



A MESSAGE FROM COMMISSIONER ENTRINGER



October 22nd

As many of you are aware, October 22nd is the deadline for the public comment period on Basel III. While I am sure you have received plenty of information about the potential impact to your institution if the proposal is implemented as proposed, I want to share the information I have received from the Conference of State Bank Supervisors (CSBS) relative to the issues for community banks. CSBS created a working group of state regulators to study the proposal and I want to share some of the suggestions provided. I am sure you are aware that the federal agencies released a “Capital Estimation Tool” (go to <http://www.fdic.gov/regulations/capital/calculator.html> to download the tool) which allows you to estimate the potential impact of the proposed rules. The recommendations from the working group are to run the calculator under various scenarios including: 1) Alter the bank’s loan mix.

Given the current state of the economy, the portfolio may be more conservative than typical. What if the bank became more aggressive with mortgage lending? What if construction lending were to increase? 2) Change the value of unrealized gains or losses on available securities. (Basel III Approach Values, cell C7). With the rate environment, many banks have appreciation in its bond portfolio. Under the proposed rules, this has the effect of adding capital. What will happen when rates rise and this appreciation evaporates or even becomes a loss? 3) Grow the bank. A growing economy will offer growth opportunities for a bank. How do proposed changes in risk weights and growth impact a bank’s ability to remain well capitalized?

As an organization I can tell you that CSBS is generally opposed to the proposed capital rules believing they are unjustified and will be damaging to the industry. It is important to note this is not a final rule. The federal process requires the opportunity for the public to respond. We can have an impact on the final outcome, but we must engage and provide meaningful comments. Additionally, just because the agencies place a certain provision in a proposed rule does not mean that all agencies believe it should be the final outcome. The agencies will use the public comments to support their arguments. Finally, it is very important for the comments to fully explain how provisions of the proposed rule could impact your bank and your ability to serve the community. So PLEASE take the opportunity to submit a comment letter; I think you know it is vitally important!

I would also like to take this opportunity to publicly commend and thank one of our examiners that many of you know, Doug Hoselton. Doug is the Supervising Examiner in the Grand Forks Field Office and he was recently quoted in the CSBS Examiner talking about ETS-ALERT which is a software tool our staff utilizes to scope the loans they will be reviewing. Doug has chaired the State Examiner Review Team (SERT) for a couple of years and recently participated in the User Acceptance Testing of the new ETS-ALERT tool being deployed in banking departments nationwide. The tool is developed by federal regulators, and state banking departments are brought in for testing of the tool before its release. The participation of Doug and other state banking department examiners in the testing phase helped demonstrate the important role that our state banking departments bring to this interagency collaborative effort. Thank you, Doug, for your valuable contribution to the development of this tool.



LOAN UNDERWRITING AND CREDIT ADMINISTRATION

This is an area that needs your ongoing attention. Our economy is booming and our banks are doing great across the state. However, we're seeing a disturbing trend. Many of the Reports of Examination reveal an alarming high level of technical exceptions from the examiners' loan reviews. Proper loan documentation is so important—it is easy to be lax when times are good, but as soon as the economy turns and borrowers start struggling, that's when you find out how good your loan underwriting and administration practices really are. Make sure you perfect your collateral so you can protect your bank from losses. Also, obtain timely financial information from your borrowers so that you can take action early if there is deterioration. At the ICBND conference in August, Dr. David Kohl appropriately warned us of some of the perils we may experience when times are good and there is quick accumulation of wealth. The statement he made that really stood out was: **“Be conservative in the good times—so that you can be courageous in the bad times—so that you can be consistent at all times.”**

Likewise, continued diligence is also necessary in suspicious activity monitoring. With expansive population growth and many “strangers” in our communities, we need to be diligent in our record keeping requirements and filing of Suspicious Activity Reports (SARs).

REAL ESTATE LOAN GROWTH TRENDS

