FEDERAL RESERVE BANK
OF NEW YORK

At 10687
February 4, 1994

DISASTER RELIEF

Supervisory Measures to Ease Financial Stress in Areas Affected by the Los Angeles Earthquake

To All Depository Institutions in the Second Federal Reserve District, and Others Concerned:

The Board of Governors of the Federal Reserve System has issued the following statement:

> The Federal Reserve Board has announced a series of steps designed to help ease financial stress in areas affected by the California earthquake.
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> A supervisory statement adopted by the Board encourages financial institutions to work constructively with borrowers who are experiencing difficulty due to the earthquake and its aftermath.
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> The statement says that banks may find it appropriate to ease credit terms to help new borrowers restore their financial strength, consistent with prudent banking practices, and to restructure debt or extend repayment terms for existing borrowers.

Printed on the following pages is the text of the Supervisory Statement issued by the Board of Governors on January 25; questions regarding this matter may be directed to Donald E. Schmid, Manager, Domestic Banking Department (Tel. No. 212-720-6611).

WILLIAM J. MCDONOUGH,
President.

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Statement on
Supervisory Practices Regarding
Financial Institutions and Borrowers Affected by
The January 17, 1994 California Earthquake
January 25, 1994

It has been a long-standing practice of the Federal Reserve to promote supervisory actions that encourage regulated financial institutions to work constructively with borrowers who are experiencing difficulties due to conditions beyond their control.

The physical and business disruption caused by the earthquake in the Los Angeles area has placed financial pressures on businesses and individuals in the affected areas, in some cases adversely affecting their ability to repay loans in accordance with original terms and conditions. Often the financial pressures stemming from such events are transitory in nature, and borrowers are able to resume payments when economic conditions improve or the borrowers' financial positions stabilize. Under such circumstances, financial institutions generally determine that the most prudent policy is to work with borrowers experiencing difficulty, in a manner that is consistent with sound business practices, rather than take more precipitous actions such as foreclosure and/or forcing borrowers into bankruptcy.

Lenders often find it in their and the borrowers' interests to extend terms of repayment or otherwise to restructure borrowers' debt obligations. Such cooperative efforts can ease pressures on troubled borrowers, improve their capacity to service debt, and strengthen financial institutions'

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ability to collect on their loans. Financial institutions in areas affected by the earthquake may also deem it appropriate to ease credit terms, consistent with prudent banking practices, for new loans to certain borrowers in order to assist the borrowers to recover their financial strength and place them in a better position to service their debts. With proper risk controls and management oversight, these actions can contribute both to the health of the local community and serve the long-run interests of lending institutions. If carried out in a prudent manner, such efforts by lenders will not be subject to examiner criticism.

Financial institutions in the affected areas may find that their levels of delinquent and nonperforming loans will increase. Consistent with long-standing practice, the Federal Reserve, in supervising these institutions, will consider the unusual circumstances these institutions face in determining any supervisory response.

One of the principal objectives of the examination and supervision process is to achieve an accurate assessment of a financial institution's loan portfolio and financial condition. In carrying out its supervisory responsibilities, the Federal Reserve recognizes that efforts to work with borrowers in communities under stress, if conducted in a reasonable way, are consistent with safe and sound practices as well as in the public interest.

The Federal Reserve also recognizes that financial institutions in disaster-affected areas may encounter difficulty

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in complying with financial reporting requirements. Institutions in earthquake-affected areas that are encountering difficulties complying with such reporting requirements should contact the Statistics Department of the San Francisco Federal Reserve at (415) 974-3145 as soon as possible for further guidance.

In addition, the Federal Reserve reminds regulated institutions of the availability of the program on documentation for loans to small- and medium-sized businesses and farms, which may assist lenders in meeting the credit needs of borrowers in disaster areas. This program allows institutions that are adequately capitalized and have a CAMEL rating of 1 or 2 to designate a basket of loans which examiners will evaluate solely on the basis of performance and will not criticize for deficiencies in loan documentation. To qualify for the exemption, the loan may not exceed the lesser of $900,000 or 3 percent of the institution's total capital. The total basket of such loans may not exceed 20 percent of total capital.

There are also several initiatives in process pursuant to the Depository Institutions Disaster Relief Acts of 1992 and 1993 (DIDRA), which provided the Federal Reserve and the other federal banking agencies with the authority to grant certain regulatory relief to financial institutions affected by major disasters. As provided in section 2 of DIDRA - 1992, for real estate related transactions affected by the earthquake, the Board may waive the appraisal requirements of Title XI of FIRREA as well as the Board's appraisal regulation.

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Under section 3 of DIDRA - 1993, financial institutions may seek, until April 1, 1995, relief from regulations governing leverage capital requirements if they are experiencing a temporary increase of assets due to the influx of insurance proceeds or government assistance funds. Financial institutions that may need such relief should contact the Supervision, Regulation and Credit Department of the San Francisco Federal Reserve at (415) 974-2932.

Pursuant to section 2 of DIDRA - 1993, in the event of a major disaster such as the earthquake, exceptions may be granted from the Truth in Lending Act and the Expedited Funds Availability Act if the exception can reasonably be expected to produce benefits to the public that outweigh possible adverse effects. For example, the Board may approve temporary relief from Regulation Z regarding consumer waivers of the right to cancel certain home-secured loans so that borrowers in the major disaster areas may more readily gain access to loan funds.

Finally, in keeping with the intent of DIDRA and previous initiatives to encourage financial institutions to meet the needs of communities devastated by major disasters, the Federal Reserve, in assessing Community Reinvestment Act performance, will give positive consideration to financial institutions' participation in programs where most or all of the financing provided to earthquake victims may ultimately benefit low- and moderate-income borrowers or such neighborhoods located outside of an institution's delineated community.

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Specific questions on these initiatives should be directed to the Supervision, Regulation and Credit Department of the San Francisco Federal Reserve at (415) 974-2986 or 2965.