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Statement by

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before the

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I appreciate the opportunity to speak to you today about the challenges that face banks in meeting the service and credit needs of low-income and minority communities. I commend the Committee for holding this hearing in a local community in Prince Georges County where questions pertaining to these factors have been raised.

It is our understanding that the Committee is interested in developing a profile of current lending activity in a specific neighborhood in Prince George's County, and then periodically reviewing the record for changes in bank credit and service delivery. As a starting point for analysis, we were furnished a list of 39 census tracts and a list of banks and thrifts which were identified by the Committee as having a branch or office located in these specific census tracts, or as I will refer to it in the testimony, the "target area".

I toured the target area with the Director of Housing and Community Development for Prince Georges County. During that visit we discussed demographics, housing, and other conditions in the county, as a whole, and in the target area specifically. I saw many encouraging developments in some areas - and opportunities in others - which I will address later in this statement.

First I would like to comment on some of the specific characteristics of the neighborhood. I will make some general observations about the overall HMDA data for the area. Then I will briefly discuss the banks for which the Federal Reserve is

the primary regulator which are located in the target area. Finally, I would like to acquaint the committee with some of the initiatives being undertaken by the financial institution regulators and the Federal Reserve specifically, to address credit availability for underserved areas.

Characteristics of Prince Georges County

Prince Georges County is an interesting area for this type of study since it has undergone some massive changes in population and demographics during the past ten years. The County estimates the 1992 population at roughly 750,000 people. This is an increase of 20,000 people just since the 1990 census, and an increase of 85,000 in population since the 1980 census.

The county's population is 58% minority, including 50% black and 8% Hispanic, Asian and other minorities. This represents a shift since 1980 when the county was majority white. The shift is a result of the out-migration of whites coupled with the in-migration of blacks, many of whom came from Washington, D.C. in search of better housing values and public school systems. Many of the blacks who have moved into the county represent middle- and upper-income families. Prince Georges County has both the highest median income for a black population and the largest number of black-owned businesses of any county in the United States.

The 39 census tracts which make up the target area of interest to the Committee differ from the county overall in some demographic characteristics. The population of the target area

is 159,000 and consists of 82% blacks and 3% Hispanic, Asian and other minorities. Even though this area has a greater percentage black population than the county as a whole, the median income for the target area of \$46,476 is very close to the county median of \$49,031. However, the median home value for the target area of \$111,779 is lower than the county median of \$123,995. The percentage of owner-occupied units in the 39 tracts (56.9%) is roughly equivalent to the county (56.2%).

During my tour of the target area, I observed that, as was expected, most of the older, lower-income housing is closest to the District line. Some of the residences in these areas are currently undergoing rehabilitation, and some of those rehabs are being financed by the County government. Others are being financed privately. There are many other homes in the general area that apparently could benefit from repair or improvement. The commercial areas in those neighborhoods are small retail strips. We did see a number of bank branches in certain commercial areas near the District line; however, there were also quite a few check cashing operations and liquor stores which also frequently cash checks.

As you travel further out Central Avenue toward Enterprise Road there is a lot of new housing and commercial development. The housing stock reflects an upward shift in income, with recently built larger, more expensive homes. I was struck by the apparent diversity of income within the relatively small area of the 39 targeted census tracts.

As indicated by the attached maps, we have plotted the locations of all the depository institutions with offices in the target area. Six of these institutions have branches or offices along the narrow Central Avenue corridor. The largest number of branches, (12), are clustered in the southwest area of the designated community. That southwest corner of the target area includes census tracts with a population which is 60-80% minority, and with median family incomes that fall in the range of 80-120% of the MSA median income (\$54,173 in 1990). The remainder of the branches are scattered throughout the neighborhoods. The areas with the lowest income do not have many branches of banks or savings and loans.

Home Mortgage Lending

The best information available about the types and volume of credit extended in the neighborhoods which are the focus of these hearings is for residential lending. As a product of the data collected under the authority of the Home Mortgage Disclosure Act (HMDA), we know both the types and volume of home loans applied for and granted in selected census tracts. We also know the race and income of the applicants and borrowers.

For this hearing, on behalf of all the agencies here today, we examined the 1992 HMDA data which is still being processed by the Federal Reserve Board. The HMDA reports are quite revealing, although I must caution that revisions to the data are still possible since we are just completing the final editing of the 1992 data. We will be happy to provide the

Committee with revised information if corrections are made.

The Federal Reserve used the preliminary 1992 HMDA data to prepare special reports showing the home lending activity of the depository institutions having branches in the target neighborhoods, in addition to a report that shows the lending activity of all lenders covered by HMDA for these neighborhoods including those, such as mortgage companies, which have no deposit-taking function.

The 1992 HMDA data show that the depository institutions with branches in the target neighborhoods received relatively few applications for credit to purchase or improve homes or refinance existing mortgages in these neighborhoods. When comparing the HMDA data and the maps showing the location of institution branches, it is somewhat surprising that, at least in the target area, branch location seems to have no relation to the number of housing-related loan applications.

According to the 1992 HMDA data, the depository institutions which have branches in the target area received 15 applications for home purchase loans, 9 of which were approved; 98 applications for refinancing, 56 of which were approved; and 150 applications for home improvement loans, 59 of which were approved. However the HMDA data also reveal that approximately 190 lenders covered by HMDA with locations outside the target area - both depositories and mortgage companies - received loan applications pertaining to properties in the target area. These lenders with office locations outside the target area include 80

banks and thrifts, 63 mortgage company subsidiaries of banks and thrifts, and 50 independent mortgage companies. I should note that the HMDA data probably understate the total number of residential lenders active in these areas since some of the lenders extending credit in these neighborhoods either are exempt from HMDA because of the institution's size (under \$10 million in assets) or location (not in an MSA), or, because of a low volume of loans are not required to report their lending in the Washington MSA by census tract.

In 1992, the roughly 190 other lenders active in the target neighborhoods received approximately 2900 applications for home purchase loans, of which 1900 were approved; 2850 applications for refinancing, of which approximately 2150 were approved; and roughly 700 applications for home improvement loans, of which 400 were approved.

One thing that is shown by the HMDA data is the disposition of housing-related applications. On a national basis, the denial rate for Black applicants for conventional home purchase loans is about twice the rate for white applicants. However, in the target area, the black denial rate of 18.8% is actually lower than the white denial rate of 20.8%.

We also looked at the denial rates for other types of housing products extended by all lenders in the target area. Historically, the denial rates nationally for FHA/VA home purchase loans have been 26.4% for black and 16.3% for white applicants. In the target area, for 1992, these rates also

reflect roughly an 8 percentage point difference and are 18.3% for black and 10.2% for white applicants. Refinancing and home improvement applications in the target area show very different denial rates than the national norms. Mortgage refinancing applications nationally have resulted in denial rates of 29.5% for black and 13.7% for white applicants. The target area, in 1992, experienced a 12.2% denial rate for black and a 10.5% denial rate for white applicants, a significantly lower disparity than the national figures. Home improvement applications demonstrated a similar pattern. Whereas nationally the denial rates were 44.2% for black applicants and 21.1% for white applicants, in the target area the denial rates were 39.5% for black and 38.7% for white applicants.

It is worth noting that while the local depository institutions accounted for a very small proportion of all the home purchase and home refinancing applications in the target neighborhoods, they were major players in home improvement loans, accounting for about 20% of total applications.

By examining the 1992 HMDA data we can learn something about the types of loans used by homebuyers in the targeted area for this review. In 1992, of the roughly 2900 applications for home purchase loans, 61% were either for FHA-insured or VA-guaranteed loans, the remainder were for conventional loans. Among low- and moderate-income black applicants for home purchase loans, 75% applied for government-backed loans, while only 49% of white applicants with similar incomes sought government-backed

credit. The reasons for these differences are not known.

State Member Banks in the Target Area

The Federal Reserve has primary regulatory responsibility for only two of the banks which appeared on the list supplied by the Committee. These two banks together have a total of four branches or offices in the designated area. One of the banks became a member of the Federal Reserve just within the past year. That bank was last examined, for compliance with the Community Reinvestment Act, by its previous regulator, in 1989, before public disclosure of CRA ratings. Consequently, we do not have a public rating at this time. That bank is scheduled for a compliance examination, which will include a review of performance under the Community Reinvestment Act, by the Federal Reserve Bank of Richmond in November. Upon completion of that examination, we will be glad to send the Committee a copy of the publicly disclosed CRA Evaluation Report.

The other state-member institution in the neighborhood was rated "satisfactory" in April, 1993. The Committee has already been sent a copy of that report. It is important to keep in mind that the evaluation of that bank is based on its entire delineated community which encompasses a large area including, but not limited to, parts of Prince Georges County.

Both state member banks offer a broad range of credit services including loans for home improvement, refinancing, and purchase (including FHA/VA loans); residential and commercial construction; small business start-up, expansion, and operation;

and general consumer loans.

One of the state member banks will cash government checks for non-customers with proper identification. The other bank provides that service for customers only. Both banks have low-cost basic checking accounts with no minimum balance; one at a monthly cost of \$3 and the other with a \$4 monthly fee. These fees include six checks per month, with a \$.50 per check fee for any checks beyond the six.

The two state member banks located in the neighborhoods had no mortgage loan purchase applications, four applications for refinancing, of which one was approved and three denied, and 25 home improvement loan applications (9 approved, 14 denied, 2 withdrawn). However, these statistics do not tell the entire lending story for these institutions.

Both state member banks have mortgage company subsidiaries. In examining the HMDA data, we also looked at the target area lending activity by these subsidiaries. The mortgage company subsidiaries received a total of 45 mortgage home purchase loan applications, of which 40 were approved, 3 were denied and 2 were withdrawn. There were 99 applications for mortgage loan refinancing in the target area, of which 73 were approved, 8 were denied and 18 were withdrawn.

Federal Reserve Initiatives

I would now like to discuss some of the initiatives in which the Federal Reserve Board is participating or initiating to increase credit availability in low-income and minority

neighborhoods.

In response to concerns in the banking industry and among potential borrowers, in March the federal banking agencies issued a joint statement on credit availability which created a special category for small and medium sized business and farm loans which could be made with less documentation than is normally required. The amount of such loans may not exceed 20% of a bank's capital. It was our hope at the time that banks would take advantage of this opportunity to increase the number of small business loans in communities such as the target area. However, it seems that only a few institutions are utilizing this basket, possibly due to slack demand.

On June 10, the agencies announced additional credit availability initiatives which included lessening paperwork and regulatory burdens for financial institutions to encourage them to make additional credit available (copy attached). These initiatives included revised valuations of collateral, better coordination among the agencies of bank examinations, and guidance on use of classification categories in commercial examinations.

These initiatives also included guidance on fair lending and referred to an interagency letter issued in May. This interagency letter on lending discrimination was signed by the principals of all the federal banking regulatory agencies and was sent to the chief executive officers of all banks, savings and loans, and bank holding companies in the country. It

stressed the serious nature of violations of anti-discrimination laws and the importance of these issues to the regulatory agencies. The letter also included guidance to the financial institutions on steps that can be taken to insure that they are complying with the relevant fair lending statutes and regulations. The recommendations included the use of second reviews for denied applications, mortgage review boards, and compensation programs in financial institutions that provide incentives to loan officers for loans made to low- and moderate-income minority applicants.

Further guidance to banks on discrimination issues is included in the Federal Reserve Bank of Boston's brochure, "Closing the Gap". This creative pamphlet discusses discrimination and provides advice to banks on ways to have an effective program which serves the minority communities in a bank's delineated area. "Closing the Gap" is now in its third printing and thousands of copies have been distributed to financial institutions and others throughout the country.

The Federal Reserve is also emphasizing compliance with fair lending statutes by improving examiner training and examination techniques for these requirements. We have developed a special "HMDA data analysis system" which allows computer analysis of the raw information to facilitate a better understanding of the HMDA data. This enables our examiners to go beyond the normal HMDA tasks as they review lending activity in cases where the analysis indicates a possible problem. Although

the data alone cannot provide evidence of discrimination, it may indicate areas that need further explanation or investigation by the examiners.

The HMDA data is also being used in a recently developed computer model which allows examiners to match minority and nonminority applicants with similar credit characteristics, but different loan outcomes. Once the pairs are selected, the examiners will pull the identified files and determine the factors used in the credit process. This model is still being tested in several Reserve Bank Districts, but initial feedback shows great promise for use in fair lending examinations.

In addition to the HMDA data, we now have a mapping program which allows us to analyze several variables and present them in an easy-to-read display. Some of the capabilities of this system are evident in the maps I have submitted that show the race, income, and housing loans in the target area.

Another major initiative currently being undertaken by the agencies is the Community Reinvestment Act (CRA) reform project. The administration has requested that the regulatory agencies review CRA and revise it to base it less on process and paperwork and more on actual credit extended or performance. The agencies are working together on this project and are presently engaged in gathering wide public input from bankers and community groups. Two meetings have been held, one with industry trade associations and one with representatives of national community advocacy organizations. Additionally, principals of

the agencies have held seven public hearings on CRA in locations throughout the country and gathered testimony from a wide variety of large and small banks and thrifts, community and other grass-roots organizations, and public officials.

In response to the recent series of articles on lending and banking services in the Washington Post, the Federal Reserve Board and the Federal Reserve Bank of Richmond invited the chief executives of the major financial institutions in the Washington metropolitan area to an information session at the Board. More than 60 local bankers attended this program.

The session featured a presentation on the Delaware Valley Mortgage Plan, an innovative bank consortium in Philadelphia which offers single-family housing loans to low- and moderate-income individuals and families. The Plan has 11 bank and thrift participants who have committed to offer creative mortgage products to lower-income persons. They also commit to not reject applications until after a credit committee for the Plan has an opportunity to explore other methods of approving the loan. The Plan has made more than \$270 million in mortgages to roughly 16,500 families since 1975. The President of the Federal Reserve Bank of Richmond has confirmed the support of Reserve Bank and Board staff for similar initiatives the local lenders may wish to pursue.

Among the goals established for the Community Affairs program at the Federal Reserve Bank of Richmond is the preparation of community profiles of all the metropolitan and

major rural areas in the District. The first profile, currently being prepared, is for all of Prince Georges County, including the target area that is the focus of these hearings. The profiles will describe the general credit needs of each area, with specific focus on low- and moderate-income neighborhoods and small businesses. The profiles will also identify various opportunities for financial institution investment. By providing demographic analysis and information on groups active in community development, the profiles should help financial institutions to respond positively to community reinvestment challenges.

After completion of the Prince Georges County profile, the Community Affairs office will sponsor a training seminar in community development finance for financial institutions, community groups and public officials in the area. This seminar will promote public/private initiatives and opportunities in the County and be a prototype for action as additional profiles are completed.

In conclusion, I thank you for the opportunity to testify today on this particular neighborhood in Prince Georges County as well as methods for addressing credit availability issues in other neighborhoods which include minority residents and small businesses. We recognize the importance of these issues and look forward to working with you to address them.

Joint Release

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

For immediate release

**Federal Regulators Announce
Additional Credit Availability Initiatives**

June 10, 1993

The four federal regulators of banks and thrifts today announced six additional initiatives to implement the President's March 10 program to improve the availability of credit to businesses and individuals. These initiatives include changes to regulatory reporting requirements and the issuance of joint policy statements on the valuation of real estate collateral, use of the "Special Mention" category in reviewing loans, and improved coordination of examinations. The changes to regulatory reporting requirements are consistent with generally accepted accounting principles (GAAP).

The agencies noted that these latest actions bring to a close the first phase of the President's credit availability program. However, all four agencies emphasized that they are continuing efforts to reduce the paperwork and regulatory burden that impedes the flow of funds to creditworthy borrowers.

The actions announced today cover these areas:

■ **In-Substance Foreclosures**

In the past, the agencies' rules required certain loans to be reported as in-substance foreclosures. In the revised guidance issued today, the agencies make it clear that a collateral dependent real estate loan need not be reported as foreclosed real estate unless the lender has taken possession of the collateral. However, appropriate losses must be recognized. This guidance is consistent with the approach taken by the Financial Accounting Standards Board (FASB) in its new standard on loan impairment.

■ **Returning Nonaccrual Loans to Accrual Status**

In the past, a loan that was partially charged off could not be returned to accrual status until all missed payments had been made up to bring the loan to current status and the institution expected to receive the full contractual principal and interest on the loan.

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This reporting requirement also applied in situations where the borrower showed a renewed ability and willingness to service the remaining debt. Accordingly, institutions sometimes found it difficult to work with borrowers who were experiencing temporary difficulties in a way that would maximize recovery on these troubled loans.

To address this problem, the agencies are making two revisions to their nonaccrual guidelines. First, banks and thrifts will be allowed to formally restructure troubled debt in a manner that will allow a portion of the debt to become an accruing asset, provided certain criteria are met. This revised reporting guidance makes the policies of the bank and thrift regulatory agencies consistent.

Second, in some cases, borrowers have resumed paying the full amount of scheduled contractual principal and interest payments on loans that are past due and in nonaccrual status. Under the guidance issued today, banks and thrifts will be allowed to return such past due loans to accrual status, provided the institution expects to collect all principal and interest due and the borrower has made regular payments in accordance with the terms of the loan over a specific period of time.

■ **Regulatory Reporting Requirements for Sales of Other Real Estate Owned (OREO)**

The agencies will separately issue guidance to banks and thrifts that generally conforms regulatory reporting requirements for sales of OREO with generally accepted accounting principles (GAAP), as set forth in FASB Statement No. 66. These changes delete certain requirements for minimum down payments for sales of OREO. Financial institutions and examiners should refer to FASB Statement No. 66 for a detailed discussion of the accounting principles that apply to sales of real estate.

■ **Review and Classification of Commercial Real Estate Loans**

The agencies are reaffirming their guidelines issued in November 1991 to ensure that examiners are reviewing commercial real estate loans in a consistent, prudent and balanced manner. Today's policy statement reiterates that the evaluation of commercial real estate loans is based on a review of the borrower's willingness and capacity to repay and on the income-producing capacity of the underlying collateral over time. The statement emphasized that it is NOT regulatory policy to value collateral that underlies real estate loans on a liquidation basis.

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■ **Supervisory Definition of Special Mention Assets**

The agencies are concerned that improper use of the "Special Mention" loan category in examiners' reviews of loan portfolios may inhibit lending to small- and medium-size businesses. Accordingly, all four agencies have adopted a uniform definition for this category.

The use of a common definition will lead to more consistent supervision among the four agencies. It will also enable examiners to more readily segregate Special Mention assets from those warranting adverse classification. The agencies have agreed to use classified assets, which by definition do not include Special Mention assets, as the standard measure in expressing the quality of a bank or thrift's asset portfolio.

■ **Coordination of Holding Company, Thrift and Bank Examinations**

The four agencies are issuing interagency guidelines to coordinate their supervision and examinations in order to minimize the disruptions and burdens associated with the examination process. Under the principles laid out in the guidelines, the agencies will work to eliminate duplication in examinations by multiple agencies. Examinations and inspections of a particular legal entity will be conducted by the primary supervisor for that entity. The agencies will increase coordination of examinations and will establish procedures to centralize and streamline examinations in multibank organizations.

The initiatives announced today follow a number of actions previously taken by the four agencies to implement the President's credit availability program. Those actions include:

- **Interagency Policy Statement on Documentation of Loans (March 30, 1993)**
- **Interagency Letter on Lending Discrimination (May 27, 1993)**
- **Proposed Rule on Revised Appraisal Requirements (June 4, 1993)**
- **Interagency Release on Joint Fair Lending Initiatives (June 10, 1993)**

The four agencies emphasized that they will continue their efforts to reduce paperwork and regulatory burdens and improve the ability of small businesses and consumers to gain access to credit. For example, in the coming months, the agencies expect to modify their procedures for corporate applications (e.g., applications for charters, mergers, and branches) to make them less duplicative and more uniform.

Joint Statement

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

For immediate release

**Interagency Guidance on
Reporting of In-Substance Foreclosures**

June 10, 1993

On March 10, 1993, the four federal banking and thrift regulatory agencies issued an Interagency Policy Statement on Credit Availability. That statement indicated that the agencies would seek to clarify the reporting treatment for in-substance foreclosures (ISF) and would work with the accounting authorities to achieve consistency between generally accepted accounting principles (GAAP) and regulatory reporting requirements in this area.

Under existing accounting guidelines for determining whether the collateral for a loan has been in-substance foreclosed, a loan is transferred to "other real estate owned" (OREO or REO) and appropriate losses are recognized if certain criteria are met. Such OREO designations may impede efforts to improve credit availability and may discourage lenders from working with borrowers experiencing temporary financial difficulties.

The Financial Accounting Standards Board (FASB) recently issued Statement No. 114, "Accounting by Creditors for Impairment of a Loan," addressing the accounting for impaired loans. This Standard also clarifies the existing accounting for in-substance foreclosures. Under the new impairment standard and related amendments to Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings" (FAS 15), a collateral dependent real estate loan (i.e., a loan for which repayment is expected to be provided solely by the underlying collateral) would be reported as OREO only if the lender had taken possession of the collateral. For other collateral dependent real estate loans, loss recognition would be based on the fair value¹ of the collateral if foreclosure is probable. However, such loans would no longer be reported as OREO. Rather, they would remain in the loan category.

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¹ Fair value is defined in paragraph 13 of FAS 15.

Accordingly, the agencies have concluded that losses² must be recognized on real estate loans that meet the existing ISF criteria based on the fair value of the collateral, but such loans need not be reported as OREO unless possession of the underlying collateral has been obtained. The agencies believe that this interagency guidance, coupled with other agency actions currently being taken, will reduce impediments to the availability of credit.

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² Consistent with GAAP, loss recognition would consider estimated costs to sell.

Joint Statement

Office of the Comptroller of the Currency

Federal Deposit Insurance Corporation

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For immediate release

Revised Interagency Guidance on Returning Certain Nonaccrual Loans to Accrual Status

June 10, 1993

Introduction

On March 10, 1993, the four federal banking agencies issued an Interagency Policy Statement on Credit Availability. That policy statement outlined a program of interagency initiatives to reduce impediments to the availability of credit to businesses and individuals.

As part of that program, the agencies are making two revisions to existing policies for returning certain nonaccrual loans to accrual status. The revised policies should remove impediments to working with borrowers who are experiencing temporary difficulties in a manner that maximizes recovery on their loans, while at the same time improving disclosures in this area.

The first change conforms the banking and thrift agencies' policies on troubled debt restructurings (TDRs) that involve multiple notes (sometimes referred to as "A"/"B" note structures). The second change would permit institutions to return past due loans to accrual status, provided the institution expects to collect all contractual principal and interest due and the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms.

The revised policies are effective immediately. Thus, institutions may elect to adopt such changes for purposes of the June 30, 1993, Consolidated Reports of Condition and Income (Call Report) and Thrift Financial Report (TFR). Revised Call Report and TFR instructions will be distributed as of September 30, 1993.

TDR Multiple Note Structure

The agencies are conforming their reporting requirements for TDR structures involving multiple notes. The basic example is a troubled loan that is restructured into two notes where the first or "A" note represents the portion of the original loan principal amount which is expected to be fully collected along with contractual interest. The second part of the restructured loan, or "B" note, represents the portion of the original loan that has been charged off.

Such TDRs generally may take any of three forms. (1) In certain TDRs, the "B" note may be a contingent receivable that is payable only if certain conditions are met (e.g., sufficient cash flow from the property). (2) For other TDRs, the "B" note may be contingently forgiven (e.g., note "B" is forgiven if note "A" is paid in full). (3) In other instances, an institution would have granted a concession (e.g., rate reduction) to the troubled borrower but the "B" note would remain a contractual obligation of the borrower. Because the "B" note is not reflected as an asset on the institution's books and is unlikely to be collected, the agencies have concluded that for reporting purposes the "B" note could be viewed as a contingent receivable.

Institutions may return the "A" note to accrual status provided the following conditions are met:

- (1) The restructuring qualifies as a TDR as defined by FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructuring," (SFAS 15) and there is economic substance to the restructuring. (Under SFAS 15, a restructuring of debt is considered a TDR if "the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.")
- (2) The portion of the original loan represented by the "B" note has been charged off. The charge-off must be supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. The charge-off must be recorded before or at the time of the restructuring.
- (3) The "A" note is reasonably assured of repayment and of performance in accordance with the modified terms.
- (4) In general, the borrower must have demonstrated sustained repayment performance (either immediately before or after the restructuring) in accordance with the modified terms for a reasonable period prior to the date on which the "A" note is returned to accrual status. A sustained period of payment performance generally would be a minimum of six months and involve payments in the form of cash or cash equivalents.

Under existing reporting requirements, the "A" note would be disclosed as a TDR. In accordance with these requirements, if the "A" note yields a market rate of interest and performs in accordance with the restructured terms, such disclosures could be eliminated in the year following the restructuring. To be considered a market rate of interest, the interest rate on the "A" note at the time of the restructuring must be equal to or greater than the rate that the institution is willing to accept for a new receivable with comparable risk.

Nonaccrual Loans That Have Demonstrated Sustained Contractual Performance

Certain borrowers have resumed paying the full amount of scheduled contractual interest and principal payments on loans that are past due and in nonaccrual status. Although prior arrearages may not have been eliminated by payments from the borrowers, some borrowers have demonstrated sustained performance over a period of time in accordance with the contractual terms. Under existing regulatory standards, institutions cannot return these loans to accrual status unless they expect to collect all contractual principal and interest and the loans are brought fully current (or unless the loan becomes well secured and in the process of collection).

Such loans may henceforth be returned to accrual status, even though the loans have not been brought fully current, provided two criteria are met: (1) all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period, and (2) there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms involving payments of cash or cash equivalents. Consistent with existing guidance, when the regulatory reporting criteria for restoration to accrual status are met, previous charge-offs taken would not have to be fully recovered before such loans are returned to accrual status.

Loans that meet the above criteria would continue to be disclosed as past due (e.g., 90 days past due and still accruing for Call Report and TFR purposes), as appropriate, until they have been brought fully current.

Additional Guidance

The Financial Accounting Standards Board (FASB) recently issued Statement No. 114, "Accounting by Creditors for Impairment of a Loan," which establishes a new approach for recognizing impairment on problem loans and for recognizing income on such loans. In addition, the standard establishes new disclosure requirements for impaired loans for financial reporting purposes. In light of the significance of those changes, the agencies are reevaluating regulatory disclosure and nonaccrual requirements that will apply when the statement becomes effective, and expect to issue revised policies at a later date.

Joint Release

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Federal Deposit Insurance Corporation
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Office of Thrift Supervision

For immediate release

**Interagency Policy Statement on
Review and Classification of Commercial Real Estate Loans**

June 10, 1993

On March 10, 1993, the four federal regulators of banks and thrifts issued an Interagency Policy Statement on Credit Availability. This policy statement outlined a program of interagency initiatives to reduce impediments to making credit available to businesses and individuals.

One impediment to making credit available to commercial real estate borrowers may be problems in evaluation of real estate collateral. The federal bank and thrift regulatory agencies have been working with their examination staffs for some time to ensure that commercial real estate loans are evaluated in accordance with agency policy. In issuing today's policy statement, the federal bank and thrift regulatory agencies are reaffirming the guidelines in the November 7, 1991 Interagency Policy Statement on the Review and Classification of Commercial Real Estate Loans. The November 7, 1991 policy statement provides clear and comprehensive guidance to ensure supervisory personnel are reviewing commercial real estate loans in a consistent, prudent and balanced manner. A copy of that statement is attached.

The November 7, 1991 statement clarified regulatory policy on real estate valuation and classification. The evaluation of commercial real estate loans is based on a review of the borrower's willingness and capacity to repay and on the income-producing capacity of the underlying collateral over time. The value of collateral increases in importance as a loan becomes troubled and the borrower's ability to repay the loan becomes more questionable. The statement emphasizes that it is NOT regulatory policy to value collateral that underlies real estate loans on a liquidation basis. (See the discussion on "Examiner Review of Individual Loans, Including the Analysis of Collateral Value," beginning on page 3 of the policy statement.)

Furthermore, the policy statement discusses management's responsibility for reviewing appraisal assumptions and conclusions for reasonableness. Appraisal assumptions should not be based solely on current conditions that ignore the stabilized income-producing capacity of the property.

Management should adjust any assumptions used by an appraiser in determining values that are overly optimistic or pessimistic. The policy statement also indicates that the assumptions used in a discounted cash flow analysis (such as discount rates and direct capitalization rates) should reflect reasonable expectations about the rate of return that investors require under normal, orderly and sustainable market conditions. Unrealistic or unsustainable high or low discount rates, "cap" rates, and income projections should not be used.

The use of appropriate assumptions in a discounted cash flow analysis is particularly important in determining the value of collateral for a troubled, project-dependent commercial real estate loan (involving income-producing property). The agencies use this valuation for determining the amount of the loan that is adequately secured by the value of the collateral. The November 7, 1991 Interagency Policy Statement indicates that generally, any portion of the loan balance that exceeds the amount adequately secured by collateral values and that can be clearly identified as uncollectible should be classified "loss." The portion of the loan balance that is adequately secured by the value of the collateral should generally be classified no worse than "substandard." The policy statement also indicates that, when an institution has taken a charge-off in sufficient amount so that the remaining recorded balance of the loan (a) is being serviced (based on reliable sources) and (b) is reasonably assured of collection, classification of the remaining recorded balance may not be appropriate.

The federal bank and thrift regulatory agencies will continue to ensure their examiners implement the policy statement appropriately and uniformly. Each agency has an appeals process for institutions with significant concerns about examinations, including any concerns relating to the supervisory treatment of commercial real estate loans.

Attachment: Interagency Policy Statement on Review and Classification of Commercial Real Estate Loans, November 7, 1991

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Joint Statement

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

For immediate release

**Interagency Statement on the
Supervisory Definition of Special Mention Assets**

June 10, 1993

The March 10, 1993 Interagency Policy Statement on Credit Availability indicated the federal banking and thrift regulatory agencies would issue guidance clarifying use of the Special Mention definition for regulatory supervision purposes. The four agencies have agreed on the definition of "Special Mention" as stated below. This definition should also be considered by an institution when performing its own internal asset review.

The definition of Special Mention is as follows:

A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

In the past, the agencies used different terminology and definitions for Special Mention. Supervisory reports and their contents also varied between agencies. The use of a common definition will lead to more consistent application of supervisory procedures. The definition will also enable examiners to more readily segregate Special Mention assets from those warranting adverse classification. It will also ensure that the Special Mention category is not used to identify an asset which has as its sole weakness credit data exceptions or collateral documentation exceptions that are not material to the repayment of the asset.

The agencies are in the process of developing examiner guidance explaining how the Special Mention category will be used in the assessment of the overall condition of an institution. The agencies have agreed to conform their policies and guidance to the following principles:

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- Classified assets, which by definition do not include Special Mention assets, will be the standard measure used in expressing the quality of a bank or thrift's loan portfolio and other assets. The agencies will not express asset quality in terms of "criticized assets," a term that is generally recognized as including both Special Mention and classified assets.
- The agencies will ensure their policies, examiner guidance, and internal monitoring systems do not call for internal reporting of criticized asset totals or percentages. However, examiners will continue to consider the level and trends of assets categorized as Special Mention in their analysis as appropriate.
- In implementing Section 132 of the FDIC Improvement Act, Standards for Safety and Soundness, the agencies will use classified assets and not use criticized assets as a measure of asset quality.
- Special Mention assets will not be combined with classified assets in reports of examination or in corporate applications.

Each agency will make appropriate revisions to its examiner guidance, and all will work to ensure their guidance is consistent among the agencies. The guidance will emphasize that it is inappropriate to use the Special Mention category to capture loans solely because of their nature or type, such as small business lending or affordable housing lending.

Implementation of the revised definition will be effective immediately. Examiner guidance will be forthcoming shortly.

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Joint Statement

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

**Interagency Policy Statement on
Examination Coordination and Implementation Guidelines**

June 10, 1993

This statement outlines a program for coordinating examinations of insured depository institutions and inspections of their holding companies by the federal financial regulatory agencies. This program expands on existing interagency agreements, and responds to the industry's concern over the increased burden on organizations supervised by multiple regulatory agencies.

The objective of the program is to minimize disruption and avoid duplicative examination efforts and information requests, whenever possible. The significant elements of the program include:

- Coordinating the planning, timing and scope of examinations and inspections of federally insured depository institutions and their holding companies;
- Conducting joint interagency examinations or inspections, when necessary;
- Coordinating and conducting joint meetings between bank or bank holding company management and the regulators;
- Coordinating information requests; and
- Coordinating enforcement actions, when appropriate.

The program emphasizes full cooperation and coordination by the agencies in supervising large banking organizations and organizations that are in a less than satisfactory condition. Additional effort will also be made to reduce the regulatory burden on the remaining population of depository institutions.

Guidelines for implementation of the program are attached.

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IMPLEMENTATION GUIDELINES

1. PURPOSE

These guidelines were developed to strengthen coordination and cooperation among the federal banking agencies in examining and supervising banking organizations and to carry out the provisions of the March 10 Interagency Policy Statement intended to minimize the disruptions and burdens associated with the examination process. The provisions are:

- Eliminate duplication in examinations by multiple agencies, unless clearly required by law;
- Increase coordination of examinations among agencies when duplication is required; and
- Establish procedures to centralize and streamline examinations in multibank organizations.

These guidelines address the coordination of the examinations by federal agencies of depository institutions and the inspections of their holding companies. To achieve the desired strengthening in the coordination of the federal agencies' examination/inspection activities, the guidelines focus on the planning, staffing, timing and conduct of examinations and inspections; the conduct of joint management meetings to discuss inspection and examination findings; and other areas of mutual concern.

2. PRIMARY SUPERVISORY AND COORDINATION RESPONSIBILITY

Examinations/inspections of a particular legal entity will be conducted by the federal regulatory agency that has primary supervisory authority for that entity. In carrying out its supervisory responsibilities for a particular entity within a banking organization, each regulatory agency will rely on examinations/inspections conducted by the primary regulator of the affiliate to the extent possible, thereby avoiding unnecessary duplication and disruption to the banking organization. In certain situations, however, it may be necessary for a regulatory agency other than the entity's primary supervisory authority to participate in the examination or inspection of the entity in order to fulfill its regulatory responsibilities. These guidelines provide procedures for handling such situations.

Primary supervisory authority and coordination responsibilities are organized as follows:

OCC	national banks;
FDIC	state nonmember banks;
OTS	thrift holding companies and savings associations; and

FRB parent bank holding companies, nonbank subsidiaries of bank holding companies, the consolidated bank holding company and state member banks.

The primary federal regulator is responsible for scheduling, staffing and setting the scope of supervisory activities, including coordinating formal and informal administrative actions, as necessary. In fulfilling these responsibilities, the primary regulatory agency should consult closely with the other appropriate agencies when there is need for coordination.

3. OVERVIEW

The agencies will make every effort to coordinate the examinations and the inspections of banking organizations. Coordinated examinations and inspections may not be practical in all cases because of resource constraints, serious scheduling conflicts, or geographic considerations; however, particular emphasis for implementing this program will be placed on banking organizations with over \$10 billion in consolidated assets and those banking organizations (generally, with assets in excess of \$1 billion) that exhibit financial weaknesses.

4. PRE-EXAMINATION COORDINATION

Where multiple regulators have authority over a legal entity, representatives from the appropriate supervisory offices should meet quarterly as necessary to discuss supervisory strategies for specific banking organizations, and at least annually to review and establish examination and inspection schedules, to plan for the next year, and to consider the need for coordination in the following areas:

- Sharing the strategy and scope of each examination/inspection;
- Determining if agencies other than the primary regulator of a particular entity should participate in the examination/inspection of that entity;
- Determining whether a consolidated request letter should be prepared to avoid duplicative information requests;
- Sharing examination/inspection work papers and resulting findings and conclusions from prior examination/inspection efforts; or
- Other areas as necessary.

5. INTERAGENCY REVIEW OF BANK, NONBANK AND PARENT COMPANY ACTIVITIES

Certain areas or functions transcend legal entity distinctions, such as internal audit, credit review and the methodology for determining the allowance for loan and lease losses. Such functions may be located at the bank or holding company level. The primary regulator of the depository institution and the holding company may both have supervisory responsibility to assess such functions. In these cases, examinations or inspections of such areas should be conducted on a coordinated and concurrent basis to avoid duplicative reviews and unnecessary disruption.

The primary regulator of the entity being examined/inspected should take the lead on such a coordinated examination or inspection, unless there is mutual agreement that another agency will serve as the lead agency. The responsibilities of the lead agency, in consultation with other appropriate agencies, include developing the scope of the examination or inspection and determining the staff requirements. The lead agency will also coordinate examination/inspection scheduling and the presentation of examination/inspection findings to the appropriate management.

6. COORDINATION OF MANAGEMENT MEETINGS

At the conclusion of examinations and inspections conducted under these guidelines, the agencies should coordinate and plan joint meetings with the board of directors to discuss the findings and conclusions. Agencies will be guided by the coordination responsibility definitions outlined in Provision 2 of this program, unless otherwise agreed upon.

7. PROCESS FOR HANDLING SIGNIFICANT DIFFERENCES BETWEEN THE AGENCIES IN FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Prior to forwarding examination and inspection results to management or boards of directors, every effort should be made to resolve any significant differences concerning major findings, conclusions and recommendations.

Such differences should be resolved by examiners, or officials at the regional level, within 10 business days of identification. If resolution cannot be achieved following full review and communication between the regional offices, the matter should be referred to the national level, where it will be resolved within a reasonable time frame.

8. INSPECTION AND EXAMINATION REPORTS

The primary regulator will prepare the formal report of examination or inspection covering the entity for which it is the primary federal regulator and in those cases for which it serves as the lead agency. The report should be addressed and transmitted to the directors of the entity for which the regulator is the primary federal supervisory authority and, as necessary, it may be sent to the directors of other entities that have a need for the information. The agencies may mutually agree, if necessary and appropriate, to prepare a joint report.

9. INFORMATION REQUESTS

Any request for information to be obtained from an entity for supervisory purposes should normally be made through the entity's primary regulator. The primary regulator should also share relevant supervisory information with the other appropriate regulatory agencies.

10. COORDINATING ENFORCEMENT ACTIONS

When enforcement action is contemplated by one or more regulatory agencies, consideration should be given to initiating a joint enforcement action to address and correct deficiencies within a banking organization. At a minimum, each agency considering enforcement action should inform other regulatory agencies. This provision reaffirms the existing interagency enforcement agreement.

11. OTHER MATTERS

The agencies will establish arrangements to monitor coordination efforts and to resolve any differences that arise under this program.

The agencies will also endeavor to coordinate with state banking departments, where appropriate and feasible.

June 10, 1993

Joint Release

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

For immediate release

**Interagency Policy Statement on
Fair Lending Initiatives**

June 10, 1993

The four financial institution regulatory agencies are announcing initiatives that they will pursue over the next several months to enhance their ability to detect lending discrimination, to improve the level of education they provide to the industry and to their examiners, and to strengthen fair lending enforcement.

Background

A number of interagency efforts are already completed or are under way to improve fair lending detection techniques, enforcement, and education. For example:

- The agencies have issued a joint statement to financial institutions that reaffirms their commitment to the enforcement of the fair lending laws and provides the industry with guidance and suggestions on fair lending matters.
- The agencies are working on a revised supervisory enforcement policy for dealing with violations of the Equal Credit Opportunity and Fair Housing Acts. This revised policy will replace a policy issued in 1981. The revised policy specifies corrective actions for several different substantive violations of the ECOA and FHA.
- The agencies are developing uniform fair lending examination procedures and training programs. The agencies believe these new procedures will significantly strengthen existing discrimination detection programs. These new examination procedures will be publicly available this summer.

New Initiatives

The four agencies will pursue the following new initiatives over the next several months:

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1. Fair Lending Training for Examiners

The agencies will develop a new training program in fair lending for experienced compliance examiners that will be conducted on a regional basis. A pilot program could be held as early as Fall 1993.

2. Fair Lending Seminar for Industry Executives

The agencies will develop and sponsor regional fair lending programs for top level industry executives (chief executive officers and executive vice presidents) to explain their efforts to enforce fair lending laws and to foster additional sensitivity and awareness among lenders about discrimination issues, specifically subtle practices that impede the availability of credit to low-income and minority individuals. The first session of this program could be held later this year.

3. Alternative Discrimination Detection Methods

The agencies will explore statistically-based discrimination analysis models. These models may help identify loan applications files for review as part of the examination process. This will significantly enhance the agencies' abilities to identify loan applicants that may have received differential treatment.

4. Stronger Enforcement of Fair Lending Laws

Each agency will implement an internal process for making referrals to the Department of Justice for violations of the Equal Credit Opportunity Act. These internal procedures will ensure that appropriate cases are being put forth for consideration by senior management.

5. Improved Consumer Complaint Programs

The agencies believe that refinements to their consumer complaint systems can also better promote the broad availability of credit on a non-discriminatory basis. During the next few months, each agency will evaluate the effectiveness of its consumer complaint system in detecting and correcting credit discrimination, and alerting the agencies to industry practices that may inhibit the free flow of credit. Each agency will announce its own specific initiatives in these areas.

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