Comments of the Consumer Federation of America and the Center for Economic Justice on Proposals to Weaken Life Insurers' Capital and Reserve Requirements

Submitted to the NAIC Capital and Surplus Relief Working Group

January 27, 2009

Good morning Mr. Chairman and members of the Working Group, my name is Bob Hunter. I am Director of Insurance for the Consumer Federation of America. I have served as Commissioner of Insurance in Texas and as Federal Insurance Administrator under Presidents Ford and Carter. I am delivering these remarks on behalf of CFA and also on behalf of the Center for Economic Justice.

CFA and CEJ believe that you should not rush to a conclusion and should not attempt to make any changes that would apply to the Annual Statements for 2008. We remind you that the foundation of statutory accounting is to value assets and liabilities conservatively to ensure insurers have cash to meet their claims. The explosion in affiliate investments and captive reinsurance agreements undermines this conservatism. The current economic upheaval does too, in completely unknown ways. For instance, while regulators claim that AIG insurance subsidiaries are strong, that strength appears to rely upon a host of affiliate investments that are only as strong as AIG.

Similarly, changing accounting practices to give the appearance of more capital or surplus when no new capital or surplus is created does a disservice to statutory accounting principles and to consumer protection. We urge extreme caution as you consider reducing the available surplus and reserves that currently protect policyholders.

We have several key questions for this Working Group before you act, the last six of which we have asked you before but which remain essentially unanswered. What follows is a discussion of why it is vital that each of the questions we ask you to answer should be answered in full prior to finalizing any action on the proposals made by industry and adopted by regulators in secret, closed meetings.

I am sorry to say that NAIC's actions to date lead us to conclude that this public hearing is simply a sham to give the appearance of public input. We note that the Capital and Surplus Relief Working Group has already adopted its recommendations – discussed and agreed to in secret meetings – and that various working groups and task forces have already prepared the documents to implement the Working Group's recommendations. The fact that the full membership of the NAIC is scheduled to consider adopting these recommendations in two days indicates that the NAIC leadership expects no changes from the current recommendations. We cannot help but believe that the decisions have already been made and the public hearing is for show.

As we discuss at greater length below, NAIC has not provided any analysis of the need for these or any capital and reserve relief proposals, has not articulated what the goal of these proposals is, has not explained how these proposals will accomplish that goal, and has provided no analysis of the expected impact on capital and reserve levels for the industry as a whole or for individual insurance companies. How could any regulator responsibly vote on these proposals without these questions answered? The answer, of course, is that they can not do so.

We ask that any votes of the Executive Committee and Plenary on any recommendations from the Capital and Surplus Relief Working Group be recorded roll-call votes, so that the public can identify which regulators voted for or against the proposals.

Why Are These Proposals Receiving Emergency Treatment?

Throughout the subprime and financial crises, state regulators and the NAIC have claimed that insurance companies are strong and that state-based regulation has protected insurance consumers as federal regulators have failed to do. State regulators have claimed that they kept AIG insurance companies strong, while federal regulators allowed the holding company to fail.

Given these claims, why has the industry sought and regulators conceded emergency and rushed treatment of these proposals? Absent a compelling reason for emergency action, these proposals should not be adopted in an emergency fashion, but should be treated according to normal procedures, which include public participation and reasonable time for consideration. No state insurance department can take an emergency administrative action without a compelling reason for not utilizing the normal administrative procedures and the NAIC should act in the same manner.

Why Secret, Ex-parte and Closed Meetings?

In his January 9, 2009 response to our January 5, 2009 email raising concern with all the early secret meetings of the NAIC with ACLI, and later to discuss the ACLI request in executive session, Chair Hampton wrote (emphasis added):

> "The NAIC Executive Committee established the Capital and Surplus Working Group to perform its charges in an expedited manner. Given the ACLI proposals are asking about changes to reserves and other accounting requirements, many of the regulatory discussions were likely to involve company specific questions and comments. **Per the NAIC open meetings policy, the discussion of company specific information is a key reason for holding regulator-to-regulator meetings**."

This response is inappropriate and unacceptable. Not only does Chair Hampton, in other responses to our inquiry, advise that there was no company-by-company analysis, and therefore, no need to close off meetings to the public, but the proposals all deal with industry-wide actions – changes in manuals and procedures affecting the entire industry.

The argument that, because an individual company might be discussed, the meeting should be non-public is absurd. Using this logic, there would never be an administrative procedure requirement for public meetings to consider and adopt proposed insurance regulations – because a commenter might mention the impact of the rule on its company or the Chair might want to consider some company specific matter at some point in the proceedings.

And how does the possibility of a specific insurer being discussed justify NAIC's secret, ex-parte meetings with ACLI? The fact that NAIC has already met secretly with ACLI undermines the argument that open meetings cannot be held because it is possible that an individual insurer's situation might come up, because that logic would preclude meetings with ACLI too.

The NAIC has refused to hold itself publicly accountable to the same type of open government standards with which state agencies must comply, even though the NAIC is taking actions that have the force of law. This is why CFA and CEJ have challenged the actions of the NAIC as violations of state public meeting, public records and administrative procedures acts. As long as the NAIC continues to respond as Commissioner Hampton has, we will continue to pursue these challenges to NAIC action.

We urge the NAIC to stop these unwarranted and unreasonable secret proceedings and adhere to the same type of open meeting and open records requirements that are required in the states.

<u>Consumer Questions Remain Unanswered</u>

Chair Hampton's responses of January 9, 2009 to our questions were incomplete or simply non-responsive in several instances.

QUESTION 1: For instance, we asked for the evidence to show that changes in reserves were needed and desirable. In response, we were told that life and annuity reserves are too conservative, that current requirements establish reserves in excess of what is needed for consumer protection and financial solvency and that movement towards principles based reserving – relying on actuaries to certify reserve adequacy instead of relying on rules – is necessary to give industry greater flexibility and set reasonable reserve requirements.

We reject these arguments. First, where is the evidence we sought that reserves are excessive? Industry has cited "studies" by Milliman – studies done on behalf of and paid for by industry. Had Milliman determined current reserves requirements were inadequate, would we have seen that study?

Second, the concept of principles-based reserving is essentially the same type of self-regulation by parties with conflicts of interest that led to the subprime meltdown and financial crisis. Actuaries are not disinterested observers. Reliance on actuaries who depend upon industry for their livelihood is the same type of conflict found with rating agencies in the credit crisis. See New York Times editorial attached as Attachment 2.

The response to this question also raises the question of an inconsistency between the reason ACLI asked for these changes and the reason NAIC says it is moving forward with them. ACLI was quite clear to us that the reason these changes were sought was that the Risk-Based Capital Ratio was falling to troubling levels, namely that the 2007 industry RBC of 400[1] was anticipated to fall to about 300 at year-end 2008. ACLI told us that 300 was the level when rating agencies might consider action to downgrade insurers, so the goal of their proposal was to minimize the number of its members who might face rating agency action. ACLI said their proposals would likely raise the RBC at year-end 2008 from about 300 to about 335-340.

But NAIC gave us no clear reason for this rush to lower consumer protections except to say that "there has been no documentation presented to the Capital and Surplus Relief Working Group detailing the weak financial position of any specific life insurers, nor were (sic) there any information that insolvencies will occur…We do know however that the economic crisis has caused reductions in the value of investments held by insurance companies and companies will benefit from additional capital on their financial statements. This request to implement early proposals agreed to by most regulators may reduce some of these capital infusion problems."

Thus NAIC sees no problem of weakness or insolvency, yet rushes ahead, using dubious processes, to adopt proposals to weaken consumer protections.

QUESTION 2: We asked the NAIC to tell us the results of regulator analyses of the impact of these proposed changes on capital, surplus, reserves and RBC ratios for the industry and for individual companies most impacted by the changes.

Shockingly, the NAIC responded, "the impact of these proposed changes on stated versus meaningful capital and reserves for the industry or a particular company was not used as an analysis criteria."

This response, of course, immediately raises the question, then why were meetings not open to the public? This response also raises the question, on what basis is the NAIC determining that these changes will accomplish anything? What is the impact on the safety and soundness of insurers and will these changes leave policyholders vulnerable? A sign of undue haste here by the regulators is the complete lack of understanding of the impacts of the actions on America's policyholders.

This answer is remarkably unsatisfactory. To act without this knowledge would be irresponsible.

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[1] The RBC ratio relates an insurer's actual capital to that needed by the insurer to be safe, based on the risks the insurer has in its investment and underwriting portfolios. A RBC of 100 is usually the "company action level" where the company must develop a plan to strengthen its capital to head off potential financial trouble. A ration of 400 is 4 times the "company action" level.

We do know that the proposals will lower the level of reserves and other dollars that today protect America's consumers. There is no doubt about that. We expected that the NAIC would conduct a study of the overall adequacy of such reserves in today's economic crisis. It is disturbing that the NAIC has made no showing of what constitutes "redundant" or "excess" reserves overall, as if it is ever possible to be too safe. It is deeply troubling that the NAIC would only focus on specific language in various rules called to their attention by the ACLI that might imply some degree of excess, without examining on its own whether there is reserve redundancy overall or if there are any rules where the opposite (i.e., inadequacy) might be the case.

Of course, lower reserves will produce more capital on the books for insurers but not one dollar more of protection for consumers. What happens if insurers decide to dividend away the amount released by these relaxed accounting rules? We share the concerns expressed by Actuary Philip Bieluch in his email of January 21, 2009 to the Working Group. We agree with him that these changes should not be approved and we further agree with him when he says, "If there is a decision to move forward with any changes, I ask that dividends from the regulated insurance companies be limited to those that would have been available under the current rules."

QUESTION 3: We asked how policyholders would be affected by the proposals, if adopted by NAIC. We were told, "Final adoption of these ACLI proposed items will not have an adverse effect on the insurance company's ability to pay its policyholder obligations." Yet no support or analysis is provided to justify this statement. Of course, this answer is, at best, misleading. It is impossible for these actions not to have an adverse effect on an insurer's ability to pay; the question is whether that adverse effect is material and necessary for insurers to remain solvent. The NAIC has refused to answer this question and instead has provided a misleading statement.

QUESTION 4: We asked if the regulators believed that the rating agencies would see these changes as an actual strengthening of capital and reserve requirements and not just cosmetic.

The NAIC did not answer this question. The reason it should be answered is that, at least at ACLI, the reason for the proposals (and for the great haste) is largely to reduce the possibility that rating agencies will lower the ratings of insurers.

It is surprising that the NAIC cannot answer this key question. Professor Joseph Belth's research on this question implies that the rating agencies will not be influenced by these changes, at least not in any significant way. If the reason to rush to judgment is to mollify rating agencies, then there is no need to rush if Professor Belth's research is correct. If it is not the reason why NAIC must rush this proposal through, what is?

QUESTION 5: We asked how the various proposals would be implemented. The NAIC did not respond.

We are concerned with implementation because, in some cases, NAIC action, such as a change to certain NAIC manuals,[2] will automatically make the adopted change effective in most, if not all, states. Therefore, the NAIC's failure to use an open public process, including the use of secret meetings and closed meetings, may violate the laws of states that require notice and open meetings, if and when they vote for such a change.

QUESTION 6: We asked if the NAIC would help America's life insurance and annuity policyholders understand what their actions mean by demonstrating the "before and after" effect of the proposed changes on individual insurer's capital and reserve requirements.

NAIC's inadequate response was "I assume the NAIC would simply recommend the adoption of the proposed item and the domestic regulators will have the ability to require before and after documentation."

This approach will pull the wool over the eyes of millions of Americans holding life and annuity contracts today. Transparency should be part of the NAIC proposal to help consumers across the nation and not, as the Chair suggests, left to individual states to consider adopting if they think of it. If the NAIC cannot adopt national proposals to help consumers at the very time the NAIC is adopting national proposals in undue haste to help insurers, why should consumers continue to favor state regulation over a federal regulatory system?

We propose the following language for adoption by the NAIC as part of any approval of the ACLI proposed weakening of consumer protections:

> ***Transparency***
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> *In order to assist policyholders, there shall be full transparency for policyholders of what the financial impacts are from these changes adopted by the NAIC. During a transition period of the first 2 years starting with the first time these changes are applied, key capital, surplus and reserve amounts in the Statutory Annual Statement and Quarterly Statements and risk-based capital ratios shall be calculated showing amounts based on current and revised accounting and reserving rules and procedures.*

Conclusion

We oppose adoption of any of these changes unless the necessary research mentioned above is undertaken by NAIC to justify the changes, and the important questions we have raised are answered fully and factually. We oppose allowing any of these items to be used in the 2008 Annual Statement. We request a full explanation of the key questions

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[2] E.g., A change implemented through the NAIC Accounting Practices and Procedures Manual (AP&P Manual) would be immediately applicable in all states except New York and Florida. An example of a proposal subject to this immediate effect would be, as we understand it, the ACLI proposal to eliminate stand-alone asset adequacy for AG-39.

we raise today so that the public can know why the NAIC thinks these proposals are needed, why it is urgent to act in haste, and how the changes will impact consumers throughout the country and the companies most impacted by the changes.

If, however, you move forward with this action for use in the 2008 Annual Statement, we strongly urge adoption of the Transparency language we proposed above. Further, if you move ahead now, we offer certain comments on the individual proposals as contained in Attachment 1. We object most strongly to the Working Group's recommendation regarding the Deferred Tax Asset. This proposal changes the allowance of the admission of deferred tax asset to surplus. First, the change is the amount of DTA expected to be realized in three years (changed from one year) and raises the limit of DTA as a percentage of surplus from 10% to 15%. Both recommendations are dangerous to the soundness of an insurer. How can an entity estimate deferred tax assets three years out? We can see changing from one to two years -- given a situation where losses are sufficient to carry over for more than one year -- but more than that seems like an invitation to fudging the numbers. And increasing the percentage of surplus that is illiquid is a bad idea. While we can support changing the evaluation period from 1 to 2 years to address huge swings in a particular year, we cannot support increasing the maximum percentage DTA of adjusted capital from 10% to 15%. This change does not create capital and allowing insurers to reduce their actual capital by increasing illiquid capital is contrary to sound consumer protection practices.

CFA and CEJ believe that, absent a compelling reason for emergency action and clear articulation of the expected impact of the action, none of the recommendations from the Working Group should be adopted in emergency fashion.

We are able to provide some comments on the Working Group's recommendations for your consideration if you decide to move forward at this time:

L1a – We do not object to this proposed action because other regulatory requirements exist for use of preferred mortality tables over and above the identified restriction. We also strongly support the restriction related to questionable reinsurance practices and agree that such action must be integral to adoption of this proposal.

L1b – We agree with the Working Group that this proposal should not be adopted.

L1c – We agree with the Working Group recommendation, consistent with our recommendation on L1a.

L2 -- Without quantification of the impact of this proposal, we cannot support the recommendation.

L3 – We agree with the recommendation from the Working Group.

VA -- Without quantification of the impact of this proposal, we cannot support the recommendation.

VA2 – We agree with the Working Group that this proposal should not be adopted.

I1 – We agree that the Working Group should not approve a proposal previously rejected by another NAIC working group, but do believe the industry raises a legitimate concern about disparities created by a ratio with a near-zero denominator – it is truly the case that the industry average is near zero. We note that commercial mortgage defaults have increased significantly, as reported in the attached Dow Jones article (Attachment 3). ("Prices of securities tied to commercial mortgages have fallen sharply in recent months to the point that prices reflect a downturn even greater than the early 1990s, when default rates exceeded 30%"). This is a glaring example of the need for current analysis and quantification of the proposed action as it is an extremely dangerous time to lower consumer protections related to commercial mortgages.

A1 – **We disagree with working group proposal.** This proposal changes the allowance of the admission of deferred tax asset to surplus. First, the change is the amount of DTA expected to be realized in three years (changed from one year) and raises the limit of DTA as a percentage of surplus from 10% to 15%. Both recommendations are dangerous to the soundness of an insurer. How can an entity estimate deferred tax assets three years out? We can see changing from one to two years – given a situation where losses are sufficient to carry over for more than one year – but more than that seems like an invitation to fudging the numbers. And increasing the percentage of surplus that is illiquid is a bad idea. While we can support changing the evaluation period from 1 to 2 years to address huge swings in a particular year, we cannot support increasing the maximum percentage DTA of adjusted capital from 10% to 15%. This change does not create capital and allowing insurers to reduce their actual capital by increasing illiquid capital is contrary to sound consumer protection practices.

Attachment 2

The New York Times

January 8, 2009
EDITORIAL

Starting the Regulatory Work

The financial crisis is now more than a year old. It intensified through an entire presidential campaign and has persisted during the postelection transition. And yet, less than two weeks from Inauguration Day, it is still unclear what President-elect Barack Obama has in mind when he promises "a 21st-century regulatory framework."

The outlines of the challenge are clear. The decades-old ways — in which the Treasury and other federal regulators have relied less on rules and enforcement and more on faith in market discipline to limit risk to the system — have been a manifest failure. Anything less than a new rules-based regime would be inadequate to the task of restoring confidence and, eventually, reviving the economy. Even more basic, any new regime must be founded on a declared desire and willingness to regulate.

Will Mr. Obama deliver? Without a clear signal from the president-to-be, the early signs are not terribly encouraging. There are no prominent consumer or investor advocates among his top economic advisers. Except for Paul Volcker, the former Federal Reserve chairman, there are no officials or regulators, past or present, who have distinguished themselves by giving early warning of the impending catastrophe or taking strong action against the excesses that were fueling it.

Mary Schapiro, Mr. Obama's choice to lead the Securities and Exchange Commission, has served ably in government and industry regulatory positions, but is best known for her support of self-regulation and a greater role for principles-based regulation — basically, the opposite of clear rules. The choice of Gary Gensler to lead the Commodity Futures Trading Commission, which regulates futures contracts, is more troubling.

Mr. Gensler, a former investment banker from Goldman Sachs, one the biggest brokers of commodities, was an assistant Treasury secretary under President Bill Clinton. In 2000, he oversaw the drafting of legislation that exempted derivatives from oversight by the federal commodity regulator, including the viral credit default swaps that have amplified the current crisis. Swaps and other derivatives must be regulated. The country needs an exchange where they are openly traded and subject to the full range of regulatory scrutiny.

Ultimately, new laws for trading derivatives must be enacted by Congress, but the input of the main regulator of the commodity exchange will be important in writing and implementing the laws. Where does Mr. Gensler stand? How do his close ties to Wall Street affect his choices, his sense of what is right and what is needed? Those are among the questions that senators have to ask him at his confirmation hearing.

They will need to ask similar questions of Timothy Geithner, Mr. Obama's choice for Treasury secretary. As the president of the New York Federal Reserve Bank since November 2003, Mr. Geithner was the closest regulator to Wall Street during the years when many of the excesses that led to the crisis proliferated in plain sight.

One early sign of how serious the Obama administration is about regulatory reform will be whether officials try to couch it primarily in terms of revamping the structure of regulation. There are too many regulators with overlapping demands and authority, but a new structure must derive from new rules, not vice versa.

In addition to explicit regulation of derivatives, those rules must include limits on the amount of money that financial institutions can borrow in order to boost returns — and higher requirements for the amount of capital they must hold to support their activities and cushion their losses. A wise regulatory regime would require institutions to build up capital in good years so that they can husband their resources in lean years.

And in addition to regulating previously unregulated investment instruments, Washington must impose regulations on equally unregulated hedge funds. There was a time when institutions that were too big to fail posed the greatest danger to the financial system and economy. This crisis has shown us that financial institutions can become so interconnected that allowing them to fail is just as dangerous. The solution is to regulate financial participants outside the formal banking system.

All that would only be a start. There is an important false assumption that must be laid to rest: that protecting consumers and individual investors unduly limits corporate profits and financial innovation. The establishment of what advocates call a Consumer Credit Safety Agency is long overdue. If a process had been in place to determine the effect on consumers of financial products and practices, the current crisis may well never have happened. Consumer advocates have long been aware of the lurking dangers in the subprime lending that sparked the debacle.

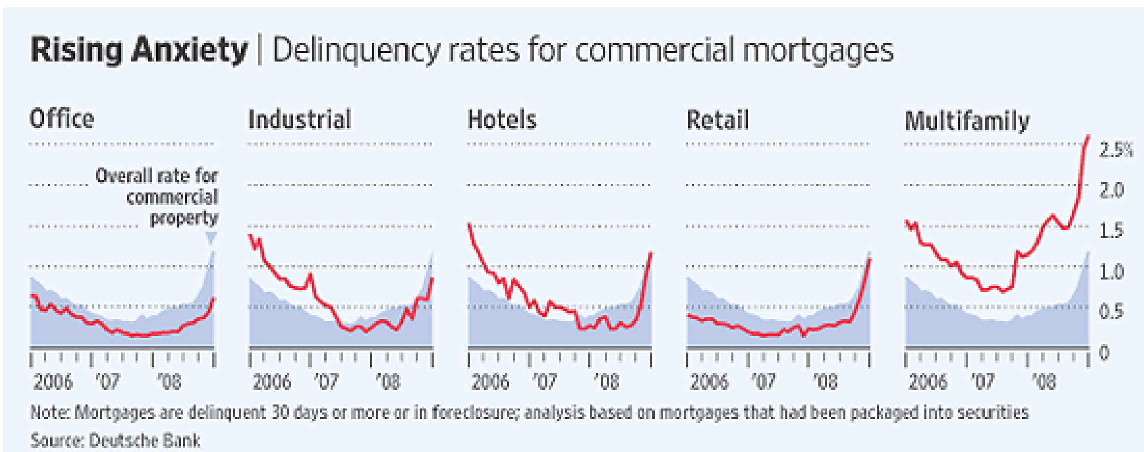
It could be that the people whose actions contributed to the mess are best equipped to clean it up. That remains to be seen. But it would be tragic if Wall Street concludes from Mr. Obama's choices that it need not worry about the world changing in ways that would fundamentally alter its pursuit of profits. You will know the new rules are working when Wall Street starts worrying.

Commercial Property Loses Shelter

As Delinquencies Surge in $3.4 Trillion Market, Investors Brace for Big Hit

By LINGLING WEI

Delinquencies on mortgages for hotels, shopping malls and office buildings were sharply higher in the fourth quarter, as the weaker economy hit landlords and threatens to cause losses for investors in the $3.4 trillion market.



Commercial real estate has held up better than the housing market, but began to struggle at the end of last year. New data from Deutsche Bank show that delinquencies on commercial mortgages packaged and sold as bonds, which represent nearly a third of the commercial real-estate debt market, nearly doubled during the past three months, to about 1.2%. The figure includes mortgages that are 30 days or more past due and in foreclosure.

The delinquency rate will likely hit 3% by the end of 2009, its highest point in more than a decade, says Richard Parkus Deutsche Bank's head of research on such bonds, known as commercial-mortgage-backed securities, or CMBS. "Throughout this year, we're going to continue to see a significant acceleration of problem loans," he says. "CMBS prices already have priced in a far greater delinquency rate on the underlying loans."

Delinquencies on commercial-real-estate loans held by banks and thrifts, which are big holders of this debt, also have risen strongly and many firms have suffered losses. According to research firm Foresight Analytics, soured commercial mortgages on banks' books jumped to 2.2% as of the third quarter of last year, from 1.5% at the end of 2007. The research firm estimates that the rate could rise to 2.6% in the fourth quarter of 2008.

Prices of securities tied to commercial mortgages have fallen sharply in recent months to the point that prices reflect a downturn even greater than the early 1990s, when default rates exceeded 30%. The $3.4 trillion of commercial mortgages in circulation is small compared with the $11.2 trillion of residential-mortgage debt outstanding, but it is still more than numerous other debt categories. Consumer credit, for instance, totals about $2.6 trillion. To be sure, commercial-mortgage delinquencies are much lower than subprime residential mortgages, the culprit for the current economic and financial crisis. About 30% of those loans to credit-impaired homeowners are at least 90 days past due.

Until recently, investors thought commercial real estate would hold up through the downturn. There was less speculative development than during previous boom cycles, and underwriting standards on commercial mortgages appeared to be better than those for residential mortgages.

But evidence is emerging that the commercial-property market -- which runs from apartment and office buildings to shopping malls and warehouses -- had some of the same excesses as the housing segment. An unusually high number of the underlying CMBS loans that are going bad were made and securitized in the past three years. That is a sign that investors overpaid greatly for those properties and that underwriting standards were loose. In many cases banks lent money based on future income assumptions rather than current cash flows, experts say.

For example, one of the delinquent CMBS loans is a $125 million mortgage secured by a shopping center in Corona, Calif. called Promenade Shops. The property's annual cash flow was $6.3 million when J.P. Morgan underwrote the loan in July 2007. But the loan was based on the assumption that the cash flow would rise to about $10.5 million.

"Delinquency rates among the most recent vintages are already surging ahead of those of older vintages. This speaks to the weakening in underwriting quality that occurred in recent years," Mr. Parkus says.

Commercial-mortgage experts say this doesn't bode well for the thousands of loans that also were made with optimistic assumptions. For example, investors are closely watching CMBS issues that were used to finance the $5.4 billion acquisition of a sprawling Manhattan apartment complex in 2006 by a venture led by developer Tishman Speyer Properties and BlackRock Realty Advisors.

Moody's Investors Service recently downgraded some classes of those bonds. If there is a debt-service shortfall, the investors in the property would have to put up more cash or face the possibility of foreclosure. Tishman, which declined to comment, has said the partners are confident in the investment and would put more capital into the project if needed.

Among the top 15 CMBS originators, loans made by Column Financial, a unit of Credit Suisse Group, currently have the highest 60-day-or-more delinquency rate, at 1.71%, according to Trepp, a New York company that tracks the market for commercial-real-estate financing. No. 2, at 1.63%, is LaSalle Bank, which is now owned by Bank of America Corp.

Banks and thrifts would suffer in a commercial-real-estate downturn because they own nearly 50% of all commercial mortgages outstanding. Many of these institutions are particularly vulnerable. According to Foresight Analytics, as of Sept. 30, 2008, some 1,400 commercial banks and savings institutions had more than 300% of their Tier 1 capital in commercial mortgages. Tier 1 capital is a key indicator of a bank's ability to absorb losses. Regulators consider anything over 300% to be excessive.

At Mutual Bank Corp. in Harvey, Ill., for instance, the amount of commercial mortgages outstanding represented 752% of its Tier 1 Capital as of the third quarter of last year, according to Foresight Analytics. And delinquencies reached 11.9%.

"We've struggled the same as other banks with commercial real estate," says Thomas Pacocha, chief credit officer at the bank, which had $1.7 billion in total assets as of the end of September. "The economy caused the situation to a great extent. When the economy rectifies itself, the bank will see a great improvement in its balance sheet."

Mr. Pacocha adds that since the third quarter, the bank has "made some progress in reducing dependence on commercial real estate."

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