



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS
75265-5906

May 11, 1999

Notice 99-29

TO: The Chief Executive Officer of each
financial institution and others concerned
in the Eleventh Federal Reserve District

SUBJECT

Allowance for Loan Losses

DETAILS

The Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision have issued a joint interagency letter to financial institutions. The letter addresses the continued uncertainty among financial institutions regarding the expectations of the banking and securities regulators on the appropriate amount, disclosure, and documentation of the allowance for credit losses.

ATTACHMENT

A copy of the joint interagency letter is attached.

MORE INFORMATION

For more information, please contact Lynn Black at (214) 922-6069. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

A handwritten signature in black ink that reads "Robert D. McTeer, Jr." in a cursive script.

**Securities and Exchange Commission
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of the Comptroller of the Currency
Office of Thrift Supervision**

JOINT INTERAGENCY LETTER TO FINANCIAL INSTITUTIONS

Last November, the Securities and Exchange Commission, Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency, and Office of Thrift Supervision (the Agencies) issued a Joint Interagency Statement in which they reaffirmed the importance of credible financial statements and meaningful disclosure to investors and to a safe and sound financial system. The Joint Interagency Statement underscored the requirement that depository institutions record and report their allowance for loan and lease losses in accordance with generally accepted accounting principles (GAAP). We stress and continue to emphasize the importance of depository institutions having prudent, conservative, but not excessive, loan loss allowances that fall within an acceptable range of estimated losses. We recognize that today instability in certain global markets, for example, is likely to increase loss inherent in affected institutions' portfolios and consequently require higher allowances for credit losses than were appropriate in more stable times.

Despite the issuance of the November Joint Interagency Statement, there is continued uncertainty among financial institutions as to the expectations of the banking and securities regulators on the appropriate amount, disclosure, and documentation of the allowance for credit losses. The Agencies now announce additional measures designed to address this continued uncertainty. These measures are consistent with the Agencies' mutual objective of, and focus on, addressing prospectively, where feasible, issues related to improving the documentation, disclosure, and reporting of loan loss allowances of financial institutions.

- ◆ The Agencies are establishing a Joint Working Group, comprised of policy representatives from each of the Agencies, to gain a better understanding of the procedures and processes, including "sound practices," used generally by banking organizations to determine the allowance for credit losses. An important aspect of the Joint Working Group's activities will be to receive input from representatives of the banking industry and the accounting profession on these matters, and will not involve joint examinations of institutions. The common base of knowledge that results will facilitate the joint and individual efforts of the Agencies to provide improved guidance on appropriate procedures, documentation, and disclosures to the banking industry. This will assist the banking community in complying with GAAP and will improve comparability among financial statements of depository and other lending institutions. The Joint Working Group will also share information and insights concerning issues of mutual concern that may arise.

- ◆ Using information gathered through the Joint Working Group and from representatives of the accounting profession and the banking industry, the Agencies will work together to issue parallel guidance, on a timely basis, and within a year on the first two items listed below, in the following key areas regarding credit loss allowances:
 - *Appropriate Methodologies and Supporting Documentation.* The Agencies intend to issue guidance that will suggest procedures and processes necessary for a reasoned assessment of losses inherent in a portfolio and discuss ways to ensure that documentation supports the reported allowance.
 - *Enhanced Disclosures.* This guidance will address appropriate disclosures of allowances for credit losses and the credit quality of institutions' portfolios by identifying key areas for enhanced disclosures, including the need for institutions to disclose changes in risk factors and asset quality that affect allowances for credit losses. The enhanced disclosures would contribute to better understanding by investors and the public of the risk profile of banking institutions and improve market discipline.
- ◆ The Agencies will work together to encourage and support the Financial Accounting Standards Board's process of providing additional guidance regarding accounting for allowances for loan losses. The Agencies emphasize that GAAP requires that management's determination be based on a comprehensive, adequately documented, and consistently applied analysis of the particular institution's exposures, the effects of its lending and collection policies, and its own loss experience under comparable conditions.
- ◆ In addition, the Agencies will support and encourage the task force of the American Institute of Certified Public Accountants (AICPA) that is developing more specific guidance on the accounting for allowances for credit losses and the techniques of measuring the credit loss inherent in a portfolio at a particular date. In particular, the AICPA task force will focus on providing guidance on how best to distinguish probable losses inherent in the portfolio as of the balance sheet date—the guidepost agreed to by the Agencies for reporting allowances in accordance with GAAP—from possible or future losses not inherent in the balance sheet as of that date. Additionally, the Agencies will ask the AICPA task force to consider recently developed portfolio credit risk measurement and management techniques that are consistent with GAAP as part of this effort. The AICPA project already has been initiated and will include representatives from the accounting profession and the banking industry, as well as observers from the SEC and the banking agencies.
- ◆ Senior staff of the Agencies will continue to meet to discuss banking industry accounting and financial disclosure policy issues of interest that affect the transparency of financial reporting and bank safety and soundness. These discussions will address progress in the application of accounting and disclosure standards by banking institu-

tions, including those impacting the allowance for credit losses, with particular focus on recently identified issues and trends. The meetings also will be used to coordinate projects of the Agencies in areas of mutual interest. The first of these meetings was held on January 27.

The Agencies believe that the actions announced above will promote a better and clearer understanding among financial institutions of the appropriate procedures and processes for determining credit losses in accordance with GAAP. The Agencies intend that these steps will enhance the transparency of financial information and improve market discipline, consistent with safety and soundness objectives. In recognition of the specialized regulatory nature of the banking industry and in order to resolve ongoing uncertainties in the industry, with the announcement of these initiatives, the Agencies' focus, in so far as feasible, will be on enhancing allowance practices going forward.