

Highlights of [GAO-11-489](#), a report to the Ranking Member, Committee on Financial Services, House of Representatives

Why GAO Did This Study

Since the onset of the financial crisis in 2008, commercial real estate (CRE) loan delinquencies have more than doubled. The federal banking regulators have issued statements and guidance encouraging banks to continue lending to creditworthy borrowers and explaining how banks can work with troubled borrowers. However, some banks have stated that examiners' treatment of CRE loans has hampered their ability to lend. This report examines, among other issues, (1) how the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve), and the Office of the Comptroller of the Currency (OCC) responded to trends in CRE markets and the controls they have for helping ensure consistent application of guidance and (2) the relationships between bank supervision practices and lending. GAO reviewed agency guidance, examination review procedures, reports of examination, and relevant literature and interviewed agency officials, examiners, bank officials, and academics.

What GAO Recommends

Federal banking regulators should enhance or supplement the 2006 CRE concentration guidance and take steps to better ensure that such guidance is consistently applied. The Federal Reserve and OCC agreed with the recommendations. FDIC said that it had implemented strategies to supplement the 2006 guidance.

View [GAO-11-489](#) or key components. For more information, contact A.Nicole Clowers at (202) 512-8678 or clowersa@gao.gov.

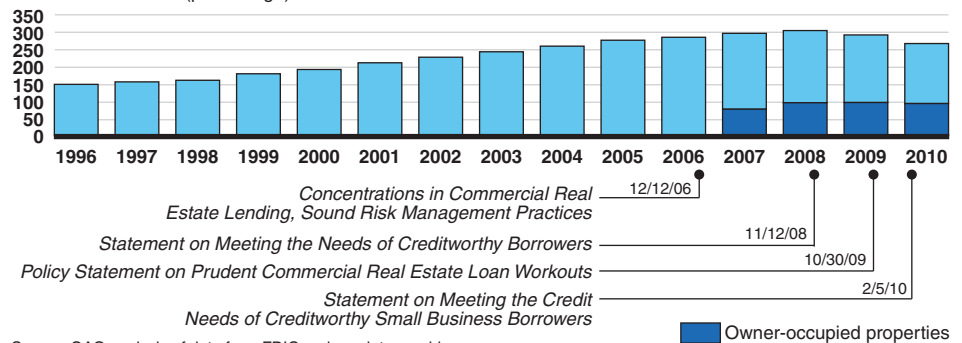
BANKING REGULATION

Enhanced Guidance on Commercial Real Estate Risks Needed

What GAO Found

Aware of the potential risks of growing CRE concentrations at community banks, federal banking regulators issued guidance on loan concentrations and risk management in 2006 and augmented it with guidance and statements on meeting credit needs and conducting CRE loan workouts from 2008 to 2010. The regulators also conducted training on CRE treatment for examiners and internal reviews to help ensure compliance with CRE guidance. Nevertheless, a number of banks reported that examiners have been applying guidance more stringently since the financial crisis and believe that they have been too harsh in treatment of CRE loans. Regulators have incorporated lessons learned from the crisis into their supervision approach, which may help explain banks' experiences of increased scrutiny. GAO found that examiners generally provided support for exam findings on loan workouts, but identified some inconsistencies in applying the 2006 CRE concentration guidance—which is similar to what some of the regulators uncovered in their internal reviews. Moreover, regulatory officials had varying views on the adequacy of the 2006 guidance, and some examiners and bankers noted that the guidance lacked clarity on how to comply with it. As a result, examiners and bankers may not have a common understanding about CRE concentration risks.

Average CRE Concentration among Community Banks and Regulatory Guidance
CRE concentration (percentage)



Source: GAO analysis of data from FDIC and regulatory guidance.

Although many factors influence banks' lending decisions, research shows that the capital banks hold is a key factor. Capital provides an important cushion against losses, but if a bank needs to increase it, the cost of raising capital can raise the cost of providing loans. High CRE concentrations also can limit a bank's ability to lend because the bank may need to raise capital to mitigate the concentration risk during a downturn. Economic research on the effect of regulators' examination practices on banks' lending decisions is limited, but shows that examiners' increased scrutiny during credit downturns can have a small impact on overall lending. Although isolating these impacts is difficult, the recent severe cycle of credit upswings followed by the downturn provides a useful reminder of the balance needed in bank supervision to help ensure the banking system can support economic recovery.