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Testimony of

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Before the House Committee on Financial Services

Hearing on
H.R. 5816, the Commercial Real Estate Stabilization Act of 2010

July 29, 2010

Mr. Chairman Frank, Ranking Member Bachus, and Members of the Financial Services Committee: Thank you very much for the opportunity to testify at today's hearing on behalf of financial institutions in the United States. My name is Ernie Panasci and I am a Shareholder and Director of Jones & Keller, P.C., a law firm with offices in Denver and Greenwood Village, Colorado. Over the years, I have also been a member of the Board of Directors of several financial institutions.

Jones & Keller is considered a small law firm with approximately 30 attorneys that represents approximately 75 financial institutions throughout the Western Region of the United States. Our financial institutions group consists of approximately 12 attorneys, most of whom devote a substantial portion of their time to representing financial institutions in this region. Personally, I have represented financial institutions since 1981 and I devote in excess of 75% of my time to working with financial institutions. As an attorney in the financial institutions arena, I work closely with management and the boards of directors of these financial institutions. As part of my representation of these financial institutions, I have frequent contact with regulators, including the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Federal Reserve, and State Bank Commissioners in the Western United States. What was once regular interaction with financial institution regulatory agencies has increased, over the past 18 months, to daily interaction with regulators. To say these are trying times for both bankers and regulators is an understatement. The attempt of both bankers and regulators to professionally and accurately perform their duties has at times led to difficult interaction. However, both the regulators and the bankers realize that each has their own job to perform and I believe there is a level of respect between them.

The House of Representatives and the Senate have attempted to deal with these difficult financial times and the Dodd-Frank Wall Street Reform and Consumer Protection Act recently enacted into law by President Obama is evidence of everyone's intent to move this process along. I am here today to discuss H.R. 5816, the Commercial Real Estate Stabilization Act of 2010, and complimentary legislative regulatory proposals that would increase the availability of credit and improve the financial condition of financial institutions. My analysis of this bill leads me to believe it will be a step in the right direction to unclog the commercial real estate lending markets. It is an understatement to state that there is a logjam in providing credit to the commercial real estate market. With increasing capital demands by regulators and the now concrete percentage limitations placed upon the dollar amount of commercial real estate loans pursuant to the commercial real estate lending guidelines, it is extremely difficult, if not impossible, for financial institutions to make new commercial real estate loans. One would only need to read the written enforcement actions posted on the websites of regulatory agencies to realize that there are ever-increasing capital demands being placed upon financial institutions. The old 8 and 10 percent capital guidelines have been replaced by 10 and 12 percent, and in some instances even greater capital requirements. Most financial institutions are having a difficult time in raising equity capital and as such are not able to make new loans because each dollar lent by a financial institution requires 10 cents to 14 cents of additional capital, depending upon the capital requirements imposed upon the institution by its regulator.

The Commercial Real Estate Credit Guaranty Program would enable financial institutions to remove the guaranteed portion of these credits from their CRE portfolio and in certain instances enable them to make additional commercial real estate loans in the future. The program as outlined in the Bill would be a benefit to financial institutions. However, I suggest

that the House consider limiting the maximum guaranteed amount to one institution to approximately 3 percent of its total risk weighted assets as of a certain date and, if possible, increasing the amount of the total guaranteed dollars to some amount in excess of $25 billon. My belief is that the Secretary of the Treasury will find great interest in this program and will be inundated with applications to have commercial real estate credits participate in the program.

In additional to the Commercial Real Estate Credit Guaranty Program, I applaud Congress for its passage of the Dodd-Frank Act. In particular, I believe that Section 616 of the Dodd-Frank Act is very relevant to the proposed Commercial Real Estate Credit Guaranty Program and Small Business Lending Fund Program (H.R. 5297). As you know, Section 616 requires the Federal Reserve, in establishing regulations for capital standards, to make such standards countercyclical. In other words, in times of economic prosperity, the capital standards should be higher and in times of economic stress, the capital standards should be lower. With the combination of a decrease in the capital standards applicable to banks during these economic times and the implementation of amortization provisions of the Small Business Lending Fund Program, overall, banks will be in a much better position to lend to businesses. I encourage the Federal Reserve to act on these countercyclical regulations as soon as possible given the fact that we are still in the middle of an economic crisis.

While I believe the foregoing will provide some relief to financial institution lending and to financial institutions, I cannot stress enough the importance of the implementation of the temporary amortization authority currently provided for in H.R. 5297. As you are aware, Regulation H enacted by the Federal Reserve in the 1980's assisted agricultural banks with the amortization of agricultural loan losses. The FDIC report concerning the banks that participated in this program states that of the 301 banks in the agricultural capital forbearance program, 201

were operating as independent institutions one year after leaving the program; another 35 had been merged without FDIC assistance, and 65 banks failed. As these results indicate, after a period of forbearance, a large majority of the institutions in the program either were able to recover as independent institutions or had sufficient value to be acquired by merger partners without FDIC assistance. Losses of the 65 banks that failed were similar to those of comparable failed banks, a fact suggesting that the period of forbearance did not result in serious deterioration. Of the 65 failed banks in the program, 59 were under $100 million in total assets and had losses of 21 percent of assets. In comparison, 965 banks with assets less than $100 million that were not in the forbearance program and failed during 1986 through 1994 had a 22 percent loss rate. As you can glean from these statistics, the agricultural loan loss amortization program previously implemented in the 1980s did not increase the losses to the insurance fund, but rather reduced such losses.

The combination of increasing capital demands and heightened loan losses due to the economic conditions that the country as a whole has been experiencing have contributed to a decrease in not only commercial real estate loan, but also small business lending. Many bankers now realize that loan portfolio diversification is a necessity and are not able to undertake small business lending due to the aforementioned issues. Enabling eligible institutions to amortize loan losses as outlined in H.R. 5297 will significantly enhance banks ability to increase small business lending because of the positive impact it would have on banks' capital. Full and fair public disclosure is required in H.R. 5297 as was provided under the old Regulation H. In addition, sufficient safeguards are provided in H.R. 5297 in that it specifically provides that the appropriate federal banking agency is to establish regulations defining minimum underwriting standards that must be used for loans made by eligible institutions. Temporary amortization

authority provided for in H.R. 5297 has appropriate safeguards for public disclosure and sound underwriting standards for the future.

Small business lending is essential to the American economy. There is no question that the lending markets were frozen at the time of the unparallel economic crisis that started in 2008 and to a lesser degree continues today. The revitalization of the American economy is tied directly to the availability of credit for small business. I think Congress has made progress in alleviating these conditions through the passage of the Dodd-Frank Act and other legislation. However, I strongly believe that the passage of H.R. 5816 and the inclusion of the temporary amortization authority provided in H.R. 5297 will contribute significantly to increase lending by financial institutions and the recovery of small business in the United States.

Thank you very much for the opportunity to testify at today's hearing. I am pleased to answer any questions the Members of the Committee may have.