
Preliminary Results of OCC Horizontal Review

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Key Weakness Cited by OCC

1. Loan Grading
2. Repayment Analysis
3. Credit Monitoring
4. Underwriting
5. Problem Loan Administration
6. Noncompliance with Appraisal Guidance

Loan Grading

Grading = Risk Rating

- Banks are Required to Risk Weight their Assets
 - Risk Weighting Requires Risk Rating Systems
 - Estimated Default Probability, aka Frequency (EDP, EDF, DP, DF)
 - Estimated Loss Given Default (LGD)
 - $EDF \times LGD = \text{Estimated Loss}$
 - Model Development

Model Development

Analyze Data to Determine What Drives Losses / Defaults

- High LTV
- Low Debt Coverage
- Poor Tenant Quality
- Vacancies at Property
- Property Mismanagement
- Lack of Experience by Owner/Developer
- Weak Relationship with Lender

Repayment Analysis

Key Change in Dodd-Frank

- Banks are Required to Use Higher of “Start Rate” or “Fully Indexed Rate” cited in Loan, including Amortization
- Puts an End to Underwriting Loans based on “Teaser” rates

Credit Monitoring

Commercial Real Estate

- Collect Periodic Financials From Borrower over Life of Loan, including Income/Expense, Assets, Liquid Assets

Residential

- Collect Periodic Credit Score From Borrower over Life of Loan

Underwriting

Use Prior Data to Determine Borrower's Ability to Repay Loan

- Is Underwriting Independent of Loan Production
- Underwriting versus “Polishing” the File

Problem Loan Administration

Aggressively Monitor Borrower's Ability to Repay Loan

Monitor Asset Value

Analysis Options

Foreclosure

Deed in Lieu

Note Sale (Discounted)

Walk Away

Non Compliance with Appraisal

Code of Federal Regulations www.eCFR.gov, Title 12

- 1-199 = OCC
- 200-299 = Federal Reserve
- 300-399 = FDIC
- 500-599 = OTS
- 700-799 = NCUA

Most Regulators refer to OCC Rules

Section 341. to 34.203 are Real Estate Lending and Appraisals

Details available via www.AppraisalRegulations.com

Appraisal Rules – 34.43 cites when required

- (1) The transaction value is \$250,000 or less;
- (2) A lien has been taken as an abundance of caution;
- (3) The transaction is not secured by real estate;
- (4) A lien has been taken for purposes other than the real estate's value;
- (5) The transaction is a business loan that: (i) Has a transaction value of \$1 million or less; and (ii) Is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment;
- (6) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;
- (7) The transaction involves an existing extension of credit at the lending institution, provided that: (i) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or (ii) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs;
- (8) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgaged-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met OCC regulatory requirements for appraisals at the time of origination;
- (9) The transaction is wholly or partially insured or guaranteed by a United States government agency or United States government sponsored agency;
- (10) The transaction either: (i) Qualifies for sale to a United States government agency or United States government sponsored agency; or (ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate;
- (11) The regulated institution is acting in a fiduciary capacity and is not required to obtain an appraisal under other law; or
- (12) The OCC determines that the services of an appraiser are not necessary in order to protect Federal financial and public policy interests in real estate-related financial transactions or to protect the safety and soundness of the institution.

Interagency Appraisal & Evaluation Guidelines

<http://www.federalreserve.gov/boarddocs/srletters/2010/sr1016a1.pdf>

48 Pages

Bank's Board of Directors, or Designated Committee Must Adopt Policies for Effective Appraisal and Evaluation Programs

Independence ordering, appraisal and reviewing both appraisals AND evaluations

Select Criteria to Evaluate and Monitor Panel – appraisal AND evaluations

OPEN DOCUMENT NOW

Questions / Answers

A red and black racing bicycle is shown from a side profile, leaning on its kickstand. The frame is bright red with black accents and features the 'GIRO' logo. The wheels are black with red and white graphics. A black helmet with red and white accents and the 'GIRO' logo is on the floor in front of the bike. A pair of red and black cycling shoes is also on the floor. The background is a plain white wall and a light-colored tiled floor.

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