BARNEY FRANK, MA, CHAIRMAN

U. S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

October 29 2009

The Honorable Ben S. Bernanke
Chairman
Board of Governors
Of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance
Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable John Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

The Honorable Debbie Matz
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Dear Chairman Bernanke, Chairman Bair, Comptroller Dugan, Chairman Matz and Acting Director Bowman:

It is now recognized that the vast majority of problem sub-prime loans were originated by non-bank lenders. Yet, it is the already highly regulated traditional depository banks that are feeling the greatest regulatory pressure as a result of the current economic crisis. In particular, one of the biggest challenges faced by community banks (but shared by all banks) is how to respond to the calls from Congress to increase lending to stimulate the economy and to work with troubled borrowers on foreclosure mitigation, while dealing with increasingly stringent directives from regulators that can preclude banks from doing just that.

Community banks became strong and viable players in the financial services industry because they fill an important need, and it would be short-sighted to weaken that role through over-zealous regulatory actions - actions based not on wrong-doing or poor management practices at these banks, but on changes in the economic environment and toughening regulatory standards.

It is critical now more than ever that regulatory personnel out in the field apply a measured approach to examinations that is directed by agency leadership rather than subject to arbitrary decisions in the field. Examiners that are now being inappropriately tougher in their analysis of asset quality and are consistently requiring downgrades of loans whenever there is any doubt

about the loans condition are acting counter to the kind of balanced approach required in the current economy.

Worsening conditions in many markets have strained the ability of some borrowers to pay on their loans, which often leads regulators to insist that a bank make a capital call on the borrower, impose harmful amortization schedules or obtain additional collateral. These steps can set in motion a "death spiral" based on fire-sale prices for assets to raise cash, a drop in the comparable sales figures the appraisers use, which results in market devaluations of other assets. These actions are directly counter to the message from Congress calling for banks to work with borrowers to help them through these difficult times and to make credit available.

While there is no question that regulatory gaps and other regulatory short-comings were a significant contributor to the economic crisis, those gaps were largely within the non-bank lending market and Wall Street banks.

We call on regulators to show some temperance in their regulation of traditional banks. Not to jeopardize core safety and soundness principles, but to show some restraint in the immediate enforcement of new rules that may prove to be excessive at a time when community banks are least able to respond. A self-fulfilling prophecy of community bank failures, shrinking credit availability and a slower economic recovery can all result from a regulatory over-reaction to the current crisis.

Here are some examples of problem areas that have been brought to our attention by constituents:

1. "Unofficial" Capital Requirements—the official regulatory standard for being "Well capitalized" is basically 5% for Tier One Capital and 10% for Total Risk Base Capital. Some bankers indicate that individual examiners have in some cases unofficially moved these numbers to as high as 8-9% and 12% respectively. The impact is that many community banks have to restrict their growth (lending activity) in order to shrink their balance sheets and meet these standards. Restricting lending activity, especially to small businesses—is counter productive to helping the economy recover.

2. In many cases the traditional "CAMELS" rating exercise for banks appears to have become an "A" –asset quality –exam. We have always understood that weakness in asset quality in an institution could be mitigated by strength in other areas such as Capital, core earnings and liquidity. Examiners now seem to say if asset quality is bad all the other components are also unsatisfactory.

3. Valuation of assets—Banks are being forced to write assets, loans and Other Real Estate Owned, down to current "market" value. The problem is that there is virtually no market for some of these assets (developed lots for example) *at present,* leading to artificially low prices for those assets that have to be sold under duress. However, many of these markets are expected to recover in the future, and the forced writedowns to "fire-sale" values now are making the banks' capital crunch artificially and unnecessarily worse.

4. Discouragement of the use of short term borrowings from Federal Reserve, Federal Home Loan Bank, or CDARS reciprocal CD's, etc. Regulators seem to be re-establishing their old aversion to a bank funding its operations with anything but deposits. The pressure in this area is often applied by lowering liquidity grades on exams for those banks that do make use of what the examiners deem "excessive" borrowing. This "message" is in turn causing some institutions artificially to constrict lending in order to reduce their amount of borrowings to please the regulator

These are just a few examples, but the overall message is clear. While our regulators need to uphold proper safety and soundness standards in this difficult economy, unnecessarily aggressive decisions made in the field by individual examiners or teams intended to require banks to hold or acquire capital in excess of the official regulatory standard for being "well capitalized" must be avoided, to prevent more banks from failing unnecessarily. We are calling upon you to take the long view, use their wisdom and experience to guide their field staff toward a more appropriate application of the core principles of safety and soundness regulation in order to enable our banks to assist fully in our economic recovery.

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WALT MINNICK