BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

February 25, 2010

BEN S. BERNANKE
CHAIRMAN

The Honorable Ken Calvert
Member of Congress
Washington, D.C. 20515

Dear Congressman:

The Board of Governors of the Federal Reserve System appreciates the opportunity to respond to the concerns expressed in your January 29, 2010, letter regarding the interagency *Policy Statement on Prudent Commercial Real Estate Loan Workouts*, issued on October 30, 2009. In your letter, you expressed specific concerns that the interagency policy statement has not helped stabilize the commercial real estate market, and that regulators continue to encourage lenders to write down the value of performing loans, even when payments may be current. Further, you encouraged the Federal Reserve and other regulators to develop a process for measuring and evaluating the effectiveness of the recent guidance, including establishing specific measures to more clearly differentiate between performing and non-performing loans.

I can assure you that the Federal Reserve shares your concerns regarding these issues and has made the assessment of commercial real estate exposures at supervised institutions one of its highest priorities. The Federal Reserve has taken several steps to ensure that supervisory policies and practices do not inadvertently impede sound lending, not only in the commercial real estate market, but in other sectors as well. The Federal Reserve is well aware of the potential adverse economic effects of financial institutions retreating from sound lending opportunities because of concerns about potential criticism from examiners. These concerns were the principal driver of the recently issued interagency policy statement. Working with the other federal regulatory agencies and state regulators, our objective in developing this guidance was to reiterate supervisory expectations to both the industry and examiners.

The Federal Reserve has taken a number of steps to reinforce the expectations outlined in the interagency policy statement to both bankers and examiners. In conjunction with the other federal and state banking agencies, Federal Reserve staff has participated in a number of teleconferences with various industry groups to discuss the guidance, which have reached several thousand bankers to date. This industry outreach will continue throughout the year and has already provided us with insight on the issues faced by bankers in working through the problems in their commercial real estate loan portfolios.

Shortly after the release of the guidance, Federal Reserve staff instituted a System-wide examiner training initiative that is currently in progress. As a starting point, the Director of the Board's Division of Banking Supervision and Regulation has emphasized to the heads of supervision at each of the twelve Federal Reserve Banks the importance of ensuring examiners follow the key principles outlined in the interagency policy statement. In addition, examiner training includes a detailed discussion of the expectations and key messages outlined in the interagency policy statement, as well as emphasis on how examiners should evaluate commercial real estate loans that have been restructured because of reductions in collateral value or borrower cash flow. Examiner training is proceeding through late March 2010 and, in total, the instructors expect to reach approximately 1,000 Federal Reserve and state examiners across the United States. Additionally, an interagency training program has been developed specifically for commercial real estate examiners involved in the shared national credit program, which includes the largest commercial real estate loans in the nation. The focus of this training, which is scheduled to begin in late March 2010, is to ensure that shared national credit examiners properly follow the interagency policy statement when evaluating individual loans at banks.

Initial feedback from Federal Reserve Banks indicates that examiners are focused on evaluating commercial real estate loans in accordance with the guidance. Federal Reserve Board staff has completed an examiner survey of banks' workout practices, which will act as a baseline for collecting information to assess the effectiveness of the guidance going forward. We also are asking examiners to capture, where possible, information on troubled debt restructurings and other types of loan workouts and dispositions as part of the ongoing examination process. The Federal Reserve Board's staff is also exploring the feasibility of more formal statistical approaches for measuring and evaluating the effectiveness of this recently issued interagency CRE policy statement. In addition, we are considering adjustments to the Consolidated Report of Condition (Call Report), filed quarterly by banks, to obtain more detailed information with respect to their commercial real estate loan restructurings.

We are also engaged in ongoing efforts to make examiners better informed about conditions in commercial real estate markets. We are working with the Office of the Comptroller of the Currency on a loan-level data collection effort for commercial real estate loans at the largest U.S. banks, which will provide critical information on the credit quality and performance of these loan portfolios. The Federal Reserve also purchases market data in order to provide examiners and research staff with access to current information on national, regional, and local commercial and residential real estate markets. For example, examiners have access to data on property prices, vacancy rates, rents, and indicators of demand at the city, state and national level. In addition, economists from across the Federal Reserve System provide analytic support to examiners through the maintenance of a data repository of market information and as part of various examiner training programs.

Preliminary analysis of recent data offers some encouragement that CRE refinancings and workouts are beginning to take place. Of note, the volume of troubled loans that were restructured by banks increased by almost 32 percent during the fourth quarter of 2009, the quarter in which the guidance was issued. And, while overall real estate lending continues to decline due to a sharp contraction in construction lending, loans outstanding in several other commercial real estate sectors increased modestly in the fourth quarter.

Going forward, these data collection and analysis efforts noted above will help us evaluate both the developing state of the CRE market and the effectiveness of our supervisory guidance over time. Ongoing industry and examiner outreach will also be essential as the agencies and the industry work through the difficult issues in the commercial real estate and other lending markets. Your interest in our activities related to the commercial real estate market is appreciated, as well as the opportunity to respond to your concerns. Please do not hesitate to contact us if you have any further questions.

Sincerely,