the accuracy of monthly and/or quarterly shared-loss claim certificates; ensuring compliance with loss mitigation efforts; testing the assuming bank's policies and procedures to ensure uniform criteria are being applied to both loss share and non-loss share assets; reviewing internal audit reports and the external independent public accountant report ensuring internal controls are in place; and ensuring that adequate accounting, reporting, and record keeping systems are in place. Thus far, we have found that the overwhelming majority of assuming banks are diligent in their efforts to comply with all the terms of the shared-loss agreements.

Conclusion

The pace of economic recovery has been slow, presenting challenges to banks and their borrowers. The FDIC and the other regulators have instituted policies that can help banks and their borrowers navigate this difficult economy. FDIC bank examiners have strong professional skills and judgment, and understand the significant efforts that banks are making to address the complexities of this environment. They are working diligently to implement our balanced approach to bank supervision. The FDIC will continue to work with banks to strengthen their financial position so they can increase lending and contribute to economic growth in Georgia and across the nation.

Throughout the financial crisis, the FDIC has brought stability to the banking system by providing depositors quick access to their funds through timely resolutions of failed banks. The shared-loss agreements that the FDIC has employed during this banking crisis have saved the DIF and the banks that pay FDIC premiums approximately

$39.7 billion. Shared-loss agreements have insured that problem loans from failed banks have remained in the private sector with incentives to engage in loan modifications and the possibility of new sources of credit for troubled borrowers.

We appreciate the opportunity to testify today and will be happy to answer any questions.

Statement by Jim Edwards

CEO of United Bank, Zebulon, Georgia

Before the

Subcommittee on Financial Institutions and Consumer Credit

August 16, 2011

Dear Chairman Bachus, Subcommittee Chairman Capito, Representative Westmoreland, Representative Scott and other members of the Subcommittee,

My name is Jim Edwards and I am Chief Executive Officer of United Bank based in Zebulon, Georgia. I appreciate the opportunity to speak to you today concerning the state of banking in Georgia and our bank's experience working with FDIC loss share agreements.

United Bank's corporate office is located 50 miles south of Atlanta and 40 miles east of Newnan. I joined United Bank in 1993 and became CEO in 2002. I'm proud to say that I represent the third generation of my family to work with United Bank and the banks from which it was created. I am active in both state and national bank trade associations and currently serve as chair-elect of the Georgia Bankers Association and also serve as a member of the American Bankers Association Community Bankers Council.

United Bank traces its roots back to the founding of its predecessor, The Bank of Zebulon, in 1905. Over one hundred years later more than 90 percent of our Company's stock continues to be owned by our employees and directors who live in and care deeply about the local communities we serve. We operate 21 banking offices in 11 contiguous counties ranging from 35 to 65 miles southwest, south and east of Atlanta. Our total assets are just over $1 billion, and we offer traditional banking services along with mortgage, trust and investment products. We are pleased that we have been able to grow our employee base through this economic downturn and now provide jobs and benefits to nearly 400 people and their families.

The economic downturn which Georgia and our entire Nation have endured over the last several years has created the most challenging operating environment for banks that I have ever experienced. United Bank has historically maintained above-average capital levels and worked to make sure that our loan portfolio was well diversified among different types of lending. This conservative philosophy has served our company well during the past century of operation. This same cautious approach encouraged our Board to make the decision to apply for Capital Purchase Program funds (more commonly known as TARP) from the U.S. Treasury in late 2008. After a rigorous application process, we were approved for $14.4 million in funding. Even though we were already well capitalized at the time, the new capital provided an additional buffer in a worsening economy and has allowed us to maintain employment and continue to make loans to qualified borrowers in the communities we serve.

Since accepting this funding in 2009, United Bank has paid over $2.6 million dollars in quarterly interest payments at an approximate rate of 8 percent to the Treasury. Our current plans are to repay this TARP funding in May of 2012, which is the earliest that Treasury will allow us to do so given Treasury required subchapter S banks like United Bank to hold the funds for a minimum of three years.

United Bank has acquired three failed banks from the FDIC during the last three years, purchasing deposits in all transactions, and loans in only two transactions. In the early stages of the recession, the FDIC liquidated failed banks primarily by auctioning the deposits of an institution and retaining the loans for later disposition.

In December of 2008 United Bank purchased the deposits of First Georgia Community Bank in Jackson, Georgia using this "clean bank" type transaction without a loss-share agreement. A group of FDIC contractors stayed on site and managed the failed bank's loan portfolio for over a year, but they were given limited authority to make decisions or offer options in order to work with the customers experiencing financial difficulties. Ultimately the FDIC bundled all of the failed bank's loans into several groups and bulk sold them in an internet-based auction. The winning bidders were mostly located several states away and, therefore, knew very little about the local community. As a result, they had minimal incentive to try any long-term approaches to working with troubled borrowers.

In August of 2009, United Bank entered its first loss-share agreement with the FDIC for the purchase of deposits and loans of First Coweta Bank here in Newnan. In contrast to our earlier acquisition in Jackson, we are fully responsible for managing the loan portfolio. In return, the FDIC reimburses us for essentially 80 percent of the credit losses we experience in the loan portfolio. This reimbursement is effective for the first 5 years for commercial loans and for 10 years for one-to-four family residential loans. The loss-share agreement does not reimburse United Bank for the expenses associated with funding these loans nor does it cover the overhead needed to manage this loan portfolio and remain in compliance with the extensive requirements involved with the loss-share agreement.

In the fall of last year the FDIC informed us that First National Bank in my home town of Barnesville, Georgia soon would fail and asked us to consider submitting a bid. Although we were competitors, this was shocking and sad news. Our employees in Barnesville had always enjoyed a good relationship with First National's employees and we had historically worked together to improve the local community. Our Board ultimately decided not to submit a bid for First National due to the recent growth we had experienced from earlier acquisitions and the continuing negative economy. Shortly after the bid deadline the FDIC contacted us and explained they had received no qualifying bids and that they were preparing to close the doors, terminate the employees and send checks to depositors. They also communicated that some customers might exceed deposit coverage limits so there could be depositor losses. After considering how devastating this would be to one of our most important communities, our management team and Board decided to submit a bid to prevent the bank pay out. I'm pleased to share that we were able to hire a majority of First National's former employees and continue banking services without any disruption to customers in Barnesville.

Through these experiences I've seen the advantages of how a loss-share arrangement works as compared to the FDIC's earlier practice of using outside contractors to manage a failed bank loan portfolio. When a local community bank such as United Bank manages the loan portfolio, it has a strong vested interest in trying to take a long-term approach and work with customers to overcome their financial challenges. The primary reason for this is so that we can make the borrower a life-long bank customer. The secondary reason is that because the bank participates in any future loan loss, we work hard to try to minimize these losses. We have worked hard in Newnan and Barnesville to find solutions for struggling loan customers and have offered loan modifications and forbearance agreements. We've had a number of successes with this approach.

Under our agreement with the FDIC, United Bank is essentially required to manage the loss-share loan portfolio in essentially the same manner as we handle our non-loss-share loan portfolio. The FDIC has encouraged us to work with these customers whenever possible. The FDIC also audits our Bank regularly to make sure that we remain in compliance with all elements of the loss share agreement. This enhanced scrutiny has necessitated United Bank to hire a number of new employees to insure our compliance.

No, there is nothing good about any bank failure. Customers, bankers, businesses and in fact entire communities suffer in a variety of ways. However, as I mentioned, in our experience the current system of utilizing loss-share agreements is preferable to others used earlier in the economic cycle. In general, the resolution process works to keep the transition organized, provides maximum depositor protection, encourages confidence in the safety of deposits at a critical time and minimizes more broad-based market disruption.

Thank you again for the opportunity to share United Bank's experience in working with the FDIC on loss share agreements and I look forward to answering your questions.

<u>Statement of Gary L. Fox, CPA, CFE</u>

<u>Before the</u>

<u>U.S. House Subcommittee in Financial Institutions and Consumer Credit</u>

<u>August 16, 2011</u>

Chairman Capito and members of the committee, thank you for inviting me to participate in your hearing today. My name is Gary Fox and I was in the banking business in Georgia from January, 1981 until April 2011 when our bank was closed by the Georgia Department of Banking and Finance and sold with a loss share agreement to Hamilton State Bank. I started my career as a bank examiner with the State of Georgia and began working at the Bartow County Bank in May, 1983. I am also a Certified Public Accountant and am now in private practice.

I've divided my remarks into three categories. First, How We Got here to give you some historical perspective. Second, What Made It Worse where I'll mention issues such as appraisal policies, market disruptions caused by unprecedented government involvement, and the application of certain regulatory and accounting policies. And third I'll mention some real concerns I have with how loss-share is playing out in the market.

Included with my testimony are sides that I will be referring to that were furnished to me by John Hunt of Smart Numbers which would be a good resource for you going forward.

How we got here

I saw a lot of changes in our industry in 30 years and had the pleasure to meet and know a lot of great community bankers during that time. I have a depth of knowledge about the community banking industry in Georgia that few other people have.

The biggest change that I saw over the years (other than regulatory) was the ease of entry. When I first got into the business it was quite difficult to get a bank charter. In fact, it was quite a chore to even get a branch application approved. At that time you had to convince the chartering authority of convenience and need. Sometime in the mid 1990's that went out the window and it seemed to me the only requirement became whether or not you had enough initial capital to meet the chartering authority's requirement. As a result, we had an overabundance of banks. Many banks relied heavily on brokered deposits since there really wasn't a need for a bank in that particular community in the first place. It was also a reason why so many banks did Out of Market Lending and Participation Lending since there wasn't enough demand in the community they operated. On top of that, in 1996, Georgia passed statewide branching. Previously, Georgia had been a state that only allowed a bank to operate in the county where it was chartered in unless it formed a bank holding company and entered a new market by buying another bank in a whole bank transaction. So as a result many of the banks in markets that were not as robust branched into the metro Atlanta area to take advantage of metro Atlanta's growth. This only compounded the problem. After all, it only takes a couple of folks polluting the pool to ruin the swimming for everyone.

Another thing that got us here was prompt corrective action which was put into law in 1991 as a result of the S&L crisis. While in theory it sounded reasonable to mandate FDIC to take progressively punitive action against a bank as its capital falls towards 2 percent, in this environment it was and is a bank killer. It immediately put you in a death spiral that you could not escape. Capital dried up, liquidity dried up, customers lost confidence, employees left and regulators were no longer allowed to exercise judgment, as they were required to follow a set of draconian guidelines.

And you can't talk about how we got here without mentioning two government programs that have created market disruptions: the Troubled Asset Relief Program (TARP), and the FDIC selling failed banks with a loss-share agreement given to the acquiring bank.

What made it worse?

Most banks in Georgia that have failed have been appraised out of business. To give a specific example of the appraisal problem, in the metro Atlanta area historically the cost of a lot is 20% of the overall cost of a home. That means if you had a new home that cost $200,000 the lot cost would be $40,000. Today the cost of a lot is 5% of the overall cost of a home, meaning that in the same $200,000 home the lot cost is now $10,000. We have gone from a cost norm of 5 to 1 to an abnormal TARP and loss-share induced 20 to 1. This is visually demonstrated by slide 13 which is part of a set of slides I have included in my testimony. There is another slide, slide #20 that shows real estate asset disposals by TARP and loss-share banks. The size of the yellow dot represents the number of lots liquidated and they were all sold at less than $10,000 per lot. Unless you were one of the fortunate ones who received government assistance, you have no chance to avoid significant charges against your capital due to undue influence of government money in the market place. Another example specific to my community was a subdivision where the lots had sold in the $90,000 to $120,000 range in 2007. The loan amount was around $43,000 per lot which at the time seemed to be a safe margin. Most recently those lots were sold for $9,500 apiece by a loss-share bank. That is a decline of 89% at the minimum. This was a fully developed subdivision in a highly desirable area with a first class amenity's package.

Additionally, these types of appraisal-driven declines permeate throughout the local economy. You would think that what it costs to create something would have some relevance to its value, but not in today's world. Under the new appraisal standards many appraisers will tell you that cost is not relevant, all that matters is the market approach and to a lesser extent, the income approach. Therefore, since the market approach is the most heavily favored approach and you have federally funded asset disposals by TARP and loss-share banks we have an incredible disruption in our real estate markets here in metro Atlanta and Georgia in general.

Think about how this affects the general public. Consumers can't refinance their homes to a lower payment because their home won't appraise, municipalities that rely on real estate taxes can no longer fund schools, or police and fire protection, and to make matters worse many bankers are telling me that new appraisals are coming in 40% less than just last year.

In Georgia, until recently building and building-related businesses made up 20% to 25% of our economy. Referring back to the Smart Numbers slides notice slide #15, which shows permits issued since 1996. The norm appears to be 3,500 to 4,000 per year. The current number is around 500, which is a drop of about 86%. In Georgia we have had an industry that represented 20% to 25% of our economy not just slow down, but literally cease to exist.

Another slide that demonstrates the same point is slide #3. Normally, new homes make up about 50% of home sales but most recently they represent less than 10% of the total. This decline is not only a result of lack of inventory from lack of funding, but it is also because of the undue influence of TARP and loss-share money in the real estate market. If you look at slide #8 you will see that the average new home in the first quarter of this year sold for around $225,000 while the average resale was $97,000 primarily due to foreclosures. A lot of the asset devaluation has to do with a regulatory system trying to flush out the system as quickly as possible. As a result, the economy in general is being significantly hindered.

A couple of other accounting-related issues of great importance are Loan Loss Reserves and the Deferred Tax Asset. Historically, banks used the Experience Method (FASB 5) to fund their loss reserve. In May of 1993, an additional loss measure called FASB 114 was put into place, which I will not discuss today. Under the Experience Method banks looked back at their average five year loan losses and set aside an amount that would cover those same losses as if they were going to happen again. In the five year look back some years were better than others and the reserve balanced out. Over the last few years banks have been required to shorten their look back period to anywhere from two quarters to five quarters. This basically has the effect of capturing your worst historical loss periods and having to fund your loss reserve as if it were going to happen again. This has a direct effect on reducing capital since only part of your loss reserve is allowed to be counted toward risk based capital and none of it counts toward tangible equity (which is the ultimate measure under prompt corrective action).

Also of importance is the Deferred Tax Asset. The deferred tax asset is a balance sheet account that is the result of timing differences between financial accounting and tax accounting. A deferred tax asset is a benefit you stand to gain in the future and in our current environment this is primarily a loss carry forward. So if you had a couple of years of net losses, those losses would carry forward to reduce future tax liability when you have net income. Unfortunately regulatory requirements state that you must disallow the amount of your deferred tax asset that you can't demonstrate you can recoup in net income within the upcoming 12 months. When the entire amount becomes disallowed it must be subtracted from tangible equity. In this environment a 12 month look forward for the deferred tax asset should be reconsidered and a longer look forward put in place.

Problems with the loss share

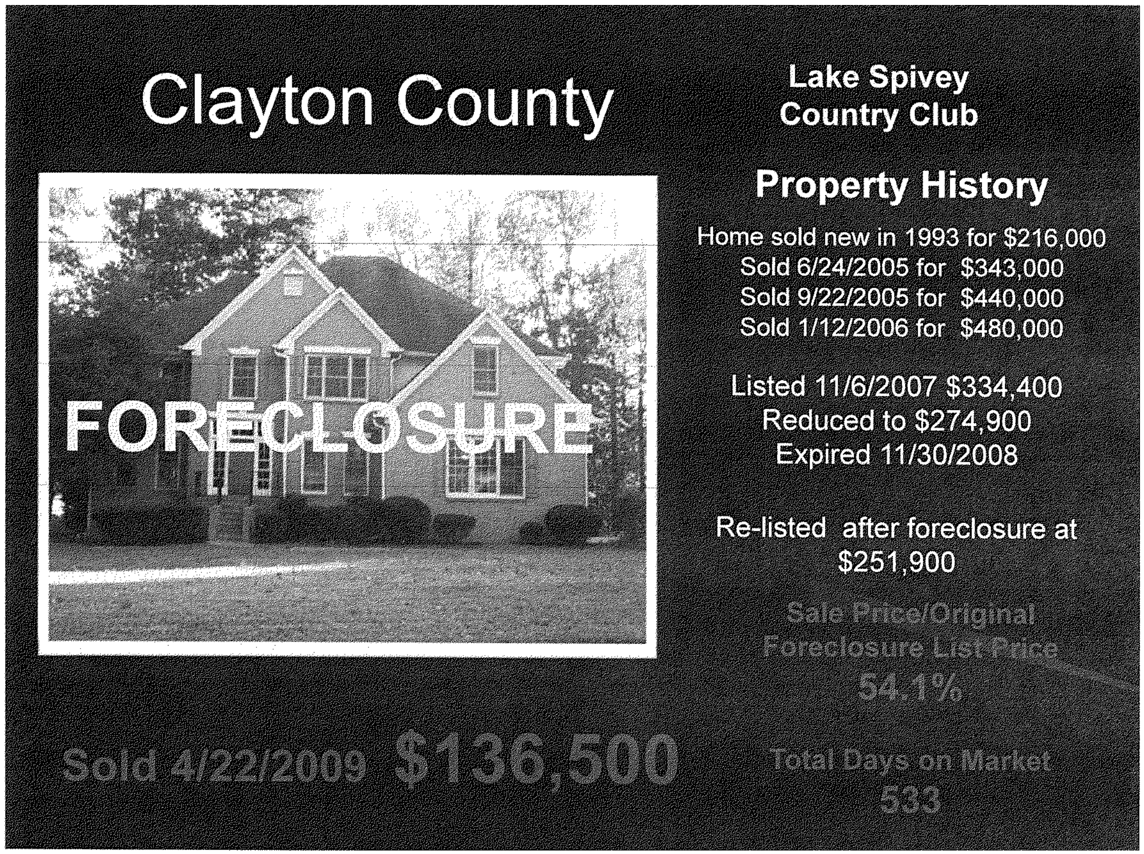
In my home county, Bartow County, there are three loss-share banks. The fact that there are so many loss-share banks in this area has only exacerbated the asset value problem. It is clear to me that loss-share banks stand to make more money by forcing the issue rather than working with the customer. In Georgia, community banks generally do balloon notes on commercial properties. This is done as an interest rate risk management tool. So at the end of 18, 24, or 36 months the entire balance of the loan is due. The commercial loss-share part of the acquiring bank's agreement, 4.15B, is for five years. I fear that as the fifth year anniversary of the loss share agreements comes closer, rather than losing the protection of the loss-share, many of these loss-share banks will pursue judgments and foreclose so as to maximize financial gains regardless of the borrowers' past performance or capacity to pay.

Another loss-share issue is home equity lines of credit. While they generally fall within the provisions of the single family loss-share agreement which is 4.15A (10 year duration), they are specifically separated from the mandatory loss mitigation provisions required for single family loans. Instead, they fall within the other shared-loss loans category which simply requires that the acquiring bank try to mitigate loss consistent with its' own policies. Since this product became popular in the early 2000's and originally had a 15 year maturity (later a 10 year maturity) many will be coming due in the next 4 to 8 years. What could easily happen is the loss-share bank will get an updated appraisal which will probably be valued down and then it will have to mitigate loss consistent with its own policies. Basically this means there will be a whole lot more pressure on an already stressed consumer and since there is no incentive to allow those loans to get outside of the loss share period we could see another round of judgments and foreclosures. As a result I think we will be mired in this real estate mess for quite a long time.

Another problem I see with the loss-share is it does not allow the loss-share bank any judgment in its collection practices. Several months ago one of these loss-share banks in our community filed suit against a borrower. This particular borrower had had a debilitating stroke and would never be able to work again and lost everything. In the prior years the bank would have written the loan off and gone on down the road. I called someone I knew who worked at the loss-share bank and asked, considering the circumstances, why are you suing this person. He simply replied that it is the only way we can collect on the loss-share agreement. I can't imagine that is our government's intent.

In closing, I also want to point out that the regulators I dealt with at all levels were both courteous and professional, and I do not believe they take any joy in closing banks. I also want to point out, particularly during the prompt corrective action process, that I was told many times by the regulators that their hands were tied. They had no choice than follow the requirements of prompt corrective action. Therefore it is clear to me it is not an issue of regulators; it is an issue of regulations. So if this committee truly wants to make a positive change it is going to have to come on a legislative level, not a regulatory level, to deal with these particular issues.

Again, I would like to thank you for inviting me to be a part of this hearing and it is my hope that something positive will come from it.

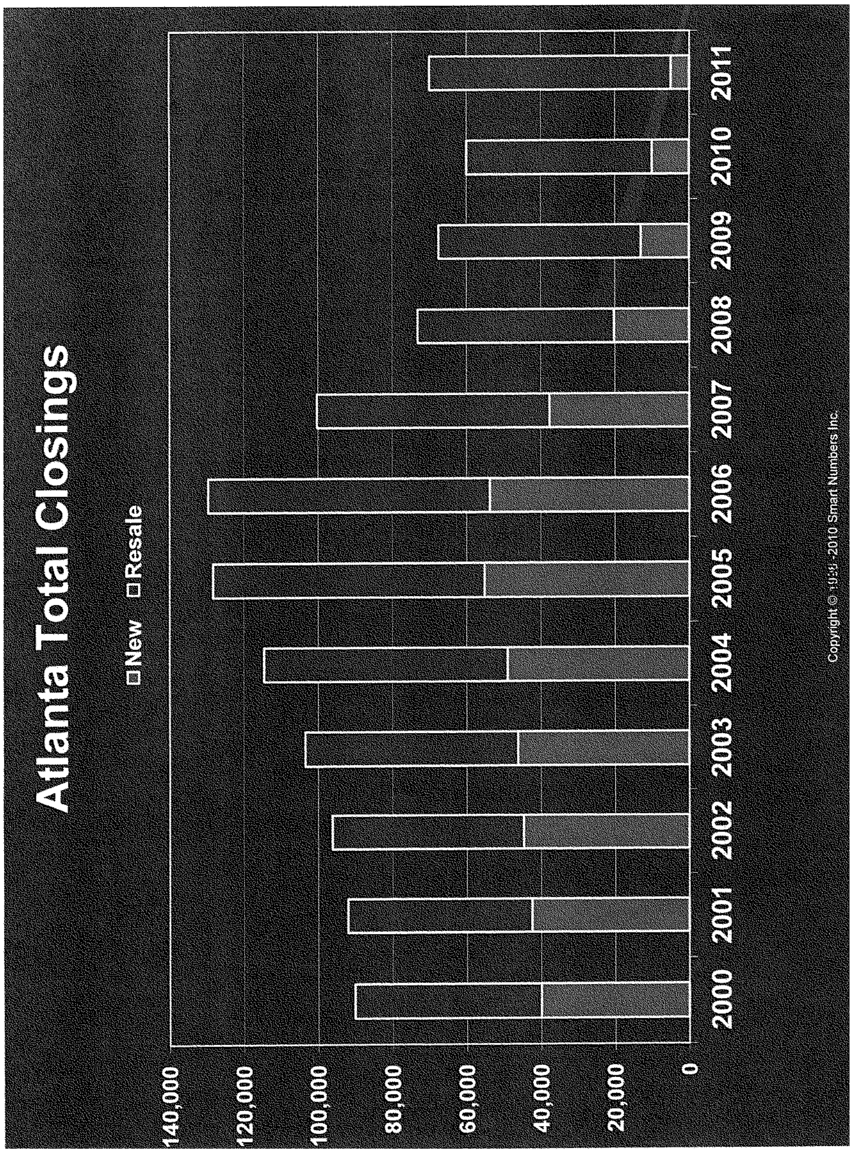

Clayton County
FORECLOSURE
Sold 4/22/2009 $136,500
Lake Spivey
Country Club
Property History
Home sold new in 1993 for $216,000
Sold 6/24/2005 for $343,000
Sold 9/22/2005 for $440,000
Sold 1/12/2006 for $480,000
Listed 11/6/2007 $334,400
Reduced to $274,900
Expired 11/30/2008
Re-listed after foreclosure at
$251,900
Sale Price/Original
Foreclosure List Price
54.1%
Total Days on Market
533

The Reserve at Timberlands (Paulding County)

Lot Prices and Date Sold		
$62,000 8/7/06	$45,000 1/29/07	$45,000 1/29/07
List Date for all 3 Homes 12/12/08		
List Price: $299,900	$349,900	$349,900
Listings Expire 12/11/09		
Homes Re-listed 2/2/10		
List Price: $222,900	$229,900	$239,900
All 3 Homes Sold 6/30/2010		
Sale Price: $80,000	$85,000	$85,000

Total Sale Price / Original List Price = $250,000 / $999,700 = 25%

Lot Ratio = Total Sale Price / Total Lot Price = $250,000 / $152,000 = 1.64


Atlanta Total Closings
New
Resale
140,000
120,000
100,000
80,000
60,000
40,000
20,000
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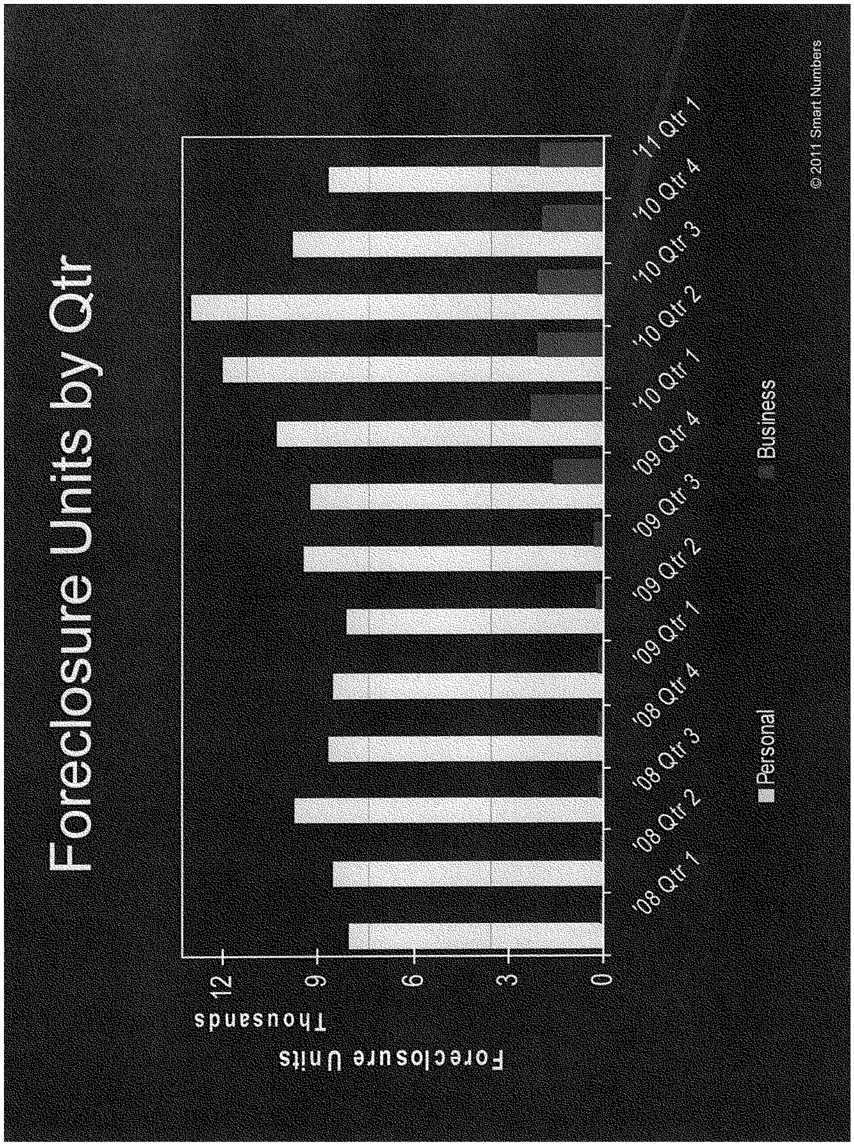
Smart Numbers Inc.


Foreclosure Units by Qtr
Foreclosure Units
Thousands
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3
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Personal
Business
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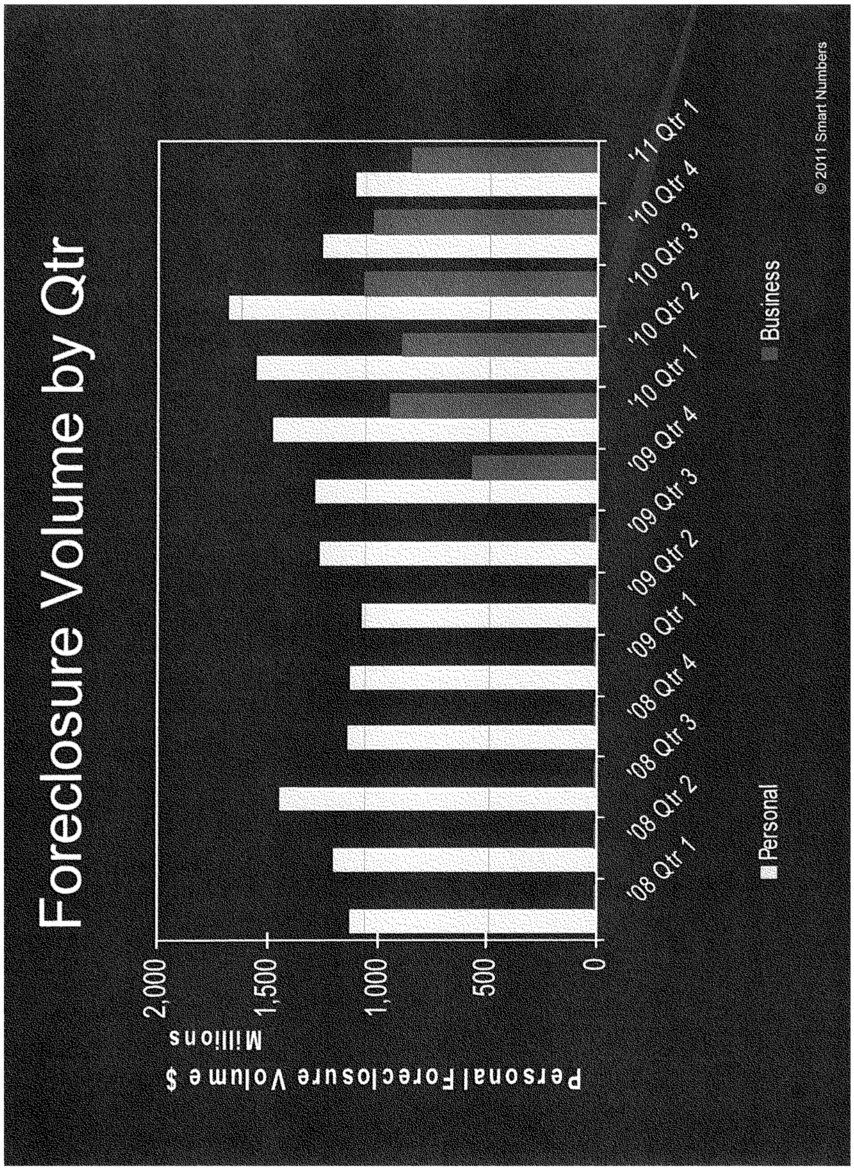
Foreclosure Volume by Qtr
Personal Foreclosure Volume $
Millions
2,000
1,500
1,000
500
0
'08 Qtr 1
'08 Qtr 2
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Personal
Business
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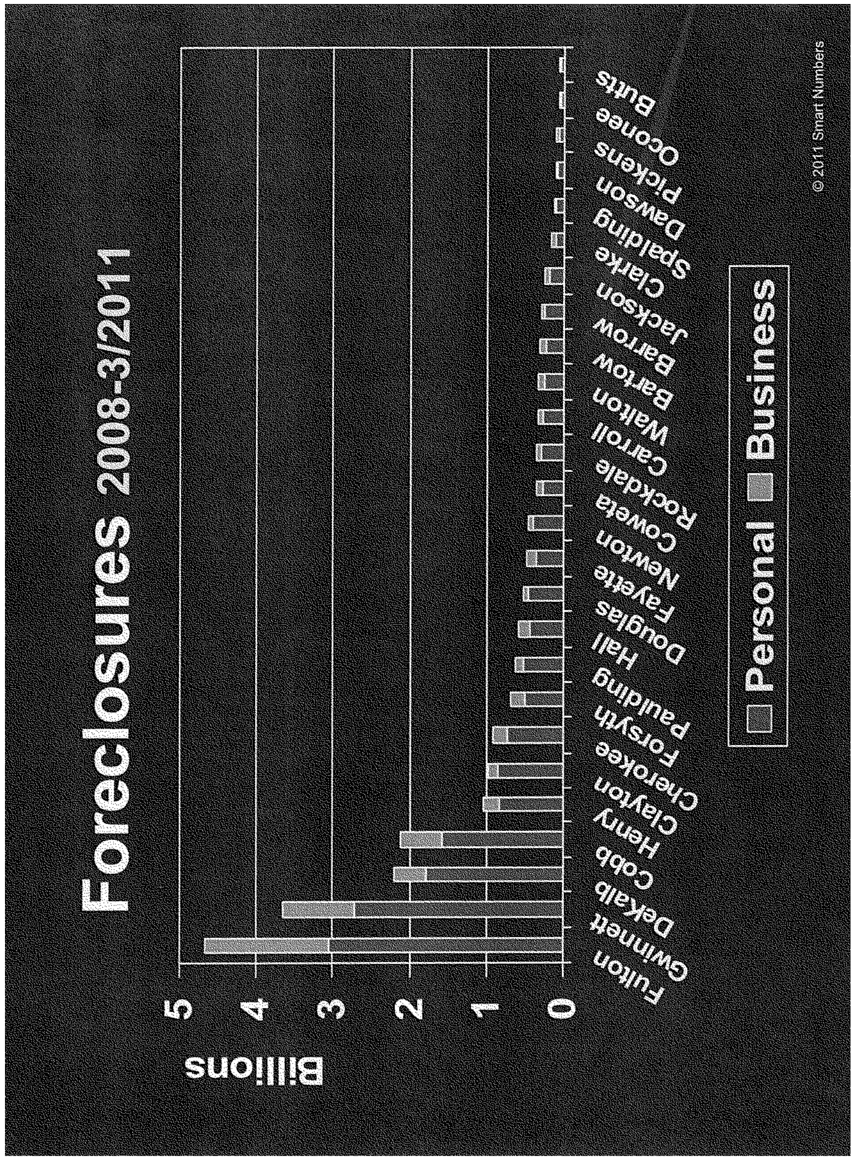
Foreclosures 2008-3/2011
Billions
0
1
2
3
4
5
Fulton
Gwinnett
DeKalb
Cobb
Henry
Clayton
Cherokee
Forsyth
Paulding
Hall
Douglas
Fayette
Newton
Coweta
Rockdale
Carroll
Walton
Bartow
Barrow
Jackson
Clarke
Spalding
Dawson
Pickens
Oconee
Butts
Personal
Business
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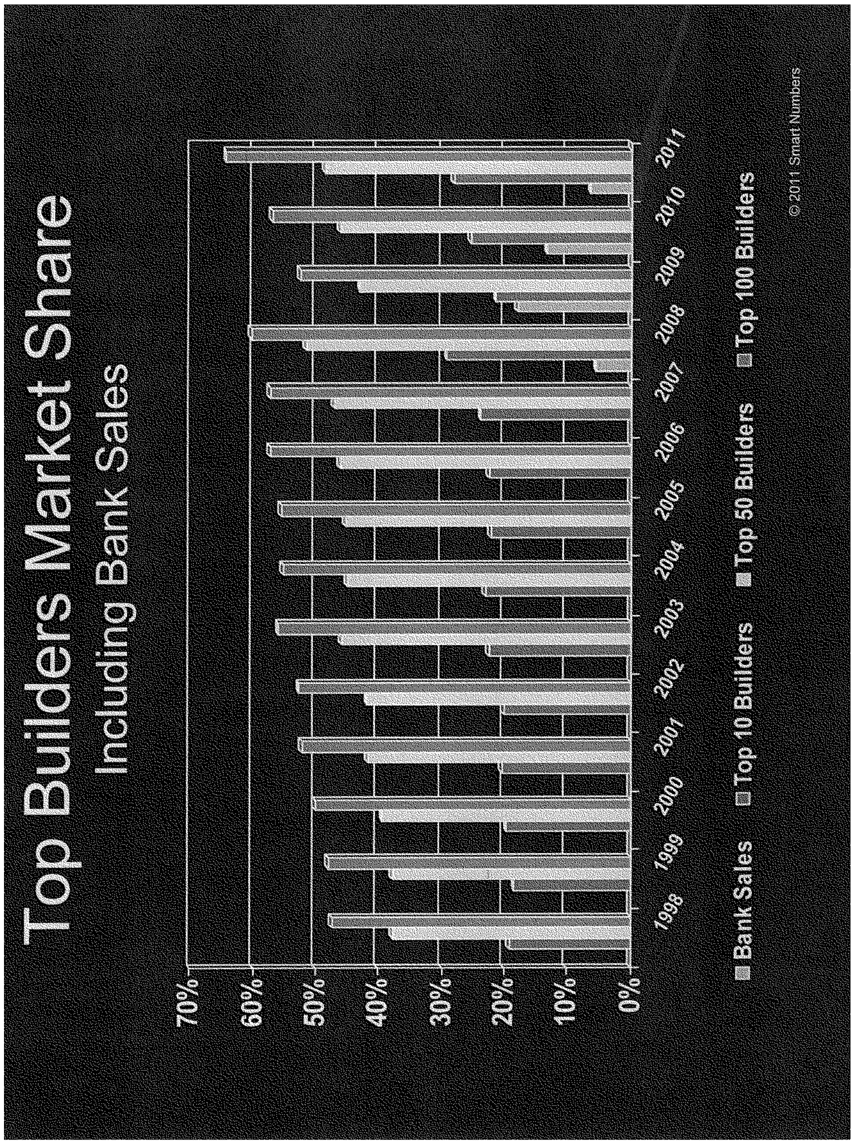
Top Builders Market Share
Including Bank Sales
70%
60%
50%
40%
30%
20%
10%
0%
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Bank Sales
Top 10 Builders
Top 50 Builders
Top 100 Builders
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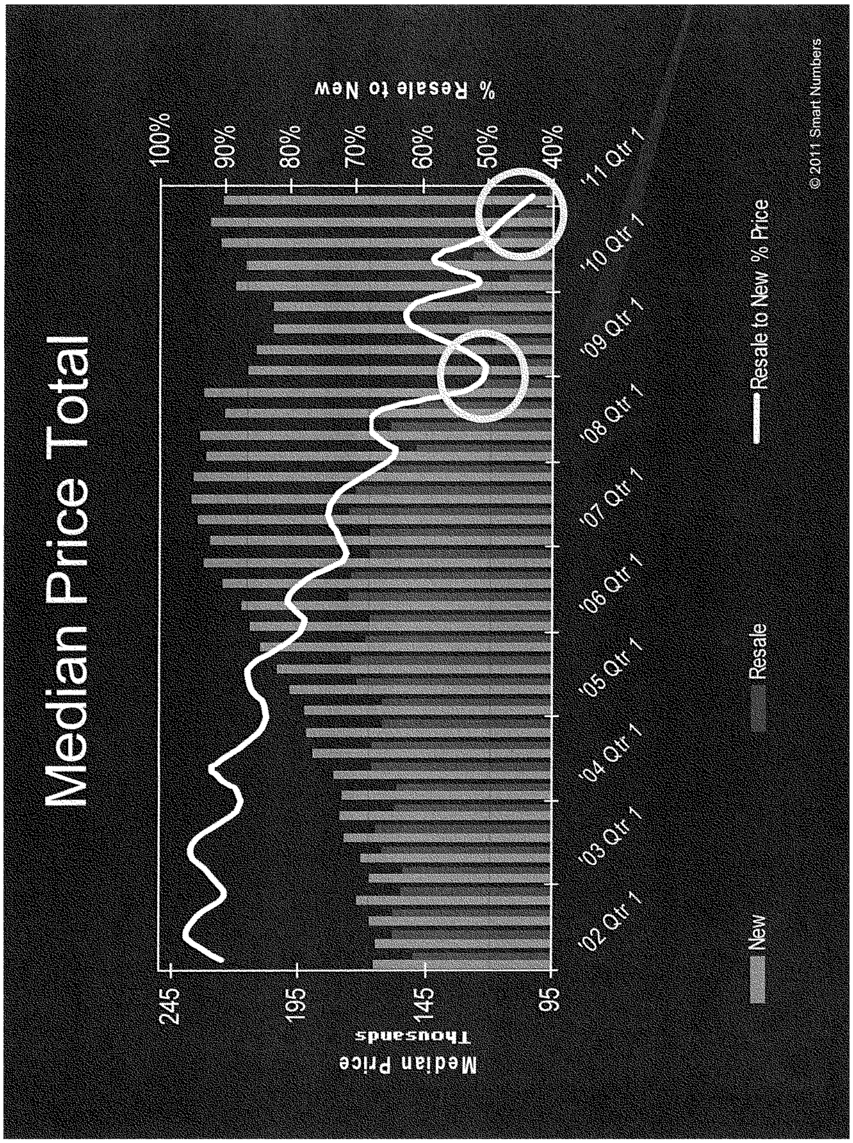
Median Price Total
Median Price
Thousands
245
195
145
95
100%
90%
80%
70%
60%
50%
40%
% Resale to New
'02 Qtr 1
'03 Qtr 1
'04 Qtr 1
'05 Qtr 1
'06 Qtr 1
'07 Qtr 1
'08 Qtr 1
'09 Qtr 1
'10 Qtr 1
'11 Qtr 1
New
Resale
Resale to New % Price
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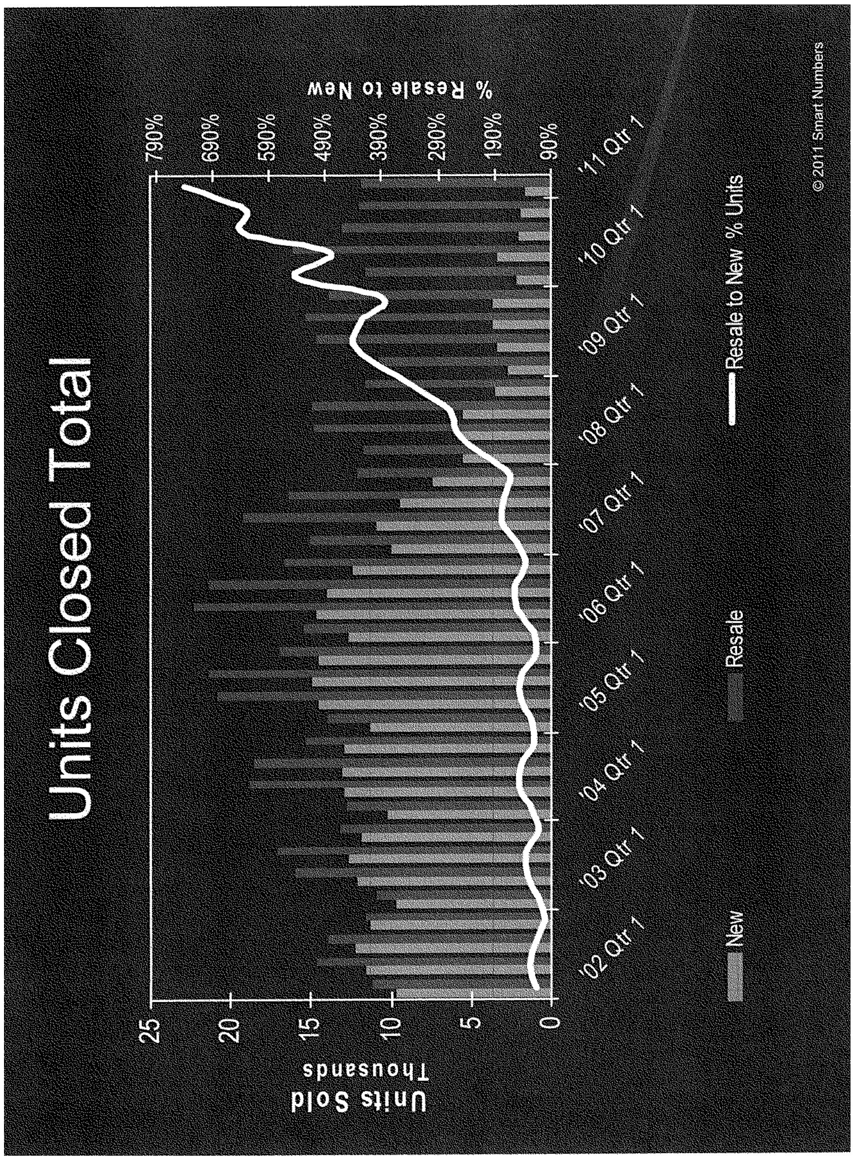

Units Closed Total
Units Sold
Thousands
25
20
15
10
5
0
% Resale to New
790%
690%
590%
490%
390%
290%
190%
90%
'02 Qtr 1
'03 Qtr 1
'04 Qtr 1
'05 Qtr 1
'06 Qtr 1
'07 Qtr 1
'08 Qtr 1
'09 Qtr 1
'10 Qtr 1
'11 Qtr 1
New
Resale
Resale to New % Units
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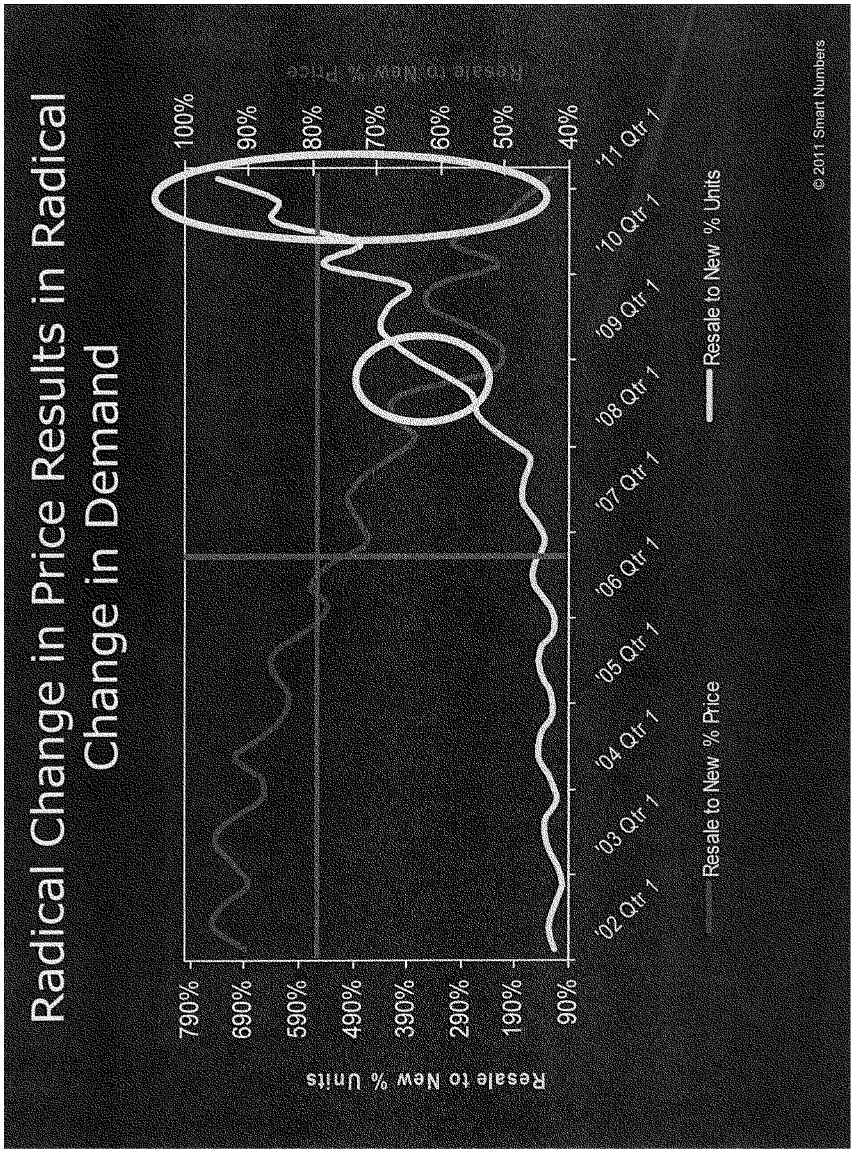

Radical Change in Price Results in Radical Change in Demand
Resale to New % Units
Resale to New % Price
790%
690%
590%
490%
390%
290%
190%
90%
100%
90%
80%
70%
60%
50%
40%
'02 Qtr 1
'03 Qtr 1
'04 Qtr 1
'05 Qtr 1
'06 Qtr 1
'07 Qtr 1
'08 Qtr 1
'09 Qtr 1
'10 Qtr 1
'11 Qtr 1
Resale to New % Price
Resale to New % Units
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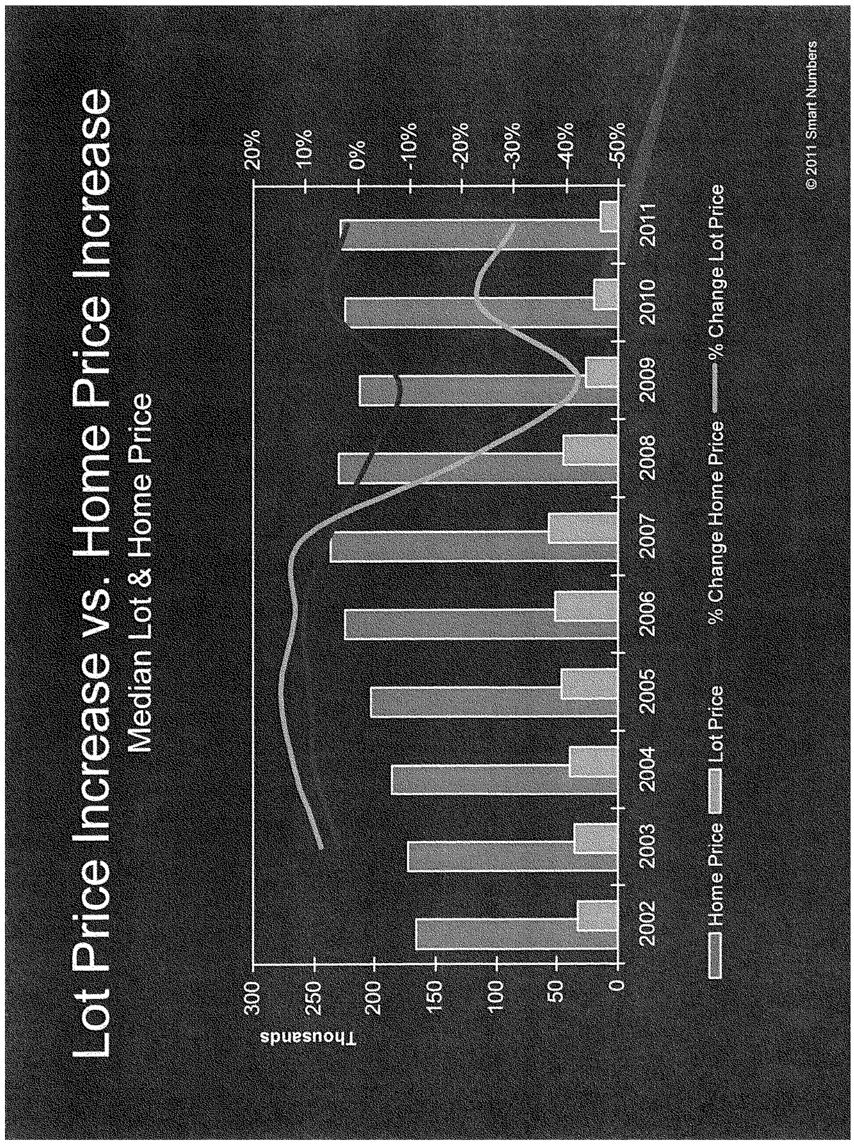
Lot Prices Crash


Lot Price Increase vs. Home Price Increase
Median Lot & Home Price
Thousands
300
250
200
150
100
50
0
20%
10%
0%
-10%
-20%
-30%
-40%
-50%
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Home Price
Lot Price
% Change Home Price
% Change Lot Price
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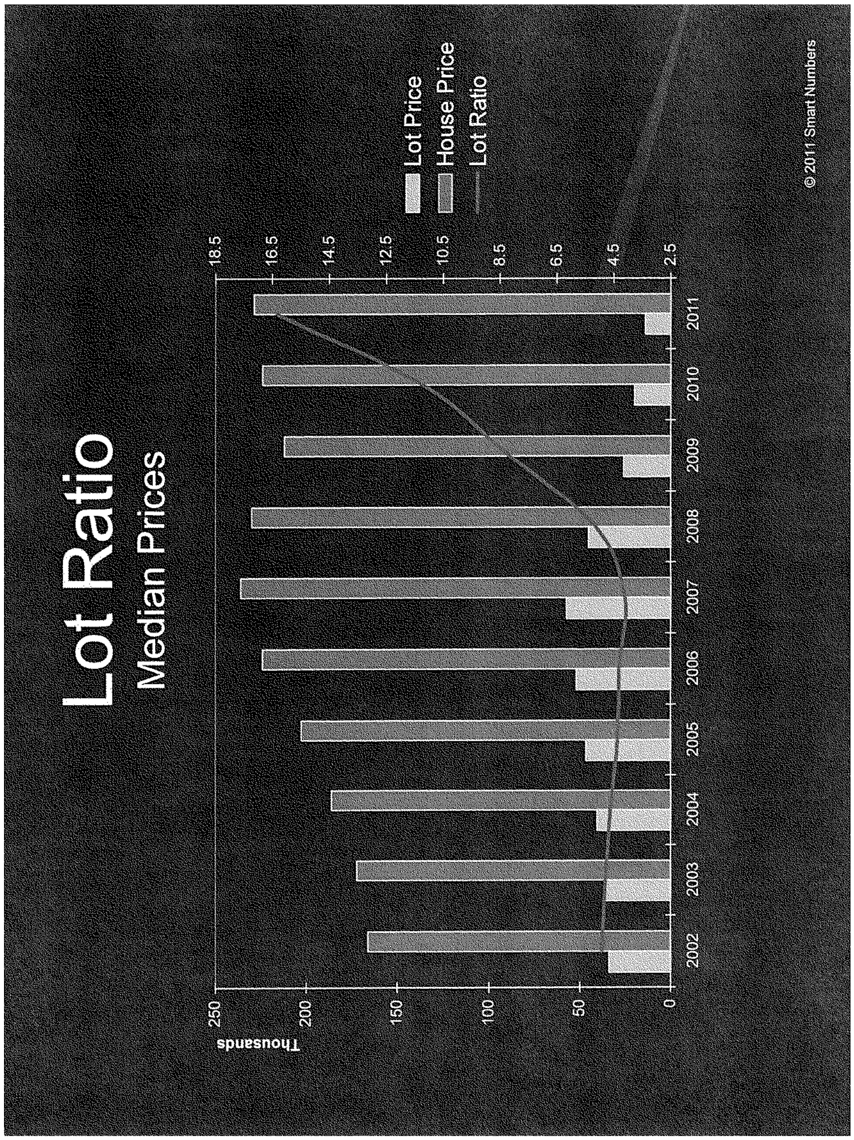
Lot Ratio
Median Prices
Thousands
250
200
150
100
50
0
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
18.5
16.5
14.5
12.5
10.5
8.5
6.5
4.5
2.5
Lot Price
House Price
Lot Ratio
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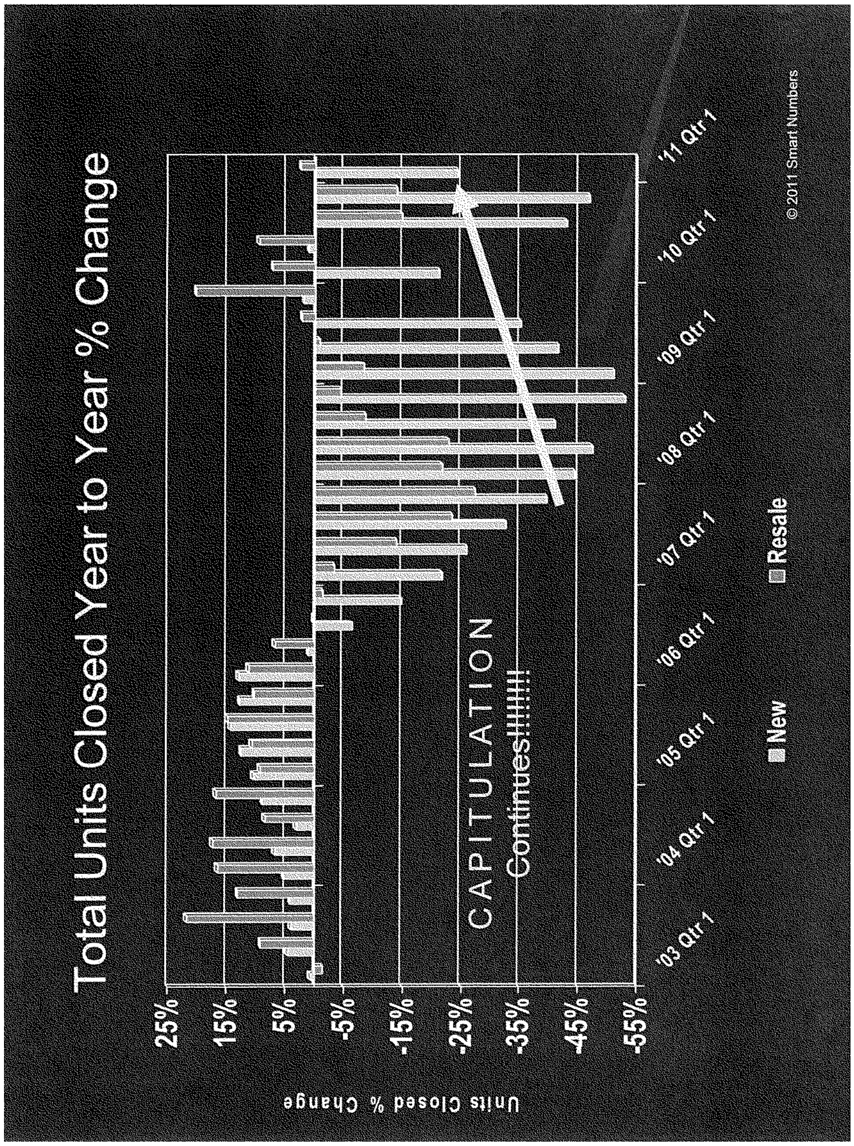
Total Units Closed Year to Year % Change
Units Closed % Change
25%
15%
5%
-5%
-15%
-25%
-35%
-45%
-55%
'03 Qtr 1
'04 Qtr 1
'05 Qtr 1
'06 Qtr 1
'07 Qtr 1
'08 Qtr 1
'09 Qtr 1
'10 Qtr 1
'11 Qtr 1
CAPITULATION
Continues!!!!!!!
New
Resale
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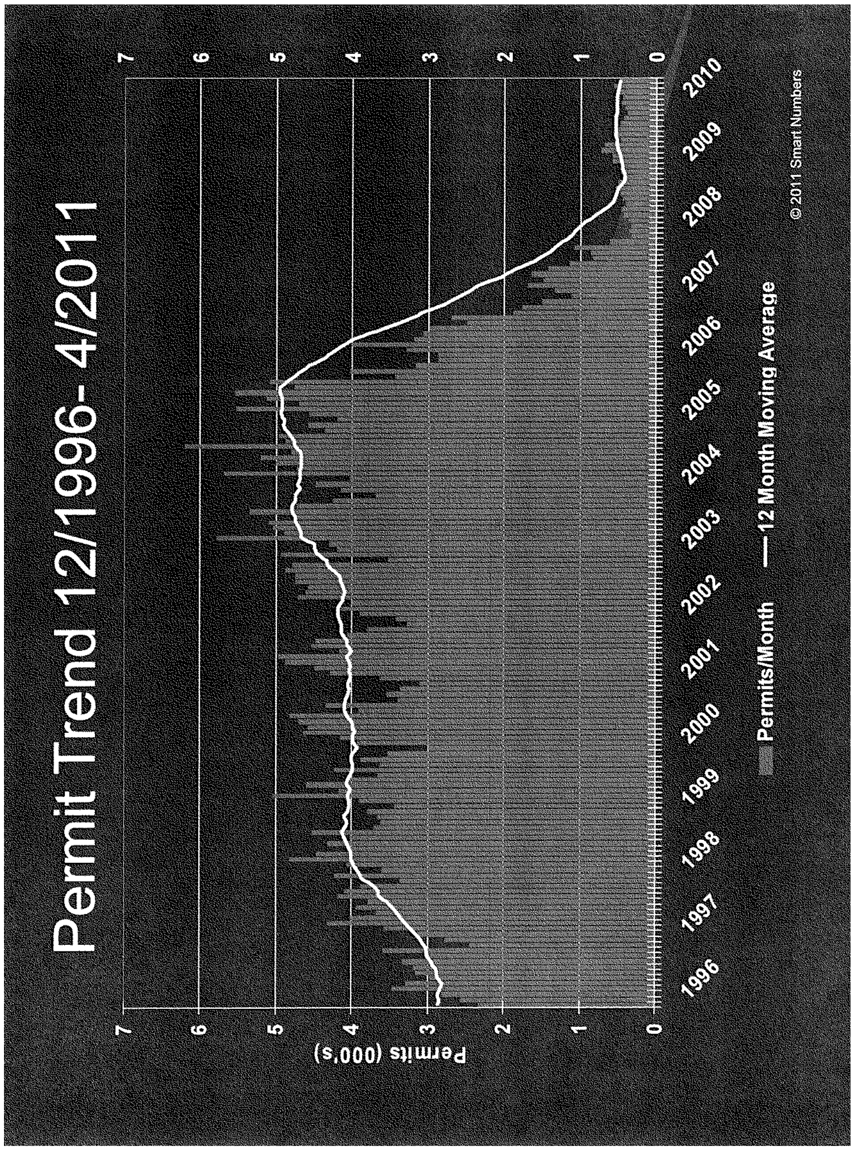
Permit Trend 12/1996- 4/2011
Permits (000's)
0
1
2
3
4
5
6
7
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
Permits/Month
12 Month Moving Average
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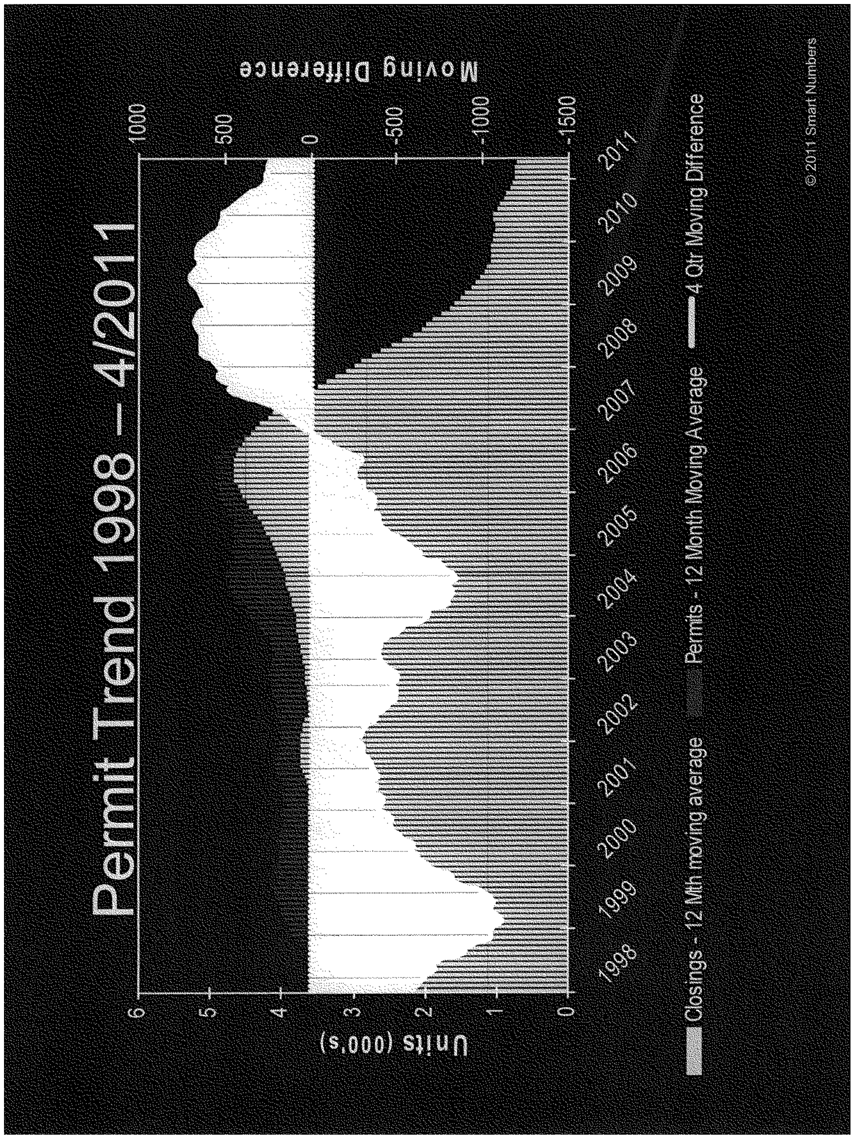
Permit Trend 1998 – 4/2011
Units (000's)
Moving Difference
6
5
4
3
2
1
0
1000
500
0
-500
-1000
-1500
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Closings - 12 Mth moving average
Permits - 12 Month Moving Average
4 Qtr Moving Difference
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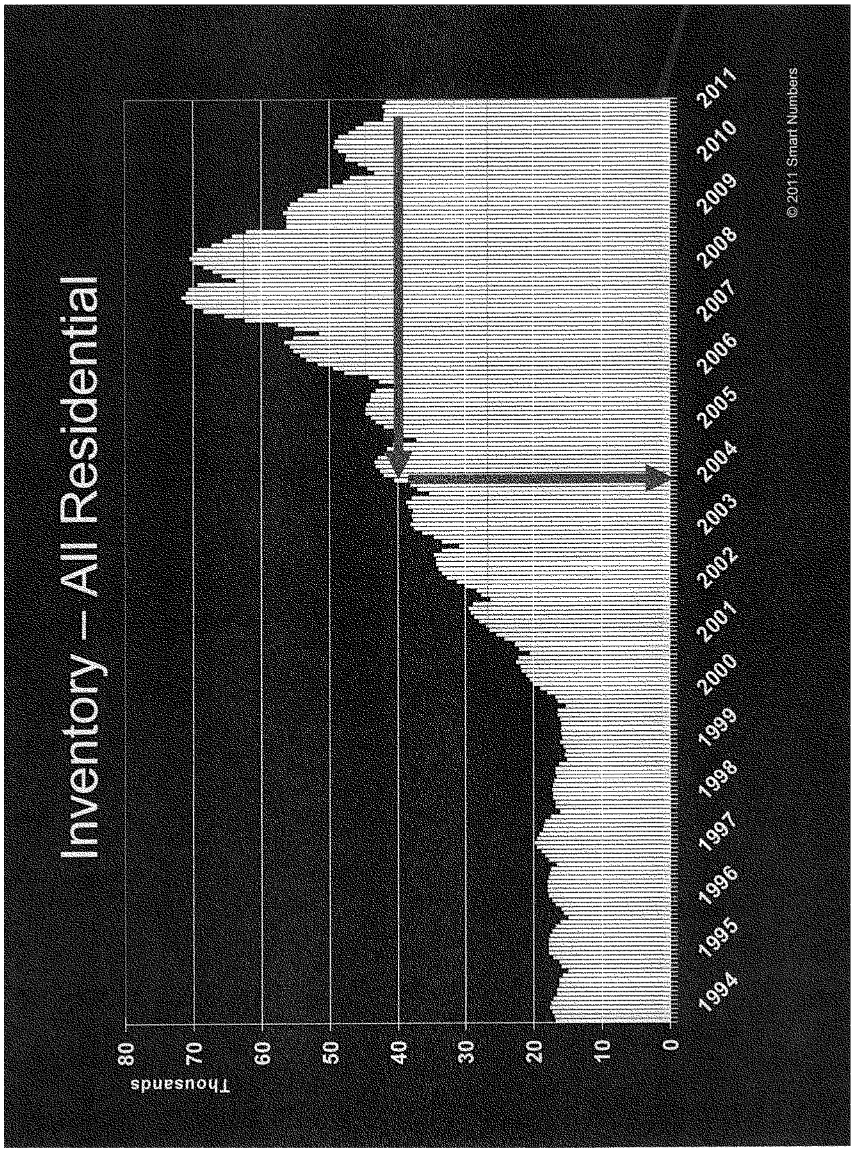
Inventory – All Residential
Thousands
80
70
60
50
40
30
20
10
0
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
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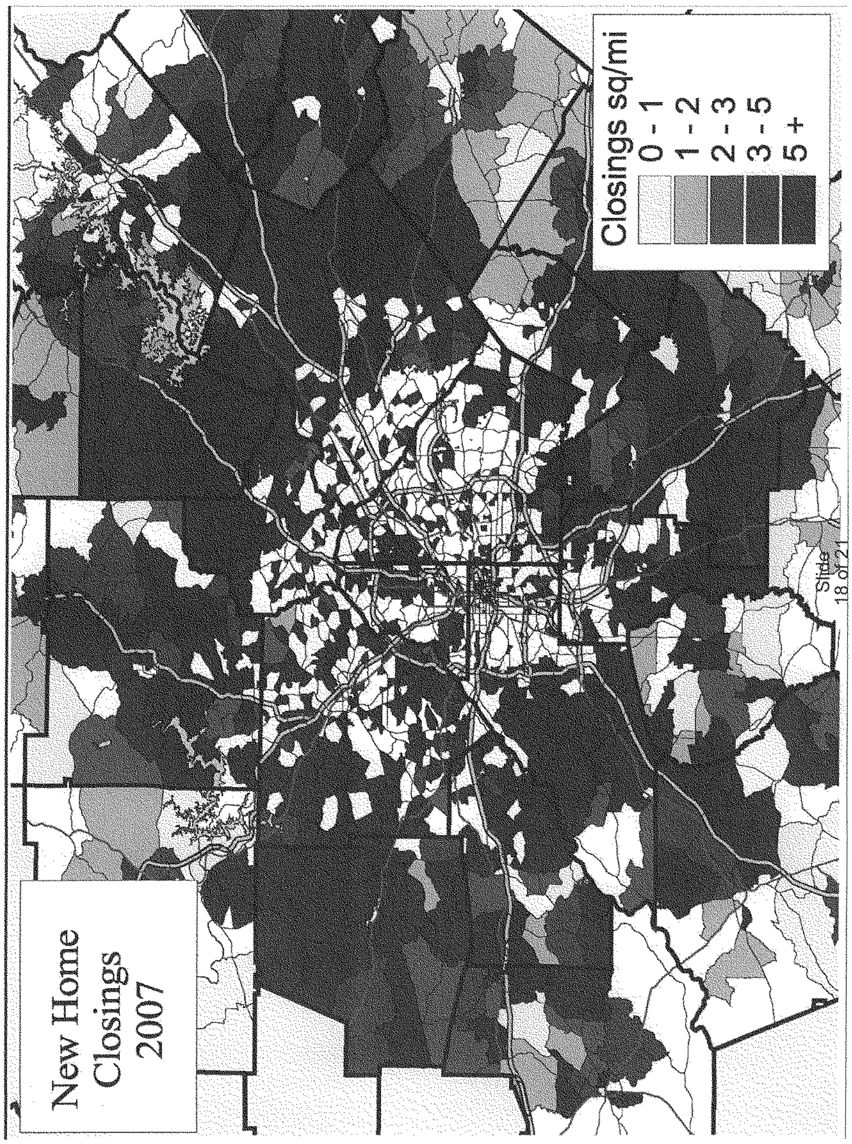
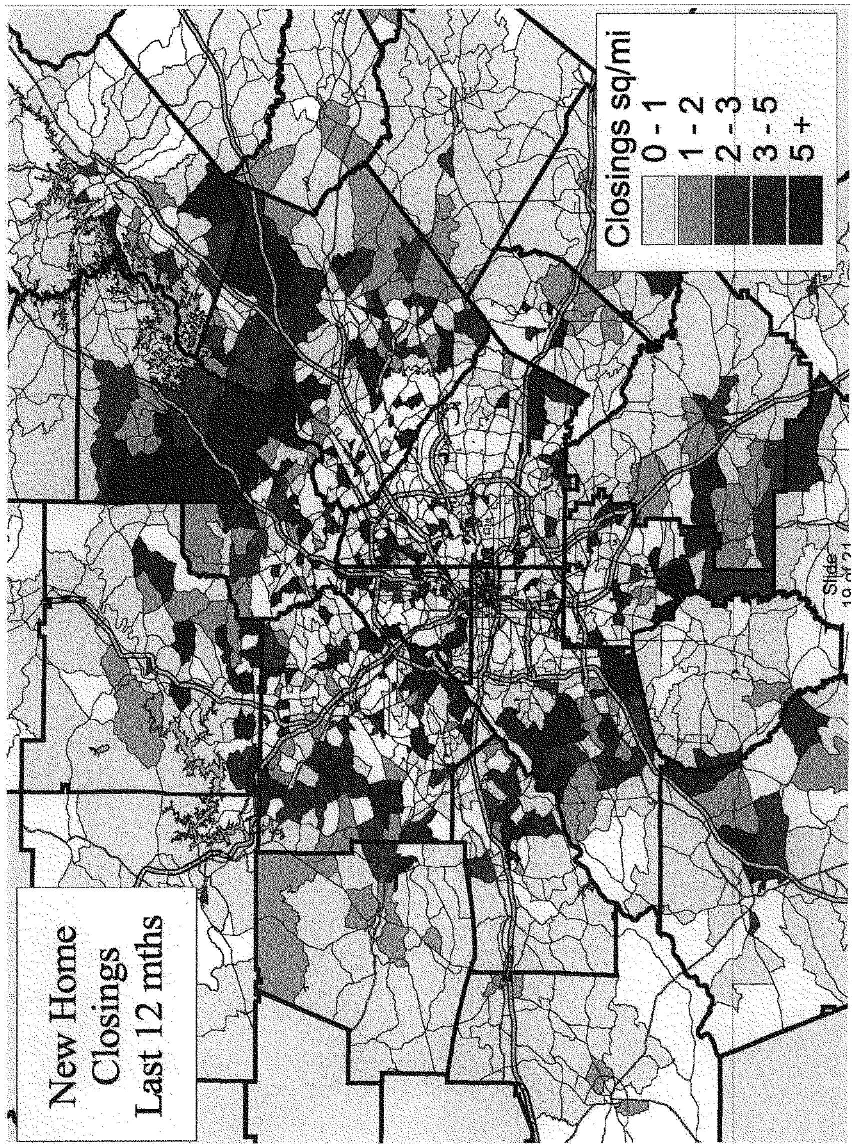
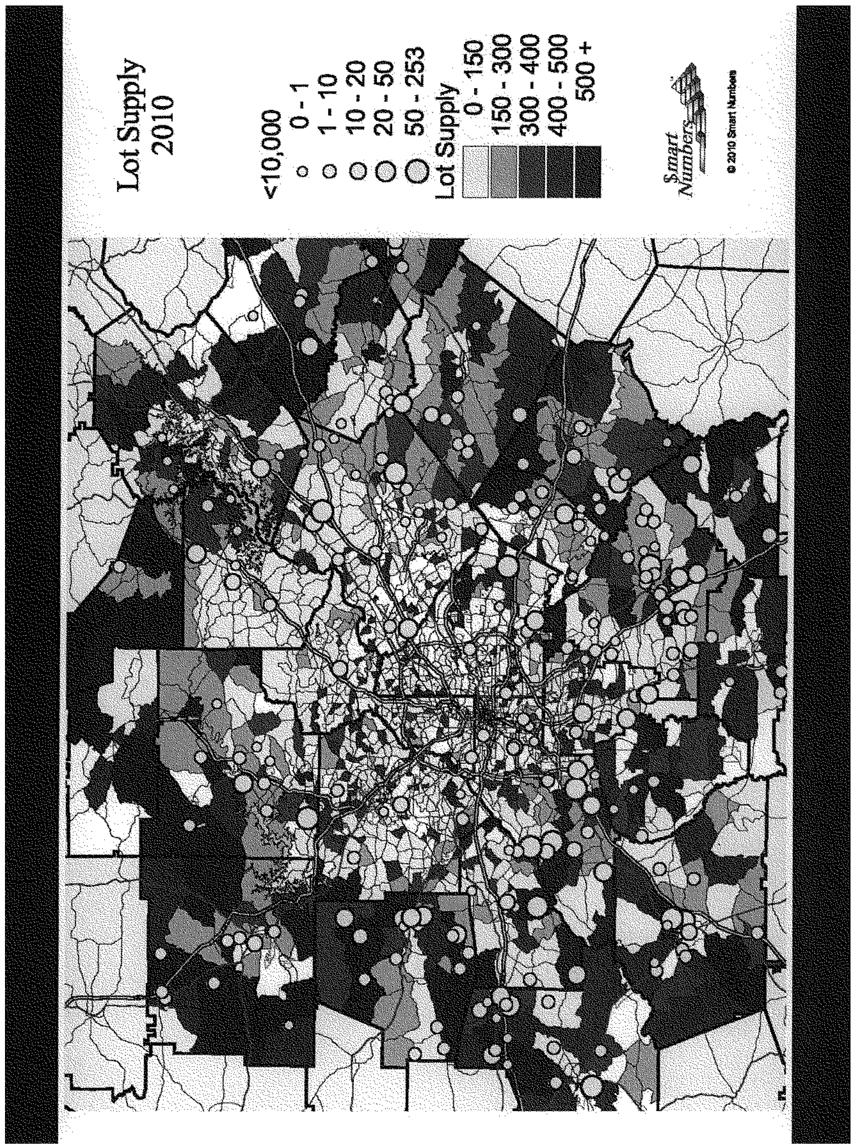

New Home Closings 2007
Closings sq/mi
0 - 1
1 - 2
2 - 3
3 - 5
5 +
Slide 18 of 21


New Home
Closings
Last 12 mths
Closings sq/mi
0 - 1
1 - 2
2 - 3
3 - 5
5 +
Slide


Lot Supply
2010
<10,000
0 - 1
1 - 10
10 - 20
20 - 50
50 - 253
Lot Supply
0 - 150
150 - 300
300 - 400
400 - 500
500 +
$mart Numbers
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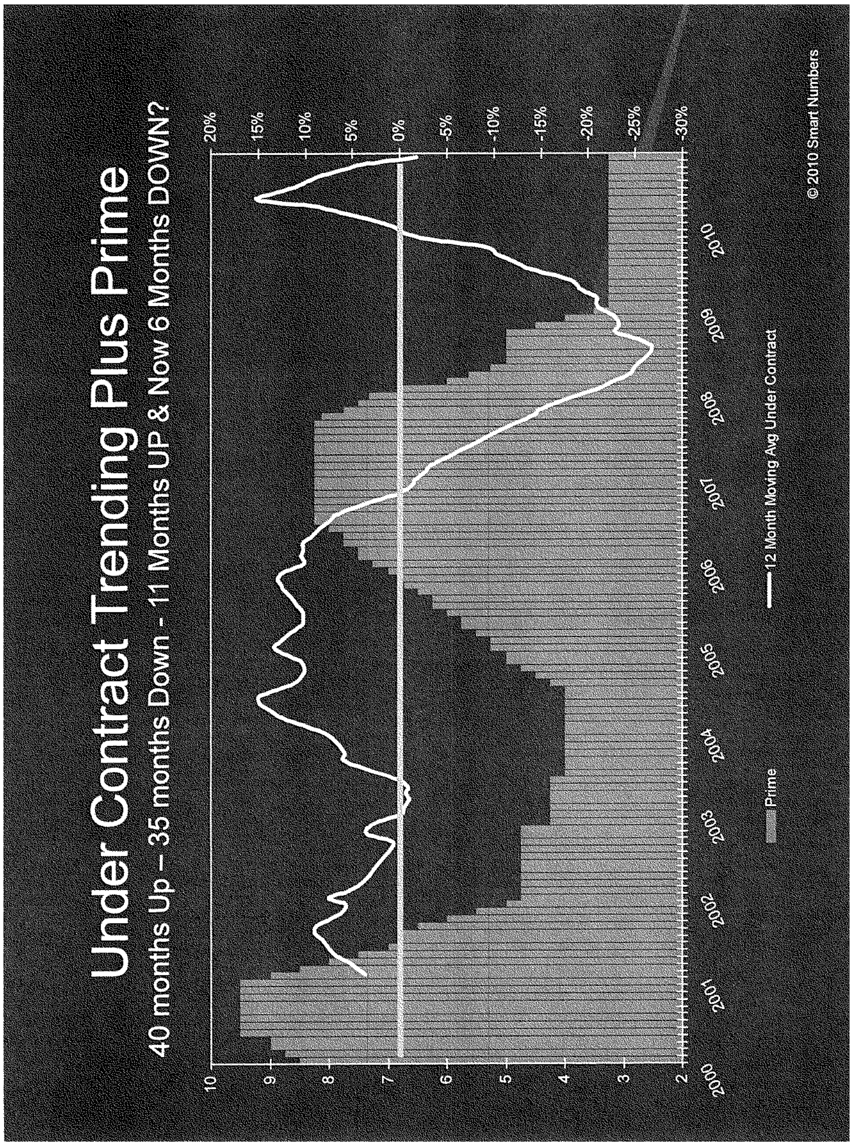
Under Contract Trending Plus Prime
40 months Up – 35 months Down - 11 Months UP & Now 6 Months DOWN?
10
9
8
7
6
5
4
3
2
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-30%
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
Prime
12 Month Moving Avg Under Contract
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Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"Potential Mixed Messages: Is Guidance from Washington Being Implemented by Federal Bank Examiners"

August 16, 2011

Statement of V. Michael Rossetti

Chairman Capito, Member Westmoreland and Members of the Committee, I sincerely appreciate the honor and the opportunity to testify before you on this subject. It is my opinion our representatives genuinely want to foster and promote a healthy banking environment so that citizens and business can prosper.

My name is V. Michael Rossetti and I have been directly involved in banking as a Director since 1999. My primary business is homebuilding. I have owned and operated Ravin Homes, Inc. for 30 years.

In your letter inviting me to testify the first two bullet points request comments on the policies and procedures of the FDIC and whether they are being applied uniformly across the country.

Although I have read about certain banks getting favorable treatment from regulators I can say that my experience is that they have acted reasonably with our bank. The problem is with the REGULATIONS and the lack of common business sense used in the interpretation of the regulations. We are being regulated so heavily that we cannot function as a facilitator in the community.

When Sarbanes Oxley was implemented our bank decided to go private so we would be exempt from the duplication of regulatory reporting. We were already performing the regulatory requirements for the FDIC. The costs and manpower required to do the redundant reporting under Sarbanes would have been crippling to our institution.

Now we have Dodd Frank to contend with. This is a 2,000+ page bill that will have 10 times the regulations attached to it after the bureaucrats' get through with writing all the rules. I see more of an issue with the amount of the regulations rather than the regulators. We are being regulated to death in ALL of our personal and business lives.

Your next point of interest concerns regional economic conditions and adjusting exam standards.

In my banking world as well as most banks in Georgia, real estate loans (AD&C Loans) were, and still are, a large part of their portfolios. In accumulating these large portfolios the banks customers were simply supplying a product that the Federal Government through Fannie and Freddie were giving away money to buy.

The current huge overhang that this created in all levels of housing development is going to take years to work down. If the regulators were able to adjust to this fact and be less onerous on banks to write down loans I believe that the liquidation of assets would be more orderly and more lucrative and create considerably less stress on banks. I will have more on this when I discuss loss/share.

The second to last point of discussion concerns safe and sound operation of banks while promoting economic growth. In my mind there are two entities that need to be considered in the economic growth equation for this topic – the banks and their customers (communities). At the present time we are restricted from doing ANY new AD&C lending no matter how secure it is due to the concentration limitations imposed by the regulators. We can't take advantage of doing a good loan and the customer can't find a bank to do that same loan. Both get hurt and the community loses jobs, etc.

My grandfather said that there are only 2 ways to get out of debt – stop spending and start making! If banks are going to survive we need to make a profit and the only way bank makes money is to lend it.

Banks that are in this position (Community Banks) are completely defensive in this arena. As of this date we don't lend unless it benefits the bank in the disposal of foreclosed property. New loans to new or existing customers don't exist at our bank.

I would respectfully request that you investigate H.R. 1755, The Home Construction Lending Regulatory Improvement Act. It addresses this and several other regulatory issues that are very germane to the discussions here today.

Now we have the last point listed in your letter and my favorite. Winding down failed institutions and the liquidation of assets by the acquiring institutions (loss/share).

This loss/share agreement allows banks to operate completely outside of normal banking policies because THEY ARE GUARANTEED TO MAKE MONEY – no matter what they sell the asset for. The same banks operate completely differently under a loan that is under the loss/share as opposed to an in house loan. To add insult to injury to our bank and the community, they will dump the assets acquired at a rock bottom price thereby destroying local property values. In my opinion the loss/share has done more to destroy property values than any other economic factor of this downturn.

Concerning troubled and failed institutions, from what I have seen the FDIC declares that anywhere from 25% to 35% of the failed institutions assets are declared as a loss to them.

Let's take our bank as an example – we are a $380 Million dollar bank. If we were closed the loss to the FDIC Insurance Fund would be between $95 Million and $133 Million. If our bank could borrow $6 to $10 million to use as capitol we would return to being well capitalized and we would be profitable. In addition we would be able to pay this back in the future.

My point is that many banks could survive with a minimal (compared to closing the bank) capitol injection. This is what should have been done with TARP funds instead of forcing them on healthy institutions and telling them they were too big to fail.

It is my sincere hope that my testimony today has given you a constructive view of these items of interest.

Again, I would like to thank you for your time today and I look forward to answering any questions you may have.

Questions Submitted by Representative Westmoreland
Hearing: "Potential Mixed Messages: Is Guidance from Washington Being Implemented by Federal Bank Examiners?"
August 16, 2011

1. The regulators are under a tremendous pressure from Congress to be more thorough and proactive in their examinations. As a result of the increased scrutiny, banks are suffering a number of adverse consequences during inquiries including prohibitions against expansion activities whether or not the inquiry regards soundness issues, even before these examinations have been completed. Banks are given 15 days to respond to their initial notice of inquiry, yet regulators are not subjected to any timetable to determine if the bank has satisfactorily resolved the issue.

    - Consumer protection is certainly a top priority, but is it not adverse to those very same consumers to prohibit the expansion of otherwise healthy banks into communities where unstable banks have failed while regulators conduct what amounts to a fishing expedition?
    - If penalties levied on a bank prior to an adverse determination by a regulator are necessary to prevent certain activities of bad actors, isn't it equally necessary and fair to ensure that the good actors are dealt with in a timely and cost-efficient manner?

As I noted in my written statement, the OCC's philosophy is to have open and frequent communications with the banks we supervise, before, during, and after our on-site examinations. Our goal in having such frequent communication is to avoid surprises or misunderstandings about the OCC's assessment of, or expectations for a bank. For example, our examiners meet with bank management at the start of each examination to discuss the purpose and scope of the examination and to answer any questions that bank management may have. Throughout the examination, examiners normally hold periodic meetings with bank management to discuss and seek clarification from bank management about potential issues. Such communication helps to prevent misunderstandings and allows bank management to provide additional information on substantive issues. Examiners review their preliminary examination conclusions and potential matters that require attention with bank management before leaving the bank. If there are open issues, examiners will generally provide bank management with an opportunity to provide additional information before the formal examination report is completed and issued. While examiners will typically establish a timeframe for such responses, we do not have arbitrary timeframes for management responses, and we will generally work with bank management teams that have shown a commitment to being responsive. We will not however, allow bank management to unnecessarily delay a response simply to avoid a needed supervisory action.

The examiners and the Assistant Deputy Comptroller who have ongoing responsibility for the bank meet with the bank's board of directors to review the results of every examination report. Once an examination is completed, and any additional information from bank management has been received and considered, we strive to complete and issue our formal Report of Examination as quickly as possible. As the condition of a bank deteriorates, we implement additional levels of review before an examination report is issued. While this additional level of review may lengthen the time for our decisions, we believe it is an important safeguard to ensure consistency

[redacted]

[redacted]

and balance in our examinations. In these cases, we instruct our local offices to keep bank management informed of the status of the review process. If material changes are made as a result of this review, we will meet with bank management to discuss those changes before the final report is issued and to give bank management an additional opportunity to present their perspective on the findings and to address any factual errors we may have made.

As noted in my written statement, additional reviews are also required before we take an enforcement action. Once a decision is made to issue an enforcement action, our policy is to provide a copy of the proposed action to the board and establish a date within three weeks for a meeting with the board to present the action and obtain the board's consent. These timeframes can be altered – either lengthened or shortened – depending on specific facts and circumstances. We do issue so-called "fifteen day letters" in cases where a civil money penalty (CMP) is being considered, but will often give a bank more than fifteen days to respond to the letter.

Our ongoing monitoring process requires quarterly contacts with each bank. The purpose of these quarterly contacts is threefold: to determine the status of any open issues from the examination; to discuss any expanded products or new activities; and to provide feedback on any new regulatory developments. Depending on the nature of the issues, periodic monitoring activities may take place on site or in person with bank management. In situations where an enforcement action is present, we conduct at least one onsite periodic visit to the bank between our full-scope examinations to monitor and discuss the bank's progress in implementing the needed corrective actions.

With respect to your first specific question, the OCC does not have a policy of prohibiting the expansion of otherwise healthy banks into communities where unstable banks have failed. We evaluate each proposed bank expansion based on the specific facts and circumstances of each proposal. In such evaluations we look to see if the bank has set forth a viable business plan with achievable and realistic operating goals. We evaluate those proposals based on the strengths of that bank's management team, not the weaknesses or failures of other bank management teams.

With respect to your second question, I agree that for well-managed and sound banks, our examination efforts should be conducted in a timely and cost-efficient manner that minimizes unwarranted burden on banks. This is one reason why we adopted streamlined "core assessment" examination procedures that form the basis for many of our examinations. As previously noted, once an examination is complete, we strive to complete and issue our Reports of Examination in a timely manner – generally within 90 days from the start of the examination for 1- or 2-rated banks and within 120 days for 3- or 4-rated banks.

2. With the current economic situation here at home and the need for our economy to grow and produce jobs and with major institutions like HSBC closing bank branches in the US and other community banks getting out of the business due to over regulation.

   - What is the FDIC/OCC/Federal Reserve doing to ensure that we do not continue to see consolidation in commercial banking that produces even greater systemic risk to the US financial markets?
   - Has the FDIC/OCC/Federal Reserve board ever discussed consolidation in the banking industry as a good thing for the U.S. banking sector?

The OCC recognizes the crucial role of community banks in providing consumers and small businesses in communities across the nation with essential financial services as well as the credit that is critical to economic growth and job creation. We also recognize that community banks generally do not need the same types of complex systems and policies that larger institutions may need to control risks. For this reason, the OCC has divided its day-to-day supervision of banks into two primary lines of businesses - one for community and midsize banks, and the other large banks - each with its own core set of examination procedures. As we issue new policies, we stress the need to tailor responses to the size and complexity of the institution.

The OCC does not have any supervisory or regulatory agenda to reduce the number of banks and thrifts in the U.S. banking sector. Indeed, we continue to meet regularly with individuals and groups who are interested in establishing new banking charters and evaluate each such application on its own individual merits. To help promote more entrants into the system and foster competition, we have approved innovative techniques, such as so-called "shelf charters" that can help expedite chartering decisions and allow new capital to enter the banking system particularly with respect to resolving troubled or failing institutions.

With respect to proposals regarding any specific merger or acquisition, our analysis and decisions are governed by relevant statutory provisions, including, where applicable, the Riegel-Neal nationwide and statewide deposit concentration limits. To further limit potential consolidation that could pose systemic risk, section 622 of the Dodd-Frank Act establishes a financial sector concentration limit generally prohibiting a financial company from merging or consolidating with, or acquiring the assets of or control of, another company if the resulting company's consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies. The OCC participated in the statutorily mandated study by the Financial Stability Oversight Council of this provision that was issued on January 18, 2011. The study concluded that the concentration limit will reduce moral hazard, increase financial stability, and improve efficiency and competition within the U.S. financial system. It also included largely technical recommendations to mitigate practical difficulties likely to arise in the administration and enforcement of the concentration limit, such as the definition of liabilities for certain companies that do not currently calculate or report risk-weighted assets.

[redacted]

[redacted]

3. I have heard concerns the Ombudsmen Office offers little help to institutions. The function of this office seems token at best because these offices do not have the ability or teeth to do anything of substance. Ombudsmen serve to facilitate communications between the bank and the agency but do not resolve issues or serve as arbitration for real conflicts that arise between financial institutions and bank regulators.

   - How will your agency make changes to make the office of Ombudsmen more substantive?

In fulfilling its supervisory responsibilities, the OCC maintains open and ongoing communication with the institutions it supervises and also fosters the fair and equitable administration of the supervisory process. By design and in order to ensure objectivity, the OCC Ombudsman functions outside the bank supervision area and reports directly to the Comptroller of the Currency. With the prior consent of the Comptroller, the Ombudsman may stay any appealable agency decision or action during the resolution of an appealable matter. The Ombudsman also may report weaknesses in OCC policy to the Comptroller, and may make recommendations regarding changes in OCC policy. The existence of a formal bank appeals process does not change the core philosophy of the OCC concerning dispute resolution. The agency remains committed to making every effort to resolve disputes arising during the supervisory process fairly and expeditiously, in an amicable, informal manner.

Banking institutions under our jurisdiction are encouraged to contact the Ombudsman to discuss any agency policy, decision, or action that might develop into an appealable matter. The Ombudsman's objective in these cases is to seek an agreeable resolution to the dispute before it develops into a formal appeal. This avenue provides an opportunity for banks to resolve issues in the most efficient and expeditious manner possible. If banks cannot resolve disagreements with their local supervisory office through informal discussion, they are encouraged to seek a further review of the decisions or actions that are in dispute.

During 2010, the OCC Ombudsman facilitated informal communication with three banks and their supervisory offices and rendered opinions on eleven formal appeals. Of the eleven formal appeals, seven (64%) were decided in favor of the supervisory office, two (18%) were decided in favor of the bank, and two (18%) were split decisions (i.e. the appeal contained multiple issues; some issues were decided in favor of the bank, others in favor of the supervisory office). Of the four appeals received year-to-date in 2011, one appeal did not meet published qualification standards for an appeal (i.e a bank may not appeal the issuance of an enforcement action), one appeal was decided in favor of the bank, and two appeals were decided in favor of the supervisory office.

- If an institution believes the Ombudsmen's office is not responsive, what legal recourse do financial institutions have if these financial institutions feel like they are being unfairly regulated or even punished for minor infractions?

National banks and thrifts filing appeals with the Ombudsman should submit information in writing fully describing the matter in dispute. To ensure that the bank's board of directors supports the appeal, the president or chief executive officer must submit a bank's appeal, and disclose in the submission the board's approval of the action. When the Ombudsman receives an appeal, he will contact the OCC management official(s) involved in the dispute. That management official(s) will submit written materials and relevant OCC documents pertaining to the appeal within 10 calendar days of the notice from the Ombudsman. The Ombudsman will also contact the bank to ensure that the OCC has all relevant materials. If requested by either the OCC management involved in the dispute or a senior bank official, the Ombudsman will arrange a meeting or a telephone call to more fully discuss the issues to be addressed in the appeal and any related matters. In the absence of any extenuating circumstances, the Ombudsman will issue a written response to the appeal within 45 calendar days of accepting an appeal.

After the Ombudsman renders a decision on a formal appeal, the Ombudsman will contact the appellant bank to ask whether the bank believes OCC examiners have taken actions against the bank in retaliation for its appeal. The Ombudsman should make these contacts (1) six months after the date of the decision letter, and (2) six months after the date of completion of the first examination of the appellant bank following its appeal. A bank may, of course, contact the Ombudsman any time during or after the appeal if the bank reasonably believes that an OCC official is retaliating against it for its appeal. Upon identifying or learning of any possible retaliatory actions, the Ombudsman will discuss the issue with the banker and make an appropriate referral to the Treasury Department Inspector General. In addition, to prevent future retaliation for an appeal, the Ombudsman may recommend to the Comptroller that the next examination of the bank exclude personnel involved in a ruling appealed by that bank.

The Ombudsman's decision is a final agency decision.

[redacted]

Questions for Kevin M. Bertsch, Associate Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, from Representative Westmoreland:

1. The regulators are under a tremendous pressure from Congress to be more thorough and proactive in their examinations. As a result of the increased scrutiny, banks are suffering a number of adverse consequences during inquiries including prohibitions against expansion activities whether or not the inquiry regards soundness issues, even before these examinations have been completed. Banks are given 15 days to respond to their initial notice of inquiry, yet regulators are not subjected to any timetable to determine if the bank has satisfactorily resolved the issue.

- **Consumer protection is certainly a top priority, but is it not adverse to those very same consumers to prohibit the expansion of otherwise healthy banks into communities where unstable banks have failed while regulators conduct what amounts to a fishing expedition?**

- **If penalties levied on a bank prior to an adverse determination by a regulator are necessary to prevent certain activities of bad actors, isn't it equally necessary and fair to ensure that the good actors are dealt with in a timely and cost-efficient manner?**

In evaluating expansionary proposals, whether or not they involve the acquisition of troubled or failing institutions, the Federal Reserve is required to assess certain statutory factors, among them, the bank's managerial resources and its record of serving the convenience and needs of its communities, including its performance under the Community Reinvestment Act ("CRA"). The Federal Reserve must evaluate the "competence, experience, and integrity of the officers, directors, and principal shareholders of the applicant, its subsidiaries and banks and bank holding companies concerned." Part of this evaluation includes consideration of the bank or bank holding company's compliance with laws and regulations (including those involving consumer protection), as well as the record of the applicant and its affiliates in fulfilling any commitments to, and any conditions imposed by, the Board in connection with prior applications.[1]

To allow any bank or bank holding company that is not in compliance with consumer protection laws and regulations to expand prior to correcting identified consumer compliance weaknesses could potentially extend the harm resulting from the less-than-satisfactory compliance to new customers, potential customers, and communities. Similarly, permitting banks and bank holding companies having less-than-satisfactory records of complying with the CRA, which was passed to ensure that banks help meet the credit needs of the communities where they have deposit-taking facilities, would be detrimental to a wider area and greater population.

The Federal Reserve considers the historical record of the bank or bank holding company when it evaluates the likelihood of management compliance in the future. A poor record of complying with consumer protection laws and/or the CRA reflects unfavorably on management's ability to

[1] Regulation Y, Section 225.13(b).

effectively identify and manage risk. In cases where an examination of the applicant is on-going and the examiners are investigating potentially significant issues, the Federal Reserve may await the results of the examination prior to making a decision on the application, depending upon the severity and number of issues involved, as well as the stage of the investigation.

In cases where an institution wishes to acquire (or to bid on) a troubled or failing institution (or its branches), it is very important that both the safety and soundness and consumer compliance (including the CRA) ratings be satisfactory.

Nevertheless, in limited circumstances, the Board has approved applications by bank holding companies that have affiliate banks with poor CRA records to expand when the target was in financial distress. In such cases, the Board found that the public benefits of preventing the failure and closure of a bank outweighed the convenience and needs factors associated with the applicant's record under the CRA.[2]

With respect to statutory timeframes for processing applications, the Federal Reserve is required to act upon expansionary applications within 91 days of receiving the last relevant material that is needed for the Board's decision. Applicants that are rated satisfactory or better for all areas that the Federal Reserve is required to consider in applications (i.e., safety and soundness, consumer compliance, and CRA ratings) may be eligible to use the Federal Reserve's expedited processing, assuming the proposal does not raise anticompetitive concerns or other substantive issues raised by public comment. Applications eligible for expedited processing are generally delegated to the Reserve Banks for approval and are often acted on within 30 days.

2. With the current economic situation here at home and the need for our economy to grow and produce jobs and with major institutions like HSBC closing bank branches in the US and other community banks getting out of the business due to over regulation.

- **What is the FDIC/OCC/Federal Reserve doing to ensure that we do not continue to see consolidation in commercial banking that produces even greater systemic risk to the US financial markets?**

- **Has the FDIC/OCC/Federal Reserve Board ever discussed consolidation in the banking industry as a good thing for the U.S. banking sector?**

When he spoke with community bankers during the annual meeting of the Independent Community Bankers of America (ICBA) earlier this year, Chairman Bernanke noted that "a major thrust of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) is addressing the too-big-to-fail problem and mitigating the threat to financial stability posed by systemically important financial firms." He emphasized that competitive distortions created by the too-big-to-fail problem produced implicit subsidies to the largest institutions'

[2] 76 *Federal Reserve Bulletin* 83-89 (February 1990) Approval Order for First Union Corporation, Charlotte, North Carolina, to acquire Florida National Banks of Florida, Inc., Jacksonville, Florida (December 22, 1989).

funding costs that were unfair to smaller competitors and that encouraged further consolidation and concentration within the financial services industry. Under the framework set forth in the Dodd-Frank Act, the Federal Reserve has been working closely with the other financial regulators in the U.S. to implement rules and other supervisory changes to address the too-big-to-fail problem.

These efforts include several components. For example, the Dodd-Frank Act requires the development of more stringent prudential standards for banking organizations with assets of $50 billion or more. These will include stronger capital and leverage requirements, expanded liquidity expectations, tighter counterparty credit limits, implementation of periodic stress tests, and the development by companies and regulators of resolution plans to wind down large firms if necessary. The requirements will be designed to take into account the costs imposed by the largest institutions on the financial system, and are expected to give those institutions regulatory incentives to reduce their size. In addition, the Dodd-Frank Act includes enhanced financial sector concentration limits--addressing a broader range of financial activities and considering a range of liabilities beyond deposits--that should militate against continued concentration. Moreover, the Dodd-Frank Act requires the Federal Reserve to consider financial stability effects when reviewing proposals by bank holding companies to acquire other banks and nonbanks. Complementing the requirements of the Dodd-Frank Act in addressing the too-big-to-fail problem, the regulatory agencies also have been working with international supervisors to develop and implement Basel III prudential standards that will raise requirements for the largest, most inter-connected banking organizations, calling on them to hold more and higher quality capital and to maintain more robust liquidity positions.

3. I have heard concerns the Ombudsmen Office offers little help to institutions. The function of this office seems token at best because these offices do not have the ability or teeth to do anything of substance. Ombudsmen serve to facilitate communications between the bank and the agency but do not resolve issues or serve as arbitration for real conflicts that arise between financial institutions and bank regulators.

(a) How will your agency make changes to make the office of Ombudsmen more substantive?

In 1995, the Federal Reserve established the position of Ombudsman and approved final guidelines to implement an intra-agency appeals process that was made immediately available to all financial institutions supervised by the Federal Reserve. Policy statements covering both of these functions were issued. The Federal Reserve System Ombudsman has four areas of responsibility:

- To act as a facilitator and mediator for the resolution of complaints concerning regulatory or supervisory actions;
- To direct complainants to the appropriate appeals process or other forum, where such forum exists, for the resolution of a complaint;

- To ensure that complaints about Board or Reserve Bank regulatory actions are addressed in a fair and timely manner; and
- To receive complaints of retaliation when a party has used the Ombudsman or any other existing avenue of appeal or complaint forum and take steps to resolve those complaints.

An inter-divisional team at the Board is currently working with the Ombudsman to update and improve policies governing appeals of material supervisory determinations (MSD appeals) and the Ombudsman role. Our aim is to revise the MSD appeals policy and streamline the MSD appeal process. We feel that doing so would improve efficacy and reduce costs to the appellant institutions. The revisions to the Ombudsman policy that we are considering would enable the Ombudsman to:

- Take a more active role in the MSD appeals process;
- Provide more meaningful conflict resolution assistance to parties; and
- Collect information and provide important feedback to senior Federal Reserve officials concerning systemic or recurring issues brought to the Ombudsman's attention.

(b) If an institution believes the Ombudsmen's office is not responsive, what legal recourse do financial institutions have if these financial institutions feel like they are being unfairly regulated or even punished for minor infractions?

Our Ombudsman makes every effort to be responsive to concerns that are raised within the scope of the authority granted to the function under the implementing statute (12 U.S.C. 4806). The Board actively encourages institutions to communicate with our Ombudsman even in situations that might be considered to involve minor infractions. Further, under the Board's Ombudsman policy, where appropriate, the Ombudsman has the authority to raise issues with senior Federal Reserve officials to attempt to reach a resolution.

It should be noted that the Board has robust procedures in place for contesting supervisory actions. Thus, as you are aware, where an institution wishes to contest any determination considered a material supervisory determination (which may include exam ratings, significant loan classifications and adequacy of loan loss reserves); the institution may pursue our appellate process. This process currently includes three separate levels of appeal; as noted above, we are working to streamline the process to improve efficacy and reduce costs to appellant institutions.

Where a formal enforcement action is proposed (such as an assessment of a civil money penalty or a cease or desist order), the institution may request a hearing before an administrative law judge (ALJ). The ALJ's decision is reviewed by the Board and the Board may either uphold or reverse the decision and issue an implementing order. The institution then has a further right to appeal to the court of appeals.

Response to Questions Submitted by
Honorable Lynn A. Westmoreland

Q1: The regulators are under a tremendous pressure from Congress to be more thorough and proactive in their examinations. As a result of the increased scrutiny, banks are suffering a number of adverse consequences during inquiries including prohibitions against expansion activities whether or not the inquiry regards soundness issues, even before these examinations have been completed. Banks are given 15 days to respond to their initial notice of inquiry, yet regulators are not subjected to any timetable to determine if the bank has satisfactorily resolved the issue.

Consumer protection is certainly a top priority, but is it not adverse to those very same consumers to prohibit the expansion of otherwise healthy banks into communities where unstable banks have failed while regulators conduct what amounts to a fishing expedition?

A1: After further clarification from your staff, the FDIC understands the question to be what might prevent a healthy institution from receiving permission to expand its operations. The FDIC considers safety and soundness and consumer protection as two sides of the same coin. Inasmuch as both functions are overseen by the same management team in most insured depository institutions, the presence of significant weaknesses in the consumer protection area can indicate an underlying safety-and-soundness issue. As such, it is appropriate to take a cautionary approach when evaluating expansionary business plans of institutions where management is untested or where weaknesses that warrant further investigation have been identified.

The FDIC conducts compliance examinations of the banks we supervise to ensure they are complying with consumer protection laws and regulations, including the Community Reinvestment Act (CRA). We focus on areas where consumers may have been harmed, and we seek corrective action when concerns are found. Violations of laws and regulations that result in illegal or discriminatory credit practices are factored into a bank's CRA rating. If a bank has a less than satisfactory CRA rating, that rating will impact any applications deemed expansionary. When determining if a bank has engaged in an illegal or discriminatory credit practice, we provide the bank the opportunity to offer additional information to assist in our decision. The timeframes for processing such cases are often extended by the need to gather, analyze, and assess all applicable data, facts, and defenses raised by the bank. This process includes ongoing communication with the bank to ensure we fully understand all facts and circumstances surrounding the issues.

When cases progress to the point where we intend to pursue an enforcement action or in situations where there is reason to believe a significant violation occurred, such as a discriminatory fair lending violation, the FDIC issues a "15-day letter" to the bank. This letter provides a detailed analysis of the issue and the FDIC's proposed recommendations, and asks the bank to respond with any additional information within 15 days. However, before reaching this point in the process, we have been in regular contact with the bank to ensure it has had an opportunity to provide any relevant information concerning the issue. The 15-day period represents a final opportunity to review the FDIC's conclusion and provide a response with any additional information not already provided. We frequently receive requests for additional time to respond and these are generally granted.

Even in cases where there are significant problems, the FDIC seeks to work with bank management to return the institution to financial strength and compliance with laws and regulations. We rely on such dialog to ensure the FDIC's supervisory programs are effective, balanced, and equitable. If a bank feels it is being unfairly regulated or treated by the FDIC, we have numerous avenues to seek an independent review. In addition to the Office of the Ombudsman, banks may request a meeting with the Regional Director, submit an email to the Division Director as outlined in FIL-13-2011 issued on March 2, 2011, or avail themselves of the formal appeals process set forth in the FDIC's *Guidelines for Appeals of Material Supervisory Determinations.*[1]

Q2: If penalties levied on a bank prior to an adverse determination by a regulator are necessary to prevent certain activities of bad actors, isn't it equally necessary and fair to ensure that the good actors are dealt with in a timely and cost-efficient manner?

A2: Time limits for the processing of applications received by the FDIC have been established through federal statute and FDIC regulations. While processing timelines differ for various types of applications filed with the FDIC, the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRIA) requires federal banking agencies to take final action on applications within a one-year period after a complete application is received. A complete application is one for which all required information and documentation is submitted by a depository institution to the FDIC. The FDIC strives to process applications and respond to requests by depository institutions according to applicable regulatory statutes and policy guidelines.

Banks that are financially strong and well-managed are eligible for expedited processing of applications involving expansionary activities, including federal deposit insurance, branch, and merger applications. The expedited processing guidelines for each application type are embodied in Part 303 of the FDIC's Rules and Regulations. However, some key factors will render a bank ineligible for expedited processing. For example, any significant CRA or consumer compliance concerns will remove a bank's application from expedited processing and could potentially result in denial of the application if the issues are not favorably resolved. Additionally, all material business plan change applications by banks in existence for less than seven years are ineligible for expedited processing. Banks insured less than seven years have been shown to pose elevated risks to the FDIC's Deposit Insurance Fund (DIF); therefore, a more in-depth analysis to adequately assess the potential risk that a material change or deviation from the most recently approved business plan would have on the bank and the DIF is necessary.

Q3: With the current economic situation here at home and the need for our economy to grow and produce jobs and with major institutions like HSBC closing bank branches in the U.S. and other community banks getting out of the business due to over regulation, what is the FDIC/OCC/Federal Reserve doing to ensure that we do not continue to see

[1] See Federal Register Vol. 75, No. 74, pages 20358-20363, April 19, 2010.

consolidation in commercial banking that produces even greater systemic risk to the US financial markets?

A3: The FDIC continues to strongly advocate for a diverse banking industry that provides vital financial services to cities, towns, and rural communities across the country. As supervisor for more than 4,000 financial institutions, most of which have less than $1 billion in assets, we understand the importance of community banks to small business and consumers on Main Street. This is particularly important in the current challenging economic environment as the availability of credit to small businesses is essential to job creation and a robust economic recovery. From a national perspective, we believe the financial services marketplace benefits from competition among large institutions and community banks. Our banking system makes available a variety of financial services products and delivery platforms to meet consumer needs. Consequently, significant consolidation in the banking industry could impact the diversity and quality of financial products and services for consumers.

The FDIC is taking steps to ensure community banks remain competitive and their concerns are considered as part of the development of banking policy. In early 2012, the FDIC intends to hold a conference on the future of community banking, and also will conduct regional community banker roundtables to obtain additional perspective on the challenges these bankers face. This will build on the advice the Corporation receives from the FDIC Advisory Committee on Community Banking. This Committee, which includes a community bank executive from Georgia, provides the FDIC with advice and guidance on a range of policy issues that impact community banks nationally, as well as in their local communities. The Committee has provided valuable input on examination policies and procedures, credit conditions, regulatory compliance matters, obstacles to the continued growth of community banks, and impediments to providing financial services in their local markets. The FDIC also has implemented a process to consider the potential burden on community banks when we issue regulatory guidance. The FDIC remains a strong supporter of the role of smaller banking institutions, and we believe they will remain a viable and critical component of the financial services sector.

Q4: Has the FDIC/OCC/Federal Reserve board ever discussed consolidation in the banking industry as a good thing for the U.S. banking sector?

A4: No. The FDIC has had no such discussions. Healthy competition among financial institutions promotes a dynamic and efficient industry while enabling businesses and consumers to choose the banking products and services that best suit their needs. We believe the diversity and competition that characterizes our nation's banking industry is a good thing as it encourages product innovation, promotes convenience, and provides for a broad range of options for banking customers.

Q5: I have heard concerns the Ombudsmen Office offers little help to institutions. The function of this office seems token at best because these offices do not have the ability or teeth to do anything of substance. Ombudsmen serve to facilitate communications between the bank and the agency but do not resolve issues or serve as arbitration for real conflicts that arise between financial institutions and bank regulators.

How will your agency make changes to make the office of Ombudsmen more substantive?

A5: The FDIC's Office of the Ombudsman is one of the federal banking agency Ombudsman programs created pursuant to the CDRIA. The CDRIA specifically defines the duty of an agency Ombudsman, providing that the Ombudsman shall "(A) act as a liaison between the agency and any affected person with respect to any problem such party may have in dealing with the agency resulting from the regulatory activities of the agency; and (B) assure that safeguards exist to encourage complainants to come forward and preserve confidentiality." 12 U.S.C. § 4806(d)(2)(A-B).

Consistent with these statutory parameters, the FDIC's Ombudsman Office assists FDIC-supervised and insured financial institutions and the public by identifying relevant authority and resources; bringing parties together to clarify the issues; helping parties explore options for resolving disagreements; and providing informal mediation services for bankers with regulatory problems. The FDIC's Ombudsman Office explains and, as appropriate, assists institutions with questions or concerns related to appeals of material supervisory determinations; answers questions about FDIC policies and procedures on open and closed bank issues; and assists with complaints regarding FDIC operations, employees, and contractors. Moreover, the FDIC's Ombudsman can refer issues, directly or confidentially, to FDIC subject matter experts in the appropriate division or office. Examples of instances where the Ombudsman has provided assistance to insured depository institutions are found on the FDIC website at http://fdic.gov/regulations/resources/ombudsman/examples.html

Approximately 1,441 industry representatives have contacted the FDIC Ombudsman since January 2010 requesting assistance (49 of which represented actionable grievances). The FDIC Ombudsman staff spoke with 3,126 members of the public about the FDIC and banking matters during the same time period. In addition to responding to requests for assistance, Ombudsman staff proactively contacted 394 financial industry representatives from January 2010 to the present through outreach visits, telephone calls, and industry-sponsored conferences.

Highlights of the FDIC Ombudsman's work are reported to the financial services industry and the public every six months on the FDIC website at: http://www.fdic.gov/regulations/resources/ombudsman/feedback1.html

Q6: If an institution believes the Ombudsmen's office is not responsive, what legal recourse do financial institutions have if these financial institutions feel like they are being unfairly regulated or even punished for minor infractions?

A6: The FDIC has in place an independent intra-agency appellate process to review material supervisory determinations made at institutions that it supervises. Under the FDIC's *Guidelines for Appeals of Material Supervisory Determinations* (SARC *Guidelines*) (75 FR 20358 (Apr. 9, 2010)), insured institutions that are FDIC-supervised may file requests for review of material supervisory determinations (MSDs). The SARC *Guidelines* describe the types of determinations that are eligible for review and the process by which appeals are considered. MSDs are broadly defined in the *Guidelines* and include CAMELS ratings, IT ratings, Trust ratings, and CRA ratings. Indeed, MSDs also include any supervisory determination that may impact the capital, earnings, operating flexibility, or capital category for prompt corrective action purposes of an institution, or otherwise affect the nature and level of supervisory oversight accorded an institution. Consequently, if an institution believes that it is being unfairly regulated or is dissatisfied with its treatment for minor infractions in the examination process, and chooses not to deal with the FDIC Ombudsman's Office, or, if the institution remains dissatisfied following interaction with the FDIC Ombudsman's Office, the institution may file a written request for review according to the FDIC's SARC *Guidelines*.

The *Guidelines* provide for a two-step process. The first level involves review of the institution's arguments by either the FDIC's Division of Depositor and Consumer Protection or the Division of Risk Management Supervision, with a written determination provided by the Director of the involved division. If still unsatisfied, the institution may file an appeal with the FDIC's Supervision Appeals Review Committee, which consists of one inside FDIC Board member, who acts as the SARC Chairman, and a representative from each of the other two inside FDIC Board members. The SARC, after considering the case, issues a written determination, often following an institution-requested oral presentation. Published SARC decisions (redacted to preserve confidential information), as well as the SARC *Guidelines*, can be found on the FDIC's website at http://www.fdic.gov/regulations/laws/sarc/. In sum, the SARC process gives FDIC supervised institutions access to review at the highest levels of the FDIC for any material supervisory determinations.

AICPA®

American Institute of CPA
1455 Pennsylvania Avenue, NV
Washington, DC 20004-108

August 15, 2011

The Honorable Spencer Bachus
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Shelley Moore Capito
Chairwoman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Lynn A. Westmoreland
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Bachus, Chairwoman Capito and Congressman Westmoreland:

I am writing to you on behalf of the American Institute of Certified Public Accountants (AICPA), the national professional organization of certified public accountants comprised of 377,000 members worldwide, including 12,000 members in Georgia, with regard to our support of H.R. 2056.

We strongly support the need for Congress to study the recent high level of insured depository institution failures which is the focus of this legislation. Historically, since the hearings that led up to the passage of the Banking Act of 1933, Congress has acted repeatedly to investigate the causes of significant bank failures. These investigations have led to statutory and regulatory reforms that have significantly strengthened our financial system. We applaud you for your leadership in this area and are confident that the studies required by this legislation will give Congress information that will be critical to its review of the cause of bank failures. The AICPA supports this bill.

The studies required by the legislation by the Inspector General of the Federal Deposit Insurance Corporation and the Comptroller General of the United States will focus in part on the consideration of accounting standards promulgated by the Financial Accounting Standards Board (FASB). As representatives of the accounting profession, we have a direct interest in that portion of this legislation on behalf of our members and the investing public which rely upon financial statements on which our members opine. We hope that our comments below will enhance the usefulness of the study.

Section 1 (b) (3) of the legislation defines "paper losses" as "any write down on a performing asset held by an insured depository institution that causes such institution to raise more capital in order to cover the write down." Using the term "paper losses" and defining it as noted above implies that the write down of a performing asset before the value of the asset has been fully realized in a market transaction is not a basis for recognizing a loss on such asset. Generally accepted accounting principles (GAAP) require financial statement preparers to recognize the potential for a loss on assets under a variety of conditions. While the fact that an asset may be performing according to contractual terms is certainly a consideration in an institution's assessment of the potential for loss, it is not the only factor to be considered. Accordingly, we are concerned that the sections of the study dealing with accounting standards and the use of fair value start from a premise that suggests that "paper losses," as defined, are not appropriate accounting considerations. Further, federal financial institution regulatory agencies have the authority to define regulatory capital requirements in a manner that could adjust for such write downs in the computation of required regulatory capital if they deem that to be appropriate. Any study of write downs of performing assets under GAAP should be coupled with a study of the applicability of regulatory capital requirements and the authority of regulators to adjust such requirements.

The purpose of financial reporting is to provide investors and other users of financial statements with clear, objective, and transparent financial information. Financial statements are designed to reflect the financial condition of the company, as defined by accounting standards. This allows the users of financial information to make informed decisions regarding investment and other business decisions, based on transparent financial statements.

Importantly, it must be recognized that financial statement accounting standards, which are issued by the FASB, are designed to provide decision-useful information to investors and other financial statement users. Regulatory capital standards are designed by the federal depository institution regulators for the purpose of safety and soundness. We should not confuse the independent private sector FASB's role to develop and improve financial accounting and reporting standards with the role and responsibility of the federal financial institution regulators' role of overseeing the safety and soundness of insured depository institutions. Because of this distinction, it is important for the study to explore the manner in which the issues, including fair value, related to bank capital requirements or lending capacity are addressed by the federal financial institution regulators.

If the studies were to focus exclusively on private sector accounting standards developed for financial reporting purposes as a cause of insured depository institution failures it could raise suspicions that accounting rules can be changed in order to manipulate financial statements and undermine the objectives of providing clear, objective, and transparent financial information. Casting doubt on accounting principles developed for financial reporting purposes can lead to a reduction in confidence in our financial markets by investors and other stakeholders.

As these studies on the impact of insured depository institution failures move forward, we ask that the focus of the studies not be directed in a manner that would undermine the rigorous process utilized to promulgate generally accepted accounting standards by the FASB, but appropriately focus on the regulatory capital determinations made by federal financial institution regulators.

Thank you for the opportunity to comment on this legislation.

Sincerely,

Barry C. Melancon, CPA
President and CEO

ajc

Small businesses feel banks' pain

By Brian Olasov

8:28 p.m. Tuesday, December 15, 2009

The FDIC recently closed its 22nd, 23rd and 24th banks in Georgia this year — more than any other state in the country. The populist response to these banking failures — and the broader financial crisis — has been to lump financial services firms together indiscriminately and rail against excessive bonuses, risk-taking and "bail out" money many of these firms received under the TARP program.

Of course, for the investors, employees and directors of these institutions, a bank failure can be a personal tragedy. But what about the rest of us? Should the average Georgian care about these closures? Aren't they merely the discipline of a free market?

If we care deeply about restoring growth to Georgia, the answer is that we should also care deeply about the outlook for Georgia's banks.

The gut-wrenching turmoil of the past 15 months — the "post-9/15" world following Lehman Brothers' bankruptcy — demands explanations, investigations and policy responses. But before we ascribe blame, we also must focus on a couple of important truths and their critical implications.

First, the small banks that are being closed in Georgia bear little responsibility for the financial crisis. Their executives are not looking for multimillion-dollar bonuses, nor are they responsible for engineering opaque mortgage-backed securities or for leveraging up their balance sheets by billions of dollars.

More importantly, the private economy cannot get back on its feet without a healthy banking system. When banks close their doors or restrict credit, greater numbers of small businesses shrink and fail. These engines of job growth sputter and their communities suffer a slow bleed. In a state as hard hit by bank failures as Georgia, this is acutely true. Regardless of whether one sympathizes with the plight of financial institutions, their fates are closely tied to our own — especially so in rural areas with few lending choices.

Bank failures in Georgia have resulted largely from lending concentrations in residential development and commercial real estate. This cycle has not yet fully run its course. Dozens of additional Georgia banks are either under formal regulatory agreements or fear they soon will be.

In a time of heightened anxiety, a banker's natural impulse is to tighten lending standards, cut lines of credit and shift assets to cash and government securities. Regulators may impose this conservatism on banks unilaterally. While understandable from the banker's and regulator's perspectives, these actions leave small businesses with few borrowing options.

In a recent speech, Federal Reserve Bank of Atlanta President Dennis Lockhart noted the connection between real estate and small-business borrowing: "Banks with the highest [commercial real estate exposure] account for almost 40 percent of all small-business loans." Unfortunately for communities that rely on banks with heavy concentrations of real estate loans, these banks frequently operate under an agreement with regulators that sharply limits any new lending, whether related to real estate or not.

Consider the shrinking availability of business credit. From Sept. 30, 2008, to Sept. 30, 2009, business loans outstanding declined 15 percent nationwide and nearly 18 percent among Georgia banks. For the same period, lines of credit were cut roughly 12 percent nationally and more than 10 percent in Georgia. When credit dries up, so does capital investment — and jobs.

Nor are consumers immune from the credit crunch. In the 12 months ending Sept. 30, credit available under credit card lines shrunk by more than $1 trillion nationally.

Both sides of the political aisle realize that government stimulus by itself cannot revive private-sector job creation. Banks must be free to resume responsible lending. In recent days, everyone from the chair of the FDIC to the treasury secretary to President Barack Obama has called on banks to meet the reasonable credit needs of their communities. Unfortunately, these calls are too often undercut by other calls, particularly from regulators who require many banks to shrink their loan portfolios and raise new capital under penalty of failure.

Until regulators and policy-makers speak with a unified voice and address the danger posed by this onslaught of failures, many of our state's banks — and their communities — will continue to suffer together.

Brian Olasov is a non-lawyer managing director with McKenna Long & Aldridge LLP where he focuses on real estate credit issues, banks and capital markets. He is also an adjunct professor at Emory Law School. The views expressed are his own.

Honorable Spencer Bachus
Chairman, House Financial Services Committee
and
Honorable Shelley Moore Capito
Chairwoman, Financial Intitutions and Consumer Credit Subcomittee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Honorable Spencer Bachus and Honorable Shelley Moore Capito,

I write to you with regards to the above captioned title to request your consideration in crafting legislation to help me, my family, many other developers, and small business owners who have been devastated by this most unfortunate and catastrophic financial debacle of the last 4 years. It is critically important for you to understand that the credit devastation and scandalous actions of Wall Street created the Real Estate Crisis and not the other way around.

I have been in the Real Estate Business for 34 years and have seen many cycles both up and down, but the devastation created by Wall Street and unscrupulous and indeed unholy alliances of the FDIC and National Home Builders masquerading as Hedge Funds is an abomination of our capitalistic society and if banks would have formed these same allegiances with private business owners, someone would certainly be going to jail.

When I discovered that RIALTO a subsidiary of LENNAR, a national home builder, had purchased our note from REGIONS Bank, I contacted them immediately. I flew to New York on Dec. 6, 2010 to meet with Mike Yaffe, who I had been speaking with and had reasonably civil conversations. He had requested my financial statements, which I supplied prior to our meeting. When I arrived at their office, we chatted for a moment I had prepared several scenarios of business concepts that we could consider to move the asset and project forward. Before we reviewed the concepts, Steve Engel, his superior joined us. The whole temper of the meeting took a 180 degree turn at that point. Mr. Engel said "Many developers think we bought these loans for the real estate and that we will take a deed in leau and let them walk away, that will not happen. You have other assets and unless you pledge to us all of your assets in support of this loan we will simply take them from you. This is business to us not friendship and if you are left bleeding on the street it will make no difference to us, we are simply in this to get value for the asset we bought at 100 cents on the dollar" If I hadn't flown from Atlanta to New York for the day just to meet with them I would have, and now wish I had, simply got up and left. I stayed to try to make the best of my trip and our meeting but little positive came from the effort.

RIALTO bought a bulk loan package from REGIONS which we believe to be $700 Million for $200 Million dollars which is 28 cents on the dollar. REGIONS had offered us, 3 days before they sold our loan of $5 Million, the chance to buy our loan for $1.5 Million or 33.33 cents on the dollar, but we had no time to arrange appropriate financing.

I continued to try to work out satisfactory solutions with Mike Yaffe and began working on a Private Home Rental project through HUD. I offered Mike Yaffe a $2 Million dollar pay-off if I could be successful on the HUD debt. Mr. Yaffe refused the $2 Million but agreed over the phone to accept $3 Million as a loan pay-off if I could be successful. After 3 months of working on our HUD proposal, we had a successful first review with HUD and were asked to generate an appraisal and market study. I went back to Mr. Yaffe to share our minor success and victory at which point he asked, how we would pay the balance of the note. I explained that our agreement was indeed for a pay-off and full satisfaction and that was the reason I spent the time I had in trying to arrange the HUD Debt. He maintained that he had never agreed to that and would settle for nothing short of a full and complete pay-off of 100% of the debt plus all ancillary cost.

I continued the efforts as they began advertising for Foreclosure. I even sent a proposal the Saturday morning of 4th of July weekend as the foreclosure was set for July 5th. At 8:20 the morning of the 5th they sent an e-mail that my Saturday Morning communication was still insufficient and they would proceed with the foreclosure. I called their office and told them that I would be attending the foreclosure and asked if they would tell me what time their attys would attend as foreclosures can take place any time between 10:00 A.M. and 4:00 P.M. At 10:15 they called me and told me that they had decided to call off the foreclosure and wanted to meet with us on there trip to Atlanta the following week. We agreed and met with them the following Wednesday.

Mr. Yaffe and Mr. Engel attended the meeting the following week where my brother and I pledged to strike a deal if at all possible to move this asset forward. We explained that we would give RIALTO the lion's share of all profits but that what they were proposing was a Lender/Slave Developer relationship and not a Lender/Developer partnership. The meeting ended and now three weeks later they have sued us personally for the guarantees and have put off the foreclosure indefinitely. When I asked why they were taking this action, Mr. Yaffe responded that this would be the best way to keep the pressure on.

There is no doubt in my mind that it is the intent of the FDIC and the current administration to completely wipe out the Middle Class of American Citizens and make an UBER Rich Society in which they would be included and a working class dependent on Government. Please help us save our middle class, hard working society and stop the FDIC and these National Home builders from destroying the competition and absorbing mass acreage and capital while all the while financed by our Federal Government.

Respectfully,

Andy Alexander

Andrew Alexander
Alexander SRP Villas LLC

Cc; Chuck Cushman
American Land Rights Association
FDIC Bank Closure and Foreclosure Coalition
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TESTIMONY OF DAVID BARIS

EXECUTIVE DIRECTOR, AMERICAN ASSOCIATION OF BANK DIRECTORS

BEFORE THE

US HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

NEWNAN, GEORGIA

AUGUST 16, 2011

Good morning Chairwoman Capito, Ranking Member Maloney and members of the Subcommittee. Thank you for the opportunity to submit this statement for the hearing record.

The American Association of Bank Directors provides advocacy, informational and educational support for bank and savings institution directors.

Your hearing today and previous hearings on the bank examination process on July 8 and May 26, 2011 are extraordinarily important. They help to shed light on a process that often is shrouded in secrecy. Bank examiners can make life and death discretionary examination decisions. Public pronouncements by federal banking agency heads, while made in good faith to make the process more transparent, may not always be consistent with what may happen during and after an examination of an individual bank.

The federal banking agencies have had virtually unbridled discretion in how they examine banks.

Until recently, Congressional oversight of the bank examination process has been limited and lacked depth.

Banks may appeal examination results to the Ombudsman of the agency that examines them, but many banks are reluctant to appeal for fear of retribution and others decide not to because they do not believe that the Ombudsman is truly independent of the agency.

Banks have no statutory right to appeal adverse results of an examination to a federal or state court.

The examiners in the field as well as some of their supervisors realize that if they err on the side of stringency, they will not be criticized. But they know that the Inspectors General of the respective federal banking agencies will criticize them for not having identified problems earlier in banks that ultimately failed. The reports of the Inspectors General frequently criticize the primary federal banking regulator of the failed bank for not having identified and acted on deficiencies earlier, but never criticize the regulator for being too stringent.

Bank examiners have discretion on a wide array of matters, including whether to classify a loan, whether to place a loan in nonaccrual even though it is performing, and to substitute their own ALLL methodology for that of the bank. This is so even though a bank might have had reasonable systems and controls in the bank to make reasoned determinations of their own, or may have relied on qualified third party auditors or loan review advisors for their determinations.

Many of these decisions are judgment calls based on the facts and circumstances of the individual bank. It matters a great deal as to the extent to which examiners allow banks to exercise reasonable discretion in exercising their good faith judgment.

During good times, examiners tend to give bankers some leeway in applying reasonable judgment as to these matters; but when the economy weakens, there is a greater tendency to substitute the examiners' judgment for that of the bankers. This is unfortunate since examiner judgments can make a recession deeper and longer than it needs to be. That is because a bank's financial condition will often dictate whether it can make loans to those who reside and do business in their community and because the uncertainty and unpredictability of examiner judgments make banks less willing to lend except in limited circumstances involving extraordinarily strong borrowers.

Another disincentive to lend is the risk of personal liability that bank directors face from enforcement actions and suits by the FDIC following a bank failure. AABD recently advised bank directors to stop approving loans until the FDIC satisfactorily provides a "safe harbor" under certain circumstances for bank directors who approve loans. The FDIC has declined the offer. Outside directors are generally individuals with no bank lender experience who rely in good faith on the recommendations of their banks' lenders and credit officers. In his Grant Interest Rate Observer dated July 1, 2011, under the heading "Chill is in the air", James Grant questioned whether bank directors will continue to approve loans in face of the potential personal liability they face if their bank fails or gets into trouble.

The banking regulators sometimes have exercised their enormous unfettered discretion in determining when to seize a viable community bank, resulting in catastrophic economic consequences for communities served by such community banks improperly seized and for their shareholders, and irreparable reputational and economic damage to the local business leaders who serve on local community bank boards of directors. There is a pressing need to protect against such regulatory abuse by requiring a higher level of accountability and transparency to ensure that the banking agencies act in accord with legal standards governing the extraordinary regulatory remedy of a bank seizure.

The Subcommittee's hearing on January 21, 2010 on the closing of Park National Bank, Chicago, a leading community bank lender to Chicago's inner city, raised significant questions about the propriety and wisdom of closing that bank.

In one especially troubling example of a plainly improper community bank seizure, a viable Denver bank with $400 million in available cash was seized by the OTS and FDIC without adequate statutory grounds. United Western Bank was on the verge of a $200 million private-sector recapitalization that would have further strengthened the bank's financial position and avoided a large and wholly unnecessary loss to the FDIC Deposit Insurance Fund. But in the face of a private-sector solution that would have led to expanded community banking activities in the Denver market, the OTS and FDIC precipitously and improperly closed the bank because, we believe, the regulators did not like the bank's business model.

Immediately following the seizure, all of the deposits and most of the assets of the bank were assumed by First-Citizens Bank and Trust Company, a North Carolina-based institution with over 400 branches that is owned by one of the 50 largest holding companies in the United States. Almost immediately following the January 2011 seizure and sale of the Bank by the OTS and FDIC, the acquiring bank closed four of United Western's eight branches, suspended United Western's large and successful SBA lending program, informed existing borrowers and new applicants that it would not make loans in the Denver market for at least 18 months, and fired approximately 50 local employees.

The regulators no doubt thought their drastic actions to impose the ultimate punishment on the bank for not embracing the business advice of the regulators would go unchallenged and their decision-making process remain secret, as they have in the almost 400 bank seizures since 2007. They were wrong in this instance. United Western Bank's owners sued the OTS and FDIC demanding the return of the bank to its rightful owners. At every turn in that proceeding, which is pending in U.S. District Court in the District of Columbia, the OTS and FDIC have attempted to evade judicial scrutiny and the exposure of their secretive internal processes. First, the OTS and FDIC sought to dismiss the case on technical grounds. Later, and only after being ordered to do so by the Court, the OTS produced a hand-picked, sanitized administrative record that excluded all of the many discussions between the agencies concerning the FDIC's distaste for the bank's business model and directive that the OTS force the bank to change that model and any internal communications discussing whether failing the bank was the right answer given its relatively strong financial position relative to other regulator-defined "troubled banks." Indeed, the regulators sought to persuade the Court that only a grand total of two internal email communications within or between the agencies were relevant to determination to seize the bank.

Notwithstanding these efforts to protect the secrecy of the regulatory proceedings leading to the seizure of this bank, in this case these proceedings may yet be exposed to public review. The OCC (who was substituted for the now-defunct OTS) was ordered by the court last week to certify the completeness of the censored administrative record or supplement the record as necessary after failing to convince the court that the administrative record, which will be made public, should consist of only those documents assembled by the OTS to support its position rather than everything, favorable or unfavorable, considered by the OTS. The court rejected soundly the longstanding position of the regulators that they are entitled by law to avoid judicial and public scrutiny of their actions and decision-making process related to seizing a community bank.[1]

While the United Western case and other subsequent cases involving other community bank seizures may ultimately cause the regulators to curtail the improper use of their extraordinary powers to seize community banks virtually at their whim, this subcommittee has the opportunity immediately to create transparency in the process and modify banking agency practice to conform to legal requirements.

[1]David Baris is a partner in the law firm of BuckleySandler LLP, which represents the former owners of United Western Bank.

This subcommittee has the authority to obtain agency materials and ask probing questions about the United Western Bank seizure and other comparably questionable recent seizures by the bank regulators. A strong community bank system is of critical importance throughout this nation to ensure availability of credit to small businesses and families. It should be the highest priority of the federal bank regulatory system to avoid wherever possible that which the FDIC and the OTS caused to occur in the case of United Western Bank, the seizure of a local bank and its resale to a large bank thousands of miles away that immediately stopped delivering certain basic banking products and services to the local community.

H.R. 2056, which passed the House of Representatives last month, is a step in the right direction. More can be done. The House Committee on Financial Services can direct the GAO to conduct a thorough study on the bank examination process to assure that the process is fair and consistent and properly gives banks reasonable discretion to classify loans, determine the accrual status of loans, adopt and apply a reasonable ALLL methodology, and make other reasonable determinations in operating their businesses.

AMERICAN BANKER®
THE FINANCIAL SERVICES DAILY
Tuesday, May 25, 2010

VIEWPOINT

Help Salvageable Banks

BY BRIAN OLASOV

My dear departed mentor and co-author, George Benston, spent considerable time in the classroom describing why banks were a different kind of corporate creature. Prominent among these distinctions was the need to establish minimum capital standards.

The market and the public policy discussion have missed his wise counsel as the financial system careened from one crisis to the next. With the Senate having passed financial reform legislation, and as the Federal Deposit Insurance Corp. contemplates prospects for hundreds of troubled banks, let us consider what purpose capital standards serve and how we might handle remaining banking problems effectively and with minimal market disruption.

Regulators and legislators agree that bank capital requirements will rise. The benefits of more capital are self-evident, but measuring capital is both treacherous and begs the question of setting ideal targets.

For publicly traded bank stocks, is market capital the right metric? Too much volatility. Value-at-risk? Widely discredited. Fair-value accounting? Healthy banks rightly protest that this exposes a bank to punitive, fire-sale liquidation pricing.

But isn't this exactly the information that the FDIC, as deposit insurer, requires to assess a bank's rising cost of resolution? Indeed, under the prompt-corrective-action law, the FDIC must act when the book value of capital hits defined thresholds. Based on recent history, we can test how well capital as measured under this law has worked. From this, maybe policymakers and regulators can reconsider the merits of mechanical capital-testing and the usefulness of these tests in pursuit of least-cost resolutions.

In 2009, 140 banks failed. On the day of each failure, the FDIC released an announcement of the closure, the resolution structure (if known) and estimated losses. The FDIC projected losses from the 140 failures averaging 25% of total assets — a negative equity ratio of 25%. For the reporting period immediately prior to failure, these 140 institutions claimed capital ratios of positive 4% — a swing of 29 percentage points as measured against total assets.

What is the utility of these stated capital ratios in a liquidation scenario? From a policy perspective, seeking to limit risks to the Deposit Insurance Fund and the American taxpayer, what does it mean to require a bank to achieve and sustain a 10% capital ratio as opposed to today's "well-capitalized" requirement of 5%? Such shifts pale in comparison to the measurement error cited above.

These numbers challenge us to think more imaginatively about bank failures, the capital-raising hurdles faced by many deserving banks, market and community disruptions stemming from such failures and the FDIC's statutory mandate to pursue least-cost resolutions. No doubt, some banks, due to poor management or unmet local market demands, should fail as banks rationalize and consolidate. Likewise, the many banks run by dedicated, conscientious officers and employees, which serve a local market's need for deposit-gathering and credit allocation, deserve to be preserved. Here, too, the limitations on capital measurement raise serious policy questions.

FDIC cease-and-desist orders against "problem" institutions typically contain two mandates: to dramatically curtail classified assets and to raise capital. For most banks operating under a C&D, this is tantamount to a death sentence.

If management liquidates classified assets in today's market, the realized losses will only deepen capital shortfalls. But potential bank capital providers shy away from troubled institutions until they are cleansed of problem assets.

In any case, investors prefer to negotiate over the carcass of an institution post-failure. We have discussed this with many distressed-asset and bank capital investors. There are no attractive "deals" to be had for still-operating institutions in competition against loss-sharing or other risk-limiting purchases and assumptions of failed banks.

To its credit, the FDIC has experimented with creative structures to limit its losses after a bank fails. It has yet to apply the same creativity to preserving marginal banks by promoting the disposition of classified assets and encouraging capital raising.

Deep pools of capital exist for both classified assets and investments in a clean bank charter. Combining these pools of capital to save a tottering institution requires a third leg to the stool: the FDIC's direct capital support.

Consider the example of a watch-list institution with total assets of $1 billion and tangible capital of $50 million — or a 5% tangible capital ratio. Market-clearing bids for classified assets may require a further writedown of $50 million, rendering the institution insolvent.

Obviously, bank management can never pursue this balance sheet clean-up in isolation. Simultaneously, a bank capital provider may be interested in the cleansed bank charter and willing to commit $25 million to partially recapitalize the bank. This still leaves the bank significantly undercapitalized, with a 2.5% leverage ratio.

Marrying this tandem bid with FDIC support of $50 million, however, would elevate the institution to good health and a clean balance sheet, infusing new capital from an outside investor and avoiding unnecessary local disruptions. From the FDIC's perspective, averting this bank's failure may have averted a cost to the DIF of $250 million (the 25% of total assets average cost of failures in 2009), and the agency satisfies its mandate to execute the least-cost resolution.

Admittedly, this fact pattern may only apply to a narrow band among the hundreds of banks on the FDIC's watch list. But direct FDIC support along with fresh capital and a purge of nonperforming assets achieves many benefits, including the encouragement of local lending activity, preserving community banks in otherwise underserved communities, conserving the DIF's dwindling resources and giving deserving managers of salvageable banks an important story to attract needed new capital.

New capital sources are crucial for restoring vibrancy to the banking industry. The FDIC's well-considered participation in recapitalizations is critical to attracting this new capital.

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Written Comments for the August 16, 2011, Field Hearing of the House Financial Services Committee's Subcommittee on Financial Institutions and Consumer Credit in Newnan, GA

The Community Bankers Association of Georgia (CBA) is a banking trade organization providing various support services to the community banks located in the state of Georgia. Among other services, the CBA provides advocacy for community banks regarding various legislative and regulatory issues. The CBA represents over 240 community banks and thrift institutions in the state of Georgia. Our members are located in rural, metropolitan and suburban areas.

We are in regular contact with community bankers from across the state and over the last three years have heard many concerns regarding the overly harsh examination environment in which their banks have been operating. The concerns are many and separate comment letters could be generated on any number of subjects; however, the comments we are submitting today will be confined to the concerns that the FDIC loss sharing agreements have created for many Georgia communities and for community banks which are continuing to struggle to survive in the current economic environment.

We understand providing loss sharing agreements to purchasing banks in order to entice them to purchase the majority of loans at a failed bank is believed by the FDIC to be the most cost-effective manner to resolve a failed bank. We also understand the FDIC believes a failed bank's loans remaining in the private sector, as occurs under loss share agreements, is a major advantage to all concerned, including the borrowers. No doubt there is some merit to the position of the FDIC on loss sharing agreements. However, based upon feedback from community bankers across Georgia, it is clear such agreements also have their significant downsides and have contributed to the struggles of many still existing community bankers, their customers and their communities.

One major concern community bankers have with loss share agreements relates to situations where a still existing bank has a participation in a loan was sold to a purchasing bank under a loss share agreement. The FDIC contends the participating banks and the borrowing customers should be better positioned by the loans remaining in the private sector with a bank they can work with on such loans. After all, the loss sharing agreements require the purchasing bank to administer loans purchased under a loss share agreement in the same manner they would if the loan had been originated by the bank. However, **there is a presumption here that the interests of the loss share bank and the participating bank will be aligned in regard to such loans. That is simply not the case.** When you think it through a bit, it is easy to understand why the interests of the respective banks can never be aligned. The FDIC will cover 80% of any loss in loans purchased under a loss share agreement, while the participating bank has no such benefit to cover the potential losses on its share of the loan. The participating bank is fully exposed to loss on its portion of the loan. The FDIC guarantee decreases the incentive of the loss share bank to work with borrowers to restructure loans and find a way for the borrower to survive and repay its loan. The most the loss share bank can lose no matter what happens on the loan is 20%, as long as they follow the terms of the loss share agreement. The FDIC expects the loss share banks to work out each loan under the loss share agreements in such a manner as to minimize the loss and they count on the 20% "skin in the game" to incent the loss share bank to do that. However, there is some risk with any restructuring of a loan. The concern that restructuring will not work out and result in greater losses and somehow invalidate the loss share bank's FDIC guarantee seems to outweigh the 20% "skin in the game" in most situations for many (not all) loss share banks. Clearly, this concern on the part of the loss share bank of losing the FDIC's guarantee serves to further decrease their incentive to work with borrowers to work out payment plans, unless there is virtually no risk in a restructuring.

The stories from participating banks abound where it appears they are being forced to take greater losses due to the manner in which the loan is being handled by the loss share bank. While the experience of participating banks varies greatly from one loss share bank to the next and to some extent from one loan to the next, the following are just a few examples of problems experienced by participating banks in dealing with loss share banks: (1) the loss share bank does not keep the participating bank informed of what is going on with the loan --- the loss share bank will not return phone calls or provide requested information on the participated loan; (2) the loss share bank makes no effort to work out a payment plan with the borrower --- they simply proceed to foreclose and liquidate collateral resulting in large losses on the loans --- but, the loss share bank's losses are largely covered by the FDIC guarantee while the participating banks are forced to take large losses diminishing their chances of survival; and, (3) in some cases the loss share banks have encouraged the borrower to file bankruptcy and not try to work through their payment problems --- again, this may not really harm the loss share bank due to the FDIC guarantee, but the participating bank is left fully exposed. We want to emphasize these problems do not exist with every loss share bank and we further want to emphasize we are not saying the loss share banks are the "bad guys" here. In fact, in our opinion, they, too, are somewhat the victims of the loss share system, due to their overriding concern not to invalidate the FDIC guarantee. Clearly, the loss share bank will always err on the side of maintaining the validity of the guarantee, if there is any question that working with a borrower could create a risk in that regard.

Community bankers believe some of the tactics used by loss share banks in the handling of these loans could possibly be construed to violate the requirement in the loss share agreement that they administer the loans as they would loans they themselves originated. The handling of loans by the loss share banks is subject to audit by the FDIC's Division of Liquidation and Resolutions, so, at one point, it was suggested to the Liquidation Division personnel perhaps a part of those audits should consist of contacting participating banks in cases where the loss share loans had participations to gain the participating banks' perspective. However, the FDIC Liquidation and Resolutions personnel indicated the staff for auditing was limited and they would likely not have the time to contact participating banks. It seems that with the knowledge this could be a problem area; the FDIC should target this area in such audits.

In summary, this situation has resulted in a very untenable situation and the negative incentive created by the loss share agreements for the loss share bank in regard to restructuring loans, <u>whether or not they involve participations</u>, has further devastated the various communities where banks have, unfortunately, failed. Local businesses which might have a chance to repay loans, if they were restructured, are closed down, harming the local economy, local property values and the local tax base. In addition, this situation is further increasing the chances that some still existing, yet struggling, banks will fail as a result of the growing losses they are taking on the participation loans they have with loss share banks.

Moving on, another significant problem community bankers believe is created by the existence of loss share agreements is the fact their existence increases the difficulty struggling community banks have in raising needed additional capital. Investors prefer to simply wait until a bank fails and purchase a failed bank with an FDIC loss share agreement on the loans, rather than invest their capital in a still existing bank which is struggling to survive. **A number of community bankers very strongly believe significant private capital will not flow the way of still existing community banks until the FDIC is no longer offering loss share agreements. Obviously to the extent still existing, struggling banks, must have additional capital to survive, impediments to raising that capital, including the loss share agreements, are increasing the chance for more failures.**

While we hope some of the general comments we have made above are of some benefit to the Subcommittee in its study of the issues surrounding bank failures, we believe the personal stories of community bankers regarding the issues discussed above would be even more revealing. We have encouraged the member banks of the CBA to send comments to you providing their personal experiences on these and other issues. Thank you for holding this field hearing in Georgia and thank you for the ability to provide comments.

If you have questions about our comments, please feel free to contact us.

Sincerely,

Steven D. Bridges
Executive Director of Legislative and Regulatory Affairs

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RE: Congressional Field Hearing | H.R. 2056

Dear Sir or Madam:

As a community banker, I would like the opportunity to offer my comments into the record at the local Congressional field hearing scheduled for August 16th.

Please see the attached document.

Sincerely,

Carl C. Hames, Jr.
CEO

CCH/na

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First Cherokee State Bank | Carl C. Hames, Jr., CEO | 9860 Hwy. 92 | Woodstock, GA 30188

Credit Availability Questions asked by the FDIC examiners

1) Please describe the obstacles your institution faces in its loan market?

Our loan market is characterized by a high concentration of real estate lending, specifically related to the residential acquisition, development, and construction industry. Many of our customers are in businesses that are directly or indirectly related to the residential construction industry. as our county became a popular headquarters for companies in many construction-related trades. For example, plumbers, electricians, drywall, lumber, heating and air, landscaping, etc. The steep decline in the construction industry has led to lower demand, fewer qualified borrowers, and customers who are struggling financially in the aggregate. When a large economic segment of the community is struggling, there is a trickle-down effect to seemingly unrelated businesses and individuals. For example, we have seen private schools, retail shops, hardware stores, etc. all struggle as well. What has happened in our community is not that much different than when the textile industry or steel industry experiences economic turmoil and the surrounding communities suffer. The typical requests we see are related to short-term capital needs with little or no collateral from businesses with declining trends in industries that are suffering. In addition, many consumer real estate transactions are difficult to close as appraisal values remain low and even below actual costs and/or actual purchase prices.

In metro Atlanta/North Georgia, there are many small banks and large banks concentrated in a relatively small geographic area. Two-thirds of all the banks in Georgia are under regulatory sanctions, the large banks have TARP and are dumping real-estate, the smaller banks who are under regulatory sanctions must reduce concentrations and dump OREO, and the fifty-eight failed banks are dumping real-estate using the benefits provided by FDIC loss sharing agreements. The results of all this is a real-estate market value spiral created in a small geographic area in a twenty-four month time frame. These facts alone make renewal of existing loans and providing new credit extremely difficult from a collateral value view point. This is before you look at the economic stresses the borrowers are under.

2) Has the regulatory process interfered with your ability to prudently originate or restructure loans? If so, explain why.

The regulatory process has interfered with our ability to prudently originate loans. From an origination standpoint, forced concentration reduction embedded in a regulatory order has been interpreted that we should not originate any new loans in categories with "undue" concentrations. It has been further implied that we should not renew them or restructure them in some cases, based on their category. When capital is at abnormally low levels, it is nearly impossible to NOT have a concentration in almost any category, since 100% of capital is the benchmark. For example, if you have $13 million in capital, a $250 million bank would have a concentration in any category with more than $13 million in loans within that category. There aren't enough categories to effectively rebuild or diversify a portfolio if the 100% of capital number is going to be used as a benchmark. It is a math problem with no solution. Furthermore, no consideration is given to the uniqueness of a local market – the regulatory process just says a concentration is a concentration – regardless of why it is. The overriding regulatory presumption is that concentrations are a result of blind mismanagement and not a reflection of the business community in which we reside. If you are in a textile, steel, or agricultural community, you would likely have a concentration in those areas as your balance sheet should probably be a reflection of your community. If the textile industry as a whole were to collapse, the banks centered in those communities would struggle. The same would hold true for community banks based in agricultural communities that suffer natural disasters or poor crop patterns. We happen to be in a construction-centric community and have a concentration in customers related to that industry. The regulatory process has dictated that we develop and implement a plan "to reduce any segment of the portfolio which Supervisory Authorities deem to be an undue concentration of credit in relation to the Bank's Tier 1 capital." In our case, it was determined by supervisory authorities that any segment over 100% was an undue concentration. This section of the order basically prohibits us from lending in many categories and specifically tells us to reduce (shrink) our portfolio in many areas. The forced reduction is in the areas of lending in which our local economy is based on and relies on the most. In addition, we are carrying excess liquidity and not lending it out due to regulatory criticism that liquidity is inadequate due to a lack of alternative sources of funding. Lending of any substance would certainly lead to further criticism of one of our CAMELS ratings. Liquidity criticism has a direct correlation to our willingness to lend in any substantive manner.

3) What steps can bank regulators take to promote the availability of loans to creditworthy borrowers at insured depository institutions?

Regulators can help by putting enforcement actions and orders in place that can facilitate returning an institution to health rather than putting an institution into a death spiral. This cycle has seen us put into such an order, and then be simultaneously criticized by the same authorities for poor trends and performance – when the very order they have us under prohibits many possible actions that could stabilize or reverse those trends. For example, regulators have and will continue to criticize us for not having adequate earnings, while simultaneously forcing us to shrink the largest and most market relevant segment of our loan portfolio - via legal order. Regulators have and will continue to criticize us for having a poor margin, while simultaneously criticizing our liquidity position despite having in excess of 20% on balance sheet liquidity. That criticism implies we should stay at or increase the amount of liquidity we carry, which leads to even poorer earnings and further criticism. The regulators have and will continue to criticize us for our position in interest rate sensitivity, even though they have ordered us to reduce lending in categories that have historically provided the largest source of floating rate loans. The regulators have and continue to criticize us for inadequate earnings and capital, while simultaneously requiring, via legal order, an aggressive reduction (aka - liquidation) in adversely classified assets - which are centered in real estate. This is despite the fact that the local economy is entrenched in one of the worst real estate valuation cycles in modern history. The order causes us to lose more money than necessary by forcing liquidation of assets at a point in time of historic low values - then we are criticized for taking those very losses. The order does not give any consideration to the economic condition of the local or national economy. This is a never ending circle. In addition, as other community banks struggle in and around our market, they are under similar enforcement actions and legal orders that require them to also reduce lending in these same segments. The aggregate practical effect of the regulatory actions across the community bank sector in our market is that they are not allowed, by legal order, to make loans to certain segments of the market until concentrations come down. The aggregate effect of "reducing" lending to an entire segment in an entire market simultaneously is devastating to all involved. If you do the math and add up 100% of the aggregate capital of the community banks in our market and restrict lending to that number to avoid undue concentrations, the market will forever be under-served – at least by community banks.

Regulatory authorities should re-examine PCA restrictions on new lines of business. For banks with high concentrations in loan categories, new lines of business are necessary to diversify the income streams for the company. They are also necessary to diversify risk within the company, and are needed in response to an evolving consumer sentiment and behavior.

In addition, there is a general silence from regulators related to the approval of any strategic or capital plans required as part of regulatory orders. There is also silence on any permission that must be obtained to manage a bank effectively. In many cases, there isn't even a "no", there is just no response. Regulatory officials seem to be paralyzed in many cases in that they are afraid to approve anything at the risk of it being hung around their neck if it doesn't work out. If regulators could provide quick, affirmative approval or denial (with commentary and feedback) of these required plans, banks would at least have clarity as it relates to their future lending strategy and capital prospects, so that communities can continue to be served. Without approval, banks are left dying on the vine and unable to pursue strategic initiatives or capital that could turn around their current condition.

GBA

GEORGIA BANKERS ASSOCIATION

the resource that empowers

August 12, 2011

The Honorable Shelley Moore Capito
Chairman, Financial Institutions and Consumer Credit Subcommittee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Capito:

On behalf of the more than 290 commercial banks and thrifts doing business in Georgia, thank you for holding a hearing of the Financial Institutions and Consumer Credit Subcommittee of the House Financial Services Committee in Georgia.

Banks in Georgia employ more than 60,000 people in communities across our state, pay taxes and keep deposits safe and accessible any time, anywhere. Our banks are the infrastructure of an efficient payment and transaction system. In many communities, bankers also are the go-to financial experts for community and civic organizations in both the volunteer and official capacity. The industry is important to our state.

A majority of our state-based banks and thrifts remain well capitalized based on regulatory guidelines. However, it is no secret that the global economic pains of the past four years have had a dramatic effect on our state and its banking industry.

The high number of Georgia bank closures is a reflection of an historic correction in real estate values.

When the national mortgage markets seized in 2008 and the subsequent meltdown in real estate values occurred, many businesses dependent on a thriving real estate market were unable to pay back their bank loans. A prolonged period of unemployment above the national average also has contributed to a lack of demand for those borrower's homes and services, further compounding the problem and losses for banks.

Those losses, combined with pro-cyclical accounting and regulatory policies, caused the regulators to close those banks that were no longer viable.

We are certain that the bankers you hear from during this hearing will shed further light on some of the regulatory related issues that have contributed to this unfortunate numbers of bank closures.

Some of our members continue to fight for their ongoing viability, many are beginning to recover incrementally but still face severe regulatory scrutiny and even more, as mentioned, are well capitalized but experiencing slow growth due to poor demand and exercising prudent caution in underwriting that the soft economy still requires. All are concerned by the growing mountain of additional rules, regulations and compliance burdens that will add cost to their business, make it too expensive to offer certain products or services and restrict their ability to make reasonable profits. Remember, too, that profitable banks are healthy banks.

GBA
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Hon. Shelley Moore Capito
August 12, 2011
Page 2

Our job as an Association in support of our members is to strengthen the banking environment in Georgia by:

1. Supporting issues that protect real estate values.
2. Supporting initiatives to help conserve and replenish bank capital.
3. Supporting policy and regulatory actions that stabilize banks.
4. Supporting policy and regulatory actions that enable lending and foster job creation.

In our view, the following barriers remain to stronger banking climate:

- Continued weakness in the broad economy and the extended period of high unemployment continue to stress borrowers and limit demand for high-quality new loans.
- Loan demand from qualified borrowers remains low.
- Difficulty in obtaining reasonable and consistent property appraisals continues to put downward pressure on property and collateral values.
- The Dodd-Frank Act is a year old, however many of the effects still will take years to determine. The most significant impact to date is the Durbin Amendment and Federal Reserves' cap on debit card interchange rates, which will roughly cut revenue from those transactions in half for many banks. Overall, additional regulatory burden will increase costs for banks and consumers, and likely reduce availability of credit.
- Regulatory examination pressures applied to real estate portfolios, bank capital, liquidity and compliance programs have caused many bankers to resort to balance sheet shrinkage and curtailment of lending. Businesses, consumers and communities suffer. Bankers, the GBA and other industry groups have asked Congress to be active in providing monitoring and oversight of regulatory activities.
- Troubled Debt Restructuring reporting requirements trigger new appraisals. There's question as to whether working with borrowers is actually creating more capital and valuation problems for banks and their customers.
- Regulatory interpretations of accounting guidelines, FAS 114/5 related to real estate continue to cause banks to use real capital to account for theoretical real estate losses, putting further stress on bank capital levels.

Breaking down some of these barriers will require broad economic and market improvement. However, regulators, legislators and policymakers can also help, too, by focusing on common-sense ways to encourage more flexibility and stability.

When economic, regulatory and policy progress are made, there are some underlying positive economic fundamentals for the State of Georgia that can trigger a more rapid, healthy and robust recovery.

- Overall bank performance is improved, throughout the state, with more banks reporting profits as well as lower levels of delinquent loans.
- Access to private capital has improved somewhat for a handful of banks.

GBA
GEORGIA BANKERS ASSOCIATION
the resource that empowers

- There is hope that the real-estate market is at or near its bottom. In the state's largest market, the S&P Case Shiller Index of home prices for metro-Atlanta showed those home prices were essentially flat for April and May. Housing inventories have declined, in general, as a result of the lack of new building in the past three years.
- The pace of foreclosures and noncurrent loans has slowed.
- Georgia is expected to be among the top five states in population growth through 2020. And, the state continues to rank highly for entrepreneurial activity, business relocations, workforce quality, infrastructure and business-friendly government.
- Georgia's ports continue to do record business. Manufacturing is improved, with the auto sector thriving.

However, as stated above, there are some barriers that would foster a stronger banking climate and those barriers must be addressed for to ignore those very real challenges will slow the recovery.

We appreciate this hearing and support Rep. Westmoreland's bill (H.R. 2056), to require an FDIC/GAO study on the effects of bank closures. This forum and the Congressman's bill are important components for everyone – bankers, policymakers and regulators – to work together toward the common goal of a better economy.

Thank you for the opportunity to comment and share the concerns of our members.

Sincerely,

Joe Brannen

Joe Brannen
President and CEO

William and Deborah Lytle
15790 Quail Trail
Bokeelia, Fl. 33922

August 11, 2011

Honorable Spencer Bachus
Chairman, House Financial Services Committee

also: Honorable Shelley Moore Capito
Chairwoman, Financial Institutions and Consumer Credit Subcommittee
2129 Rayburn House Office Building
Washington, DC 20515

Below is a summary of what I have gone through with the MultiBank 2009-1CRE Venture LLC takeover of my loan. The fact that our government has allowed this Fiasco to continue to artificially control the value of real estate and continue to stifle the economy is sickening to me. I have worked for 42 years of the last 55 and these long term investments were to provide retirement. Instead the bailouts and continued support have given a few banking institutions the ability to steel away the American Dream, take away our freedom and destroy capitalism in its true sense. The foreclosures should only be resolved to the benefit of the end user not investors. Imagine how the economy would be had all of the homeowners been given the opportunity to rewrite their mortgages for the deal given to the same banks we all bailed out and will continue to pay for. They have stolen our properties by loss in value, will profit by our loss and are using tactics to cause such accounting nightmares that they are literally stealing the property by foreclosure. Below is a summary of my experience in the only way I could put it on paper to make it simple and factual.

I have cared for these properties for seven years, paid taxes, paid insurance, paid mortgage payments with a long term goal of selling them to provide for my retirement.

The assessed value has fallen 60 percent, plus, so my 7 years of investment is gone. I cannot sell them and get back what I have put in them or continue to maintain and improve them because I can no longer rent them due to the loss of jobs and viable renters. So I have lost all the monetary value and equity, all the sweat equity, all ability to recover anything and then on top of it I am not given the opportunity to modify the mortgage to help me keep my investment BUT

The 13 bankers that we as tax payers bailed out are allowed to buy them for 40 percent of the original mortgage with an 80 percent guarantee on the return of their investment.

So now I have put seven years of investment into properties to provide my retirement and they are devalued to take away any gain I have had (stolen once)

They are sold out from under me and purchased with bailout dollars; I am paying for as a taxpayer, by the very people (13 Bankers reorganized) we bailed out. (stolen twice).

These people are trying to make it so difficult to understand the accounting of the loans or just plan cannot do it correctly which then gives them an avenue to start taking the property away by foreclosure.
(stolen a third time)

They don't care what they are doing they are guaranteed a return on their investment. Why wasn't I given that opportunity on my own investment?

Now the Situs Company (Multibank is trying to take the other two mortgages by showing different balances and telling me I have to provide proof I made the payments. One of these buildings houses my businesses and I cannot afford to loose it. They had my past due up over 25,000 or equivalent of 8 to 9 months payments because they put it in insurance escrow instead of making the payments. I had to have my insurance agents send them policies back to 2008 (they required) even though they did not own it until 2010 to show I have always paid this outright on my own. Again they have never contacted me regarding insurance ever on their own. I contacted them when I finally received an accounting that showed this huge amount of insurance escrow.

I thought it was illegal to take my mortgage payment and use it for ins. Escrow instead of putting in on the mortgage, especially when my mortgage never had an escrow account at all since it was started.

1. FDIC notified 2/1/2010 letter that Multibank 2009-1 CRE Venture LLC had purchased my mortgages (4 of them) on January 12, 2010.
2. Then I received a letter dated 2/10/2010 that the loans were sold to Multibank 2009-1 CML-ADC Venture, LLC on February 9, 2010. I was told I may be contacted by RL CML 2009-1 Investments, LLC or Quantum Servicing.
3. Then I received a letter dated 2/17/2010 that the 2/1/0/2010 letter was in error and actually Situsserv LLP would be the servicer and the new owner of the loan is Multibank 2009-1 CRE Venture LLC.
4. I had already made January, February payments to the FDIC. I did not make a payment in March on any of the mortgages as I was told three different things and upon viewing the county record my mortgages were no longer there. I decided I could not tell where my payment was going so did not send one.
5. There are four mortgages that are involved and 2 have foreclosure that I feel have been filed erroneously; due to lack of crediting the payments correctly.

6. None of my payments from January to April of 2010 were transferred to the new mortgage company.
7. My insurance policies showing the FDIC as receiver for Riverside Bank were not forwarded to the new mortgage holder nor did the new mortgage holder request any insurance documentation from me. I was never notified that there was a question regarding the listing of first insured on the insurance policies.
8. The servicer apparently starting using my mortgage payments for insurance escrow instead of making the mortgage payments.
9. Then when I finally received the first official payment coupon it was postmarked after the date is was due and of course by the time I received it was already late. There was no time to return it on time and even barely in the grace period if returned immediately. This went on for a few months. I saved all the envelopes and copies of the payment coupons to document this.
10. I initially called in June of 2010 to get an official statement of my mortgages, Situs has 4 of them. I was told that the FDIC payments would be credited and assumed that was the reason for the large amount showing due.
11. However it took until December 2010 for me to get a statement on any of the mortgages though I requested it several times, and when I finally received it the back amounts due were equal to 6 months or more and they had huge insurance escrow accounts and tax accounts instead of applying the payments to the mortgages. Again I was never consulted regarding insurance problems period.
12. Foreclosure was filed on two of the mortgages in November based on a demand letter from June 2010 and the company had been accepting monthly payment through August or September 2010. I stopped making them on these two mortgages after that because I could not tell where my money was going, they were not crediting the mortgage correctly and I had been given not copies of assignments of any of the mortgages, and they disappeared on the county record.
13. I had to pay an attorney 5,000.00 retainer and currently pay monthly for him to handle these two that had foreclosure filed.

Sincerely,

Deborah L. Lytle, Agent on properties on behalf of Myself and William H. Lytle

My name is Jerry Ownby and I own a small construction and development company. My company had three loans that were from Columbian Bank of Topeka Kansas. All of which were in good standing when FDIC/Rialto/LNV/multibank/Lennar froze all of the loans in place. This shut down construction and development work. I tried multiple times to work out the terms of the loans in a fashion that would benefit all parties involved. I ended up paying sub contractors and employees out of my personal pocket. This lead to the financial destruction of my company and a personal financial hardship of which I have yet to recover. All I ever wanted was a fair opportunity to work with whoever held the loans. This opportunity was never offered, even thou I have tirelessly tried.

1- I tried to work out a deal on each project that included the sale of the properties with active building permits, plans, presales, ect.... They didn't want to hear anything I offered. These projects went up for sale for 80% to 90% less than what was paid. There was a loss of millions of dollars in lost value. The Phoenix market too k a 30% to 40% loss, so the difference between the market loss and addition loss, by not working out together is due to the lack or unwillingness of parties listed above to work together to fix this crisis. They never negotiated in good faith and rejected any communications.
2- Approximate example of losses by project
Tempe place(Inv)-loan $5,750,000 for sale at $800,000
Camelback and 8th(rialto)- loan $6,300,000 for sale at auction start at $800,000
Portales (rialto)loan line of credit-$5,000,000 for sale at auction start at $1,300,000
17mm in loans
2.9mm for sale
14,100,000 in losses not including the legal
3- My work out would have cut the losses by 6 to 12 million. This included the sale of all necessary plans, permits, engineering, existing sales ect.. , that gave the properties there improved value.
4- There were four jobs lost in my company alone and I estimate fifty jobs lost with sub contractors.

This is truly unfortunate on every level. Tax payers, jobs lost, and my personal finances have suffered the brunt of the market crisis for my company.

August 15, 2011

Honorable Spencer Bachus
Chairman, House Financial Services Committee

Honorable Shelley Moore Capito
Chairwoman, Financial Institutions and Consumer Credit Subcommittee

2129 Rayburn House Office Building
Washington, DC 20515

Subject: August 16, 2011 Congressional Hearing, House Financial Services Committee – FDIC Bank Closures

Dear Chairpersons:

We are writing to provide additional background for our attached testimony questionnaire regarding our interactions with the FDIC and its private corporate partners following the collapse and takeover of local banks by the FDIC. We operate several corporate entities which own and operate commercial real estate properties in multiple states. As a part of those operations, we entered into loan agreements with Corn Belt Bank & Trust Company in Pittsfield, Illinois.

Corn Belt was closed by the FDIC in February 2009. During the recent and current economic downturn, many of our commercial developments began to struggle financially, resulting in difficulties maintaining our loan payments. Despite our difficulties, we did not seek to shirk our responsibilities or hide from them, but approached the FDIC and its partners about options for renegotiating and refinancing our obligations in order to weather the economic storm and still keep our obligations current. Our loans were initially transferred to Quantum Servicing, which was unresponsive and unwilling to work with us on negotiating a settlement of our obligations.

Our loans were then purchased for pennies on the dollar by MultiBank 2009-1 CRE Venture, LLC, a private company of which the FDIC is a member. I have enclosed a table of our entities and their loans now controlled by MultiBank. Our interactions with MultiBank, primarily through its for-profit partner First Colony, have been routinely discouraging. Despite our repeated efforts to negotiate, MultiBank's actions indicate that it is unwilling to and uninterested in negotiating a mutually beneficial settlement of our loan obligations. Since MultiBank purchased our loans, we have attempted communication with it through numerous telephone calls and emails, which are generally ignored. Months of non-communication are occasionally interrupted by spurts of interaction, including a single meeting with a representative at our attorney's office. Even on these occasions, however, the communication is brief and we hear nothing back for months. We have even made direct contact with multiple law firms representing MultiBank in hopes of creating a dialogue to reach a solution. The attorneys with these firms are generally receptive to our efforts and eager to negotiate with us, but the negotiations always come to a standstill when the opposing attorneys seek out MultiBank for communication or approval of proposed settlements.

Despite the fact that MultiBank purchased our loans for a fraction of their actual value, it has rejected our settlement offers with values of multiple times the loan purchase amounts. It has become clear that MultiBank's goal is simply to foreclose on our properties before seeking deficiency judgments for the remaining balances on our loans. Sadly, such efforts will result in far lower returns as there is little we have to personally contribute. MultiBank and the taxpayers would be much better served by allowing us to renegotiate the terms of our loans and work to keep our commercial developments viable through these harsh economic times. Foreclosure on the properties would require us to abandon our commercial developments, further worsening the economic climate in which they currently struggle.

We believe that MultiBank should be seeking the best possible outcome on behalf of the FDIC, rather than seeking to foreclose on as many properties as possible in a short period of time, as can be inferred by its actions. Further, our understanding of the situation is that the FDIC's agreements with these private companies include "make whole" provisions, which ensure that regardless of the amount collected on any of these loans, the FDIC has guaranteed to repay the companies a significant portion of the value of the loans. Such an arrangement would clearly provide MultiBank with no incentive to reach settlements with debtors, and encourage minimal negotiations and hasty foreclosures – actions that directly mirror our interactions with MultiBank. We ask that the Committee examine the relationship between the FDIC and its private partners to ensure that the goal of all the parties involved is a positive resolution of this tragic situation rather than a financial windfall for the privately-owned members of MultiBank at the hands of small business owners and the taxpayers.

Sincerely,

K.J. Sturhahn & D'Aunn Sturhahn

cc: Honorable Aaron Schock, Congressman, 18th District
Honorable Bobby Schilling, Congressman, 17th District

Entities and Indebtedness

Aspen Chase Investments, Inc.	original loan amount of	$221,000
Aspen Chase Investment Property 1, LLC	original loan amount of	$1,218,000
Aspen Chase Investment Property 5, LLC	original loan amount of	$1,617,000
	original loan amount of	$166,000
Aspen Chase Investment Property 6, LLC	original loan amount of	$1,411,760
Aspen Chase Investment Property 7, LLC	original loan amount of	$3,716,323
Aspen Chase Investment Property 10, LLC	original loan amount of	$199,819
	original loan amount of	$132,216
	original loan amount of	$3,850,500
Aspen Chase Investment Property 11, LLC	original loan amount of	$3,620,372
	original loan amount of	$131,129
	original loan amount of	$100,000
	original loan amount of	$150,000
	Total:	$16,534,119

American Land Rights Association
National Inholders Association

"Unlock the Bureaucracy."

National Headquarters:
30218 NE 82nd Avenue (PO Box 400)
Battle Ground, Washington 98604
Phone: (360) 687-3087
ALRA@pacifier.com

Legislative Office:
507 Seward Square SE
Washington, DC 20003
FAX: (360) 687-2973
www.landrights.org

Honorable Spencer T. Bachus III (R-AL), Honorable Shelley Moore Capito (R-WV)
Testimony For The Record On FDIC Oversight -- For the Hearing held August 16 in Newnan, Georgia
House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit
US House of Representatives, Washington, DC 20515

Testimony by Chuck Cushman, Executive Director,
American Land Rights Association
September 1, 2011

FDIC Bank Closure Policies and FDIC Authorized Aggressive Tactics by FDIC Partners Are Destroying Jobs, Small Businesses, and Communities -- Holding Back Economic Recovery and Job Creation

Problem: The FDIC's methodology, policies, and procedures, while closing an average of two banks per week have created significant, unnecessary hardships on American citizens, borrowers, and vendors of failed banks. FDIC policies have been a driving force in the destruction of local and the national economies, markets and industries, destroyed hundreds of thousands of jobs and promoted the growth and market share increases of national banks (too big to fail) to the detriment of community banks, the American people and the free market system.

The FDIC's use of Loss Share Banks (Banks or equity group formed banks, that purchase failed bank assets at deep discounts, which are further indemnified up to 80% of collection loses by the FDIC – **(Loss share banks receive reimbursement of 80% to 95% of losses on assets that don't yield a stated return**) and Public-Private Investment Program or PPIP's [partnerships with publicly-traded Wall Street hedge fund companies (such as Rialto/Lennar Multibank, Colony, Kingston, Starwood, Roundpoint, and other FDIC partners)].

These partnerships have fueled and accelerated the degradation of market economies and real estate values, artificially prolonged and deepened the current economic recession currently impacting the country. All this for the profit of the FDIC's private hedge fund partners. **The FDIC has apparently unintentionally become an active partner in victimizing hard working Americans and businesses.**

The statutory powers of the FDIC do not entitle them to pick winners and losers or to create different classes of citizens (borrowers versus depositors or the wealthy few versus the American public) especially with taxpayer money in violation of federal law (see TARP) Troubled Asset Relief Program requirements). In addition, FDIC procedures and methods have squandered the Deposit Insurance Fund in the conduct of their Receiverships and Loss Share Bank Agreements. **Finally, let's face it, the FDIC has been inconsistent and done a poor job regulating the banking industry.**

With regards to the PPIP's, the FDIC is using taxpayer/US Treasury funded interest free loans to finance the public/private structured sales, with little or no return to the taxpayer. The FDIC has shown no consideration of the unintended consequences to quality small businesses with strong track records (who were in good standing before the bank closure) and all for the profit of the FDIC and their publicly traded partners. These businesses are being destroyed by foreclosures created by FDIC policy of choosing to partner with the huge Wall Street hedge funds.

1.

These local businesses are ultimately forced into bankruptcy eliminating most from hiring workers and rebuilding the economy.

The FDIC drafted the PPIP documents, which require the minority structured sale participant, Rialto/Lennar (in this partnership called Multibank 2009-1), to pursue borrowers without regard or consideration of to the circumstances surrounding their individual loans) until they cannot be legally pursued anymore. **FDIC policy does not even consider whether most borrowers were current on their** loans.

Rialto, Multibank, and other FDIC PPIP partners aggressively litigate borrowers, attempt to force them into bankruptcy, obtain judgments and further pursue those judgments against personal assets and savings and generally attempt to ruin all borrowers and guarantors, unless they pay the loans off or gain an unappealable court decision in the borrower's favor. **They aggressively use the court system in their tactics and will punish and outspend borrowers with legal fees until they are broken as their legal budget is unlimited and paid by the FDIC using taxpayer dollars. There is no way for the average citizen to fight back in court when all the court costs and legal fees are being paid by the FDIC (taxpayer).**

These unlucky borrowers had their loan at a bank that just happened to be closed by the FDIC. Overwhelmingly these borrowers were current with their loans but the FDIC bank receivership froze all loans, funding, and loan provisions. Rialto (FDIC Partner) aggressively uses the threat of the IRS as part of their tactics and they fund their efforts with taxpayer dollars at no cost to them. **There is no effort to work with borrowers already damaged by the FDIC's tactics.**

All of this economic disaster has been orchestrated by the FDIC. The FDIC policy requires full pursuit of all judgments as a condition for the participating PPIP minority partner to get paid its share. (This statement is repeated below in context.) (See attached statements by affected borrowers.)

The PPIP's are rewarded for employing FDIC scorched earth tactics against the borrowers of the failed banks and the effect of destroying local economies, jobs, and property values in addition to the borrowers' ability to support themselves going-forward. The borrowers did not cause the bank to fail and did not cause the disruption of their loans that result from the FDIC's process and use of outside contractors with little or no oversight from FDIC or Congress.

Solution: The FDIC sponsored attacks on small business must stop. Congress must limit the ability of the FDIC and their partners to go after deficiencies and personal assets. Collections must be limited to collateral securing the loans they acquire. What is needed is a **simple amendment to the FDI Act and FIRREA**, that is a variation on the "Bridge Bank" concept, which is already in the FDIC playbook. This will eliminate the waste and misery forced on the American public and economy by the FDIC and its partner companies. Together, they are destroying local businesses (borrower's) and other members of the local communities, victims of the bank closures that were not direct customers of the failed banks nationwide.

Without diminishing the FDIC's authority or autonomy, **this amendment** provides a **Preferred Least Cost Resolution** methodology, which protects depositors, borrowers and vendors of failed banks and the markets they serve and the people living and working within those markets whether they banked at the failed institution or not. The **Preferred Least Cost Resolution** protects everyone.

It treats everyone fairly, equally and with respect. It eliminates the need for Loss Share Banks and FDIC PPIP's partners such as Rialto and Multibank. It does not create different classes of citizens and it does not favor equity groups and hedge funds over the borrowers and jobs producers in the local market, as do current FDIC methods. It is demonstrably less expensive to the deposit insurance fund than current methods utilized by the FDIC. However, if the FDIC is allowed by Congress "to do things the way they have always been done", which is clearly not the Least Cost Resolution as required by statute, then the destructive effects of their efforts and alliances are reduced and contained by limiting the extent of their collections to realizing on the collateral securing the loans they acquire. It is still their choice.

2.

PROPOSED LEGISLATION
THE PERFERRED LEAST COST RESOLUTION AMENDMENT

Without diminishing the role, historical purpose or authority of the FDIC as defined within the FDI Act and or FIRREA, we propose the following supplemental provision to the body of law known as The FDI Act and 12 USC 1821(e) and its various counterparts in their entirety known as FIRREA referred to herein as "THE ACTS":

"Notwithstanding anything contained within THE ACTS to the contrary, in which case this provision shall control and govern: The ***Preferred Least Cost Resolution*** for the resolution of the Receivership's assets shall be the contribution of capital by the FDIC, from the Deposit Insurance Fund, in an amount sufficient to adequately capitalize the Receivership's Capital Account as defined by prevailing regulatory standards for banks, in return for a preferred return not to exceed 10% per annum. During the term of the investment:

-----1. The Receiver shall retain the former bank's name, management and employees to operate the Receivership and manage the Receiver's assets and liabilities in the ordinary course and to honor all agreements, contracts and responsibilities including but not limited to all depository accounts and loan relationships of the former institution, thereby protecting all depositors, borrowers and vendors of the Receivership. The Receivership will also continue to make advances against valid loan contracts and renew loans for qualified borrowers in the ordinary course.

-----2. The Receiver shall not allow incentive compensation or excessive salary compensation to be paid to or accrued for the future payment to the former bank's management, now Receivership managers. Shareholder dividends will cease. Committee Member / Director compensation will be limited. The Receiver will employ a new Executive Manager to supervise the activities of the Receivership's managers and implementation of the regulator's safety and soundness recommendations by the Receiver's managers on the operation. The Executive Manager shall report solely to the FDIC as regulator in all matters and insure the implementation of the FDIC's policies and regulations.

-----3. Upon payment of the preferred return and return of all contributions of capital to the Deposit Insurance Fund managed by the FDIC, the Receiver and related State Banking Department will return sole control of the capital stock to the shareholders and reinstate the charter of the former bank to the shareholders and then managers of the former Receivership.

In the event the FDIC, in its sole discretion, pursues an alternate method as the Least Cost Resolution in lieu of the ***Preferred Least Cost Resolution*** for the assets of the Receivership, then the collection efforts of the Receiver, and any assignees of or successors-in-interest to the Receiver, by statute, will be limited to the disposition of collateral securing the Receivership's, assignee's and or successors-in-interest's note(s) in full satisfaction of Borrower's and Guarantor's obligations for the debt outstanding without exception.

No deficiency will be allowed or sought by the Receiver or it's assignees or successors-in- interest as a condition of note acquisition. If the Borrower desires to retain the collateral and maintain the loan payments on a current basis, then the Receiver will renew the note at a fixed market rate of interest limited to a maximum of 6% per annum including fees, for a term to maturity of not less than 60 months, on the same terms, conditions and amortization that were contained in the original contract as of the day of the Receiver's appointment, in which case a default by borrower will reinstate the Receiver's contractual right to pursue deficiencies and any other remedy allowed by law and enumerated in the original loan contract, in the event of borrower default."

CURRENT ACTIVITY OF PPIP'S PENDING INVESTIGATION

Federal law, state law and the Uniform Commercial Code prohibit a party to a contract from benefiting from any illegality. It appears that Multibank and other FDIC created PPIP structured sale entities are clearly benefiting from an illegal act.

The transaction funding the FDIC PPIP's appears to be illegal because it does not meet the requirements of TARP to borrow from the US Treasury. TARP required the borrower to provide the US Treasury with an equity interest in the borrower, so that the US Treasury could participate in the up side if a profit was realized. It is an essential component of the TARP program.

The FDIC publicly advertised that these PPIP's would be funded by TARP. These PPIP's failed to comply with the law and therefore, their use of taxpayer money appears to be illegal under the law (Troubled Asset Relief Program). The US Treasury / taxpayers were not provided an equity ownership position in the PPIP borrowers, that received the public funds interest free. THE TAXPAYER IS NOT EVEN EARNING A RETURN ON THE RISK OF TAXPAYER DOLLARS. The Multibank / Rialto PPIP alone spans 11 states across the country, representing 22 failed banks and 5,500 borrowers and $3.02 Billion Dollars.

To date, there are 27 FDIC PPIP's impacting some 39,000 borrowers nationwide and represent over $23 billion of loans and property in jeopardy. Many borrowers have already lost deficiency judgments, assets and everything they own to these tactics and many more litigations are on-going.

We respectfully request our elected representative in Congress:

-----1. Halt all funding by the US Treasury for the FDIC Public Private Partnership program until a complete audit is made by the FDIC Inspector General and the GAO (Government Accountability Office). Further, that the Congress freeze the lands taken by the FDIC and their partners with the ultimate goal of revesting these properties with the original owners where the abuse of power by FDIC and its partner companies have resulted in taking lands inappropriately and using the FDIC extreme powers inappropriately.

-----2. Congress must intervene to stop the attack on private owner assets and guarantees until these public audits are complete. The mass slaughter of small businesses and the damage to local communities must be brought to an end as quickly as possible. In other words, impose an immediate injunction against their collection activities and lawsuits until a thorough investigation can be performed.

-----3. Defund the Multibank /, and any PPIP's not in compliance with TARP, or using TARP funds.

-----4. Intervene and mandate that judgments already awarded to the Multibank & other PPIP's against borrowers be vacated due to their participation in an illegal act central to their benefit.

-----5. Intervene for a mass settlement between the Multibank & PPIP's and borrowers based solely on the transfer of collateral in full satisfaction of the debt.

-----6. Pass immediate Federal Anti-Deficiency Law that is based on recently approved Nevada Law AB 273- Anti-Deficiency Law. *This law* **limits** *PPIP*'s (like Multibank/Rialto/Lennar) *or Private Loan Speculators who re-purchase these notes for pennies on the dollar at depressed market values and make immense profits. These Loan speculators would be prevented from then also suing local borrowers for the personal deficiencies to make even more obscene profits after buying already depressed valued property or "double dipping".*

Background Explanation: RE: Amendment to the FDI Act and FIRREA: The FDI Act and FIRREA allow the FDIC in its sole discretion to resolve the assets for the failed bank in any way it sees fit. It has absolutely no responsibility for its results and impact on the economy. It is allowed to violate the most basic concepts of common law and contract law with immunity. It has no constraints on its methods or procedures and has demonstrated a preference for procedures that are slow in performance, waste Deposit Insurance Fund Dollars 3:1 or 4:1 as compared to the Preferred Least Cost Resolution proposed, aggregates foreclosures, destroys local markets, businesses and jobs and rewards the monied partners at the expense of the local borrowers, who have lost their investment. These results are completely unnecessary.

Moreover, absolute power corrupts absolutely. The FDIC will pursue its agenda and make claims of default against borrowers that are simply not true, in an effort to mask or defeat claims of "repudiation" by the Receiver, which by statute charges the default against the Receiver and effectively eliminates the Receiver's claims against the borrower and guarantor.

Since that is undesirable from their perspective (according to the FDIC and its partners everyone is guilty of something if they borrowed), the FDIC will persist in their claims in hopes of getting their way in court or using litigation as a means to get the borrower to stop the borrower from fighting their will. To those ends, the FDIC prefers to hide behind others to obfuscate the truth, their actions and intentions. They routinely use contractors in failed banks to talk with Borrowers and dispense the line the FDIC wants to project. They hide behind minority partners like Rialto/Lennar in the PPIP's or Loss Share Banks for the same reasons.

The FDIC managers are career bureaucrats and do not want to be accountable for making decisions to their superiors. So they will literally defer a resolution offer from a borrower that may be 75-85% of the loan balance in favor of selling assets off in the debt auctions for pennies on the dollar or for 20-35 cents on the dollar to PPIP's or Loss Share Banks, so they can hide behind the claim that it was out of their hands. The lesser sum was just the result of the "market" mechanism. They have literally refused 100 cent recoveries from borrowers because it was inconvenient to remove the loan from a block of loans going to auction or because they worked an alternate deal with some loan participant behind the scenes, that resulted in a discount.

The FDIC and PPIP partners' methods of operating receiverships is very disruptive to the operation and administrative processes of the loan portfolios they take over. Borrowers are often caught in the act of renewing their loans just prior to the bank's failure and those maturing loans don't get renewed. So the loan matures in the Receiver's possession or with an over-whelmed Loss Share Bank and the borrower is declared in default due to maturity.

Once the bank fails and routine loan billing is interrupted for any reason, the loans that are shown as past due in the system without regard to reason are placed on non-accrual at 3 months and statements stop being generated by the loan system, assuming statements were being sent from the outset. The point is closing a bank is very disruptive to the borrower and the administration of his note. People not receiving statements and are reluctant to send money into the big black hole and hope it gets applied properly. Months and literally a year can go by before the new, often overwhelmed note holder gets to you regarding your loan, by which time you are in default.

The FDIC requires their partners to pursue a borrower until they cannot be pursued legally anymore. They reward their partners with Loss Share arrangements that reimburse them for "losses" realized when an asset brings less than the loan balance as a result of foreclosure. The Loss Share Banks typically get an 80% reimbursement for such losses. Here is an easy example. The loan has a $100,000 balance. The Loss Share Bank only paid $35,000for it. The collateral is appraised for $50,000 in a spiral down market heavily influenced by the FDIC's procedures and impact in that market.

So the Loss Share Bank gets a $50,000 asset FMV(fair market value) for a $35,000 investment and the FDIC reimburses them $40,000 cash (80% of a $50,000 loss). The Loss Share Bank just realized $90,000 ($50,000 FMV + $40,000 cash) on a $35,000 investment. That's a 257% return with no risk. . The FDIC only offers this kind of deal to Loss Share Banks, not other smaller businesses.

The PPIP's are back-stopped or 100% guaranteed against deficiency losses using the same formula so they make even more. Meanwhile, the borrower has lost his or her investment and the note-holder is going after all of the loan holder's remaining assets to make up for a theoretical $50,000 loss. This is required by the FDIC in return for being back-stopped. In theory, it allows the PPIP a way to minimize the FDIC's back-stop exposure because the PPIP's are pursuing a **scorched earth collection policy**.

The Preferred Least Cost Resolution would have the FDIC using Deposit Insurance Fund (DIF) dollars to invest the amount of capital needed to heal the bank's capital account at a preferred return. Then, the Deposit Insurance Fund would have an earning asset instead of a loss related to the receivership of the bank. Example: American Southern Bank failed April 24, 2009. The FDIC estimated the loss to the Deposit Insurance Fund would be $41.9 Million Dollars.

American Southern had been attempting to raise $14 Million Dollars to heal its capital account and meet regulatory standards. Therefore, the Least Cost Resolution would have the FDIC investing $14 Million at 10% preferred return to the fund instead of doing it their way and losing $41.9 Million. That's a $27.9 Million savings before considering a preferred 10% return on $14 Million invested. Community Bank of West Georgia failed 6/26/2009. It was estimated that they needed $25 Million to recapitalize their capital account. The FDIC was appointed receiver and estimated a $85 Million loss to the fund. That's a 3.5:1 loss versus using the Preferred Least Cost Resolution.

This is the end of part one of the American Land Rights Association Corrected House FDIC Testimony.

Part Two – Corrected FDIC Testimony for the House Financial Services Committee by Chuck Cushman with the American Land Rights Association.

To demonstrate the impact on local markets and the aggregating of foreclosures, consider this. It is estimated that the 2009 - 2010 Loss Share Banks will dump $3.5 Billion Dollars of real estate on the foreclosure market in 2014 to take advantage of and maximize the 80% Loss Share reimbursement before it expires. The Loss Share Agreements only last for 5 years. This one single event will crush the north Georgia economy again in 2014 and delay the state's full recovery until 2025 or 2030. **Congress must stop the madness.**

Congress must investigate and curtail funding the PPIP's in violation of TARP, suspend PPIP Collection Activity of all FDIC PPIP's (like 2009-1 Multibank RES-ADC Venture, LLC and 2009-1 Multibank CML-ADC Venture, LLC 40% owned by Rialto/Lennar,) and promote a class settlement between all PPIP's and borrowers.

For example, two FDIC PPIP's entities known as Multibank 2009-1 RES-ADC Venture, LLC and Multibank 2009-1 CML-ADC Venture, LLC, purchased $3.02 Billion dollars of distressed loans in bulk, with knowledge of the loans' distressed condition, using taxpayer dollars at 0% interest for up to 7 years under the TARP program. The FDIC PPIP's are Public Private Partnerships in which FDIC retains a 60% interest and the private hedge funds (like Rialto/Lennar) retains a 40% interest). There are 27 PPIP's affecting over 39,000 borrowers and $23 Billion in loans.

The Multibank 2009 RES-ADC borrowed $441,698,466 and Multibank 2009 CML-ADC borrowed $185,207,975 from the US Treasury and both have arranged the opportunity to borrow more. Together Multibank RES and Multibank CML alone have borrowed more than ½ Billion Dollars. The American taxpayer earns no interest or return on the use of its money. Only Wall Street traded company hedge funds like Rialto Capital, a wholly owned subsidiary of a NYSE traded national homebuilder called Lennar Corporation profit from free use of taxpayer money.

(This is a restatement from the Problem section above.) The FDIC drafted the PPIP documents, which require the minority structured sale participant, Rialto (in this partnership called Multibank 2009-1), to pursue borrowers (without regard to the facts surrounding their individual loans) until they cannot be legally pursued anymore. Never mind that many if not most were current on their loans.

Rialto/Lennar, Multibank, and others aggressively litigate borrowers, attempt to force them into bankruptcy, obtain judgments and further pursue those judgments and generally attempt to ruin all borrowers and guarantors, unless they pay the loans off or gain an unappealable court decision in the borrower's favor. They aggressively use the court system in their tactics and will punish and outspend borrowers with legal fees until they are broken as their legal budget is unlimited and paid by the FDIC using tax payer dollars.

These are unlucky borrowers who had their loan at a bank that just happened to be closed by the FDIC. Overwhelmingly these borrowers were current with their loans but the FDIC bank receivership froze all loans, funding, and loan provisions. Rialto aggressively uses the threat of the IRS as part of their tactics and they fund their efforts with taxpayer dollars at no cost to them. There is no effort to work with borrowers already damaged by the FDIC's tactics. All of this has been orchestrated by the FDIC, required by the FDIC and performed with the FDIC's full knowledge and requirement as a condition for the minority partner(like Rialto/Lennar) to participate in the PPIP.

The FDIC further guarantees to fund any deficiency realized after collateral is sold, so Multibank and the participant Rialto have **no risk** of loss on the loans. They are 100% guaranteed against loss by the FDIC. NO RISK. They not only take the collateral for pennies on the dollar to make a guaranteed profit but also seek to take all assets of the borrowers in addition to the collateral on the loan. The PPIP are indemnified against loss on the disposition of collateral relative to the loan balance, which guarantee that the FDIC will reimburse the private speculators for any losses in their attempt to foreclose" on loans, and the FDIC pays all bloated legal / litigation expenses and loan management fees of the private speculator minority partners (like Rialto/Lennar).

Multibank, Rialto and other PPIP's are rewarded for employing scorched earth tactics (total destruction of an borrower's resources, purely for historic FDIC anti-business policy reasons rather than economic solution orientated reasons) **against the borrowers of the failed banks and the effect is to destroy local economies, jobs, and property values in addition to the borrowers' ability to support themselves going-forward. The borrowers did not cause the bank to fail and did not cause the disruption of their loans that result from the FDIC's process and use of outside contractors.**

The transaction funding the Multibank PPIP's appears to be illegal because it does not meet the federal requirements of TARP to borrow from the US Treasury. They are borrowing from the FDIC. TARP required the borrower to provide the US Treasury with an equity interest in the borrower, so that the US Treasury could participate in the upside if a profit was realized. It is an essential component of the TARP program . The FDIC publicly advertised that these PPIP's would be funded by TARP.

These PPIP's appear to have failed to comply with the law and therefore, their use of taxpayer money is illegal under the law (Troubled Asset Relief Program). Just the Multibank 2009-1/Rialto transaction spans 11 states across the country, representing 22 failed banks. As of March 2011, the FDIC has closed a total of 27 (illegal) structured sale transactions transferring almost 39,000 asset loans and $23.3 billion in unpaid principal balance. This spans a majority of the states and represents hundreds of failed banks across the US.

The **National Anti-Deficiency Law** *would limit the impacts of the FDIC/Federal Government policy especially when creating public/private structured partnerships with national* hedge fund speculators *(like FDIC partners Multibank/Rialto/Lennar).*

This legislation needs to be adopted in conjunction with the Preferred Least Cost Resolution Amendment proposed. It would allow the original lender the right to pursue a personal deficiency as long as the original lender was allowed to continue to operate in Receivership under the proposed amendment, provided FMV of the underlying collateral was deducted from the outstanding loan balance. If the FDIC decides to close the bank in lieu of the Preferred Least Cost Resolution, then the FDIC as Receiver would lose the right to pursue deficiencies. This legislation needs to be adopted as Federal Law as it must also apply to Federal Agencies, the FDIC and PPIP's who have already started to claim that they are not subject to state Laws like AB 273- Anti-Deficiency Law.

It is critical that the Congress take immediate action to stop the abuses by the FDIC and its partner companies. Please consider and support the recommendations contained within this testimony and proposed legislation. The FDIC and their partners are destroying small businesses, killing jobs, and worsening our chance for recovery.

Regarding FDIC openness and accountability. Numerous letters were sent by various borrowers to the FDIC Chairman Shiela Bair over more than a year. To our knowledge, none were responded to. So much for transparency.

Respectfully submitted for your consideration,

Chuck Cushman, Executive Director
American Land Rights Association
(360) 687-3087 - ccushman@pacifier.com - www.landrights.org

Contact the two coalitions working to stop this extreme FDIC abuse: FDIC Rialto Affected Borrowers Coalition (FRABCo), 10013 NE Hazel Dell Ave #237, Vancouver, WA 98685—FRABCo.org@gmail.com -- 503-972-4080. Check out the Frabco website: http://reactioncommittee.com/

Second coalition is the FDIC Bank Closure and Foreclosure Coalition section, formed by the American Land Rights Association, PO Box 400, Battle Ground, WA 98604, (360) 687-3087
It is operating under American Land Rights. Website: www.landrights.org
Contact: Chuck Cushman at ccushman@pacifier.com

See attached testimony by other FDIC Bank Closure Victims and other information below.

Other attachments, links, and references that show impact to almost 39,000 FDIC failed bank borrowers across the US:

http://www.nytimes.com/2009/04/07/business/07sorkin.html
The New FDIC Partner "Banks" **FDIC Structured Sales Transactions**
Since May of 2008, the FDIC turned to a **"partnership model to sell large numbers of distressed assets (primarily non-performing single family and commercial real estate loans and related real property) held by recently failed financial institutions." (Editors note: Many of the commercial real estate loans were performing but were bundled up in the structured sales giving tens of thousands of innocent small businesses no way out.)**

As of March 2011, the FDIC has closed 24 structured sale transactions transferring 38,800 assets and $23.3 billion in unpaid principal balance. The FDIC stays on as a partner in these transactions with the stated goal of capturing upside and appreciation as the loans are worked through and the economy and asset values recover.

For the borrowers of failed banks whose loans were acquired in the structured transactions, the new FDIC entities have become, in essence, the borrower's new bank as the loans are worked out and resolved with the new owners. (However, they are rarely worked out. Rialto, Multibank, and other PPIP' throw so many roadblocks into the process that they appear to be deliberately forcing foreclosure and bankruptcy.

Four investor groups (highlighted in yellow below) have dominated the bidding, in some cases winning multiple bids, and together accounting for nearly 60% of the book value purchased in structured transactions as well as now controlling over 50% of loans assumed by the FDIC LLC's.

Winning FDIC Structured Sale Bidder	**No. of Loans**	**Implied Price (millions)**	**Book Value (millions)**
Cache Valley Bank	761	$63	$279
Colony Capital Acquisitions, LLC	**5,104**	**$1,904**	**$4,035**
Diversified Business Strategies	147	$205	$702
Gulf Coast Bank & Trust	733	$48	$146
Hudson Realty Capital Fund V LP	110	$19	$102
Kingston Management Services	1,112	$101	$1,120
Mariner Real Estate Partners, LLC	1,062	$264	$762
OneWest Ventures Holdings LLC	3,044	$271	$1,652
PennyMac	2,829	$215	$558
PMO Loan Acquisition Venture, LLC (OakTree Capital)	279	$695	$1,703
Residential Credit Solutions, Inc.	**9,230**	**$1,191**	**$2,218**
Rialto Capital Management LLC	**5,511**	**$1,235**	**$3,052**
Roundpoint Capital Group	6,786	$416	$1,094
Square Mile Capital LLC	57	$346	$421
Starwood (Northwest Operating Company) LLC	**101**	**$2,725**	**$4,402**
Stearns Bank	520	$161	$733
Turning Point Asset Management, LP	1,456	$111	$314
Totals	**38,842**	**$9,971**	**$ 23,293**

We urge and support Congress to pass immediate Federal Anti-Deficiency Law Legislation that is based on recently approved Nevada Law AB 273- Anti-Deficiency Law –

*This law **limits** by National Builders or Private Loan Speculators (like Multibank/Rialto/Lennar) who re-purchase these notes for pennies on the dollar at depressed market values and make immense profits. These Loan speculators would be prevented from then also suing local borrowers for the personal deficiencies to make profits that are even more obscene after buying already depressed valued property or* *"double dipping". The original lender still has the right to pursue a personal deficiency as long as the fair market value of the property is deducted from the note value.*

A national ***Anti-Deficiency Law*** *will help put local businesses on a level playing field with the national competitors builders/private speculators who are trying to drive local businesses out of the market. This legislation needs to be adopted as Federal Law as it must also apply to Federal Agencies (like the FDIC) who through use of taxpayer/US Treasury funded techniques of public/private structured sales try to dispose of FDIC closed bank assets with no consideration of the unintended consequences. The* ***Anti-Deficiency Law*** *would limit the impacts of the FDIC/Federal Government policy especially when creating public/private structured partnerships with national homebuilder competitors (like Multibank/Rialto/Lennar).*

The FDIC has been giving away 7-year, no-interest, non-recourse guaranteed loans with attached Loss Share Agreements, which guarantee that the Federal government will reimburse the private speculators for any losses in their attempt to "double dip" on loans, and the FDIC also agrees to pay bloated legal fees and loan management of the private speculators. In the case of Bulk Sale Portfolio Loans, the aggregate price paid for a portfolio of loans will be pro-rated and applied to each individual loan in the portfolio. (e.g. if Loan Purchaser purchased $100 Million dollars in loans for $20 Million dollars, the assigned price paid for each loan in the portfolio would equal 20 cents on the dollar.) *The* ***Anti-Deficiency Law Federal Legislation will also add provisions to give borrowers the option to get back the ownership foreclosed properties if desired (now held by the FDIC/Multibank/Rialto/Lennar) who were previously wrongfully stripped of their property by unjust foreclosure actions that this Anti-Deficiency Law Federal Legislation would now prevent.***

This Nevada Law is explained in a video interview at:
http://www.vegasinc.com/videos/2011/jun/13/5227/

A link to the text of the Law is at:
http://www.leg.state.nv.us/76th2011/Reports/history.cfm?ID=586

What does loss share mean and how it works.
The FDIC uses two forms of loss sharing. The first is for commercial assets and the other is for residential mortgages.

For commercial assets, the agreements typically cover an eight-year period with the first five years for losses and recoveries and the final 3 years for recoveries only. FDIC will reimburse 80 percent of losses incurred by acquirer on covered assets up to a stated threshold amount (generally FDIC's dollar estimate of the total projected losses on loss share assets), with the assuming bank picking up 20 percent. Any losses above the stated threshold amount will be reimbursed at 95 percent of the losses booked by the acquirer.

For single family mortgages, the length of the agreements tend to run for 10 years and have the same 80/20 and 95/5 split as the commercial assets. The FDIC provides coverage for four basic loss events: modification, short sale, foreclosure, and charge-off for some second liens. Loss coverage is also provided for loan sales but such sales require prior approval by the FDIC. Recoveries on loans which experience loss events are shared in the same proportion as the original loss.

See additional testimony by other victims attached.

JAIME HERRERA BEUTLER
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September 15, 2011

When the Bank of Clark County shut down in 2009, millions of dollars in outstanding construction loans were taken over by the Federal Deposit Insurance Corporation. A large majority of the loan holders were current on their payments and fulfilled every obligation of their loan agreement. In some cases, due to a failing economy, loan holders experienced difficulty meeting their obligations but went to great lengths to work with the FDIC to restructure their agreements. These lendees sought to continue their construction projects while paying their obligations.

The process took a turn for the worse when the FDIC sold these loans to Rialto Capital. According to a number of my constituents, Rialto showed they were unwilling to negotiate and unwilling to listen. All pending negotiations stopped in several cases and loans were called immediately. Instead of working with loan holders to accomplish a common goal of satisfying loan agreements, Rialto chose to collect collateral and take over huge amounts of land across Southwest Washington. This left many Washingtonians bankrupt and many construction jobs unfinished.

This hearing has shown that Washington is not the only state that has fallen victim to Rialto. Job-creating builders nationwide are losing millions of dollars worth of investments due to the company's aggressive foreclosure process. In an effort to recover a maximum amount of lost deposits for bank customers the FDIC has inadvertently created a monster. By selling these loan packages to the highest bidder, non-banking institutions, like Rialto, have found an easy way to accumulate large amounts of land and money by taking advantage of the country's economic hardships. While I do not believe this is the intention of the FDIC, the circumstances it helped create must change

I applaud the Financial Services Committee, particularly Congressman Westmoreland for investigating this widespread problem, and I look forward to working with them to make sure all loan holders acting in good faith are given the opportunity they deserve to pay their debts, continue building, and keep their livelihood.

Jaime Herrera Beutler
Member of Congress