EXAMINATION OF INTERNATIONAL LOANS
Interagency Policy Statement

To All State Member Banks, and Others Concerned,
in the Second Federal Reserve District:

The following statement has been issued by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System:

A policy statement on the examination treatment of international loans was issued today by the Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Federal Reserve Board.

The agencies are in the process of implementing the International Lending Supervision Act of 1983, enacted last November 30, which sets forth a number of steps that regulators and banks must take to strengthen international lending procedures.

The statement is being issued at this time since some provisions of the Act may have an effect on year-end reports that banks may have to prepare before the final regulations are in place.

Enclosed is the text of the Interagency Policy Statement regarding the examination treatment of international loans, dated December 15, 1983. Questions regarding this matter may be directed to our Bank Examinations Department (Tel. No. 212-791-7934).

Additional copies of the enclosure will be furnished upon request.

ANTHONY M. SOLOMON,
President.
The International Lending Supervision Act of 1983 was enacted on November 30, 1983. This law sets forth a number of steps that the regulators and the banks must take to strengthen international lending procedures. The agencies are in the process of implementing the requirements of the statute, including, in appropriate circumstances, the drafting of regulations. At this time, however, the agencies wish to bring two matters to your attention since they may have an effect on year-end reports that may need to be prepared before final regulations are in place: first, a description of changes that are being made by the agencies in the examination categories for identifying credits that have been adversely affected by transfer risk problems; and, secondly, the agencies' plans for establishment of special reserves for assets whose value has been impaired by, among other things, protracted debt service problems.

Changes in Examination Procedures

The agencies have agreed to implement, with certain refinements, plans described in April of this year to introduce new uniform examination categories for identifying credits that have been adversely affected by transfer risk problems. The changes include new definitions for transfer risk classifications which are
provided in an Attachment. In addition, a new category called "Other Transfer Risk Problems," will be used to highlight credits which do not warrant classification. It will include all or a portion of credits to a country that is not complying with its external debt service obligations, but is taking positive steps to restore debt service through economic adjustment measures, generally as part of an IMF program. It will also be used to recognize situations in which there has been an improvement in recent debt service performance such that the country credits no longer warrant transfer risk classification, but still deserve special attention by bank management. Similarly, prompt recognition will be given to further improvement in debt service performance by removing country credits from this category.

As has been the practice, credits which have been classified due to transfer risk problems will be combined with commercial loan classifications used by the agencies in the evaluation of a bank's asset quality and other measures of financial soundness. Credits which have been placed in the "Other Transfer Risk Problems" category are not regarded as classified assets. Rather, exposures in this category will be considered by examiners as a judgmental factor in their general assessment of a bank's asset quality and the adequacy of its reserves and capital. This is similar to consideration given to such factors as concentrations in the portfolio, the level and composition of nonaccruing or reduced rate assets, and management's demonstrated ability to administer and collect problem credits.

In implementing the provisions of the International Lending Supervision Act of 1983 the agencies recognize the importance to the stability of both the international banking system and world economy of providing continued international flows of bank credit in the periods ahead, especially to countries implementing IMF-approved economic adjustment programs designed to correct the countries' economic difficulties in an orderly manner. Such new flows under
appropriate circumstances may strengthen the functioning of the adjustment process, help to improve the quality of outstanding credit, and thus may be consistent with the objectives of the program of improved supervision of international lending that is outlined in this statement.

Reserving Requirements

The agencies believe responsibility for recognizing and accounting for deterioration in the value of a bank's assets, including a deterioration due to transfer risk problems, rests, in the first instance, with the management of a bank and its auditors. The banking agencies also have a responsibility to assure that banks are following reasonable and prudent policies in this regard and that necessary adjustments are being made, in a consistent fashion. To assure that this is done, the banking agencies, pursuant to the International Lending Supervision Act, will require U. S. banks to establish "Allocated Transfer Risk Reserves" ("ATRR") against certain assets whose value has been found by the agencies to have been significantly impaired by protracted transfer risk problems. It will be proposed that the ATRR be applied to those international assets that have been classified for transfer risk reasons as "Value Impaired" as a result of regular reviews of country credits in accordance with examination procedures established jointly by the agencies. The minimum ATRR amounts will be determined jointly by the agencies on a regular basis. As is customary, this examination information will be conveyed directly to affected U. S. banks by their primary Federal supervisor.

In accordance with the International Lending Supervision Act, the agencies are publishing for comment a proposed regulation on the establishment of the ATRR. It is anticipated that a final regulation will be adopted in January 1984. In these circumstances, banks are encouraged to give consideration to the
current plans and judgments of the agencies in preparing financial statements for the period ending December 31, 1983. The reserve must be established by a charge against income and will not be considered as capital by the agencies. No ATRR provisions will be required if the bank has already written down the credits or charged off the requisite amounts. While the agencies do not expect these new reserves to have a material impact on aggregate 1983 bank earnings, the effect could vary from bank to bank.

In implementing the reserving provisions, the agencies wish to emphasize that the responsibility of bank managements and their auditors to recognize and provide adequately for any significant deterioration in the value of their assets, including international loans, is in no way lessened. In this regard, the agencies encourage banks to continue to bolster general reserve and capital positions against the risks involved in international lending.
CLASSIFICATION CATEGORIES

I. Substandard

This category applies when:
1. A country is not complying with its external service obligations, as evidenced by arrearages, forced restructuring, or rollovers; and
2. The country is not in the process of adopting an IMF or other suitable economic adjustment program, or is not adequately adhering to such a program; or
3. The country and its bank creditors have not negotiated a viable rescheduling and are unlikely to do so in the near future.

II. Value Impaired

This category applies when:
1. A country has protracted arrearages, as indicated by more than one of the following:
   o the country has not fully paid its interest for six months;
   o the country has not complied with IMF programs (and there is no immediate prospect for compliance);
   o the country has not met rescheduling terms for over one year;
   o the country shows no definite prospects for an orderly restoration of debt service in the near future.

III. Loss

This category applies when the loan is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted.

An example would be an outright statement by a country which repudiates obligations to banks, the IMF, or other lenders.
NON-CLASSIFIED CREDITS WARRANTING ATTENTION

I. Other Transfer Risk Problems

This category applies when:

1. A country is not complying with its external debt service obligations, as evidenced by arrearages, forced restructuring, or rollovers;

   However, the country is taking positive actions to restore debt service through economic adjustment measures, generally as part of an IMF program.

2. A country is meeting its debt obligations, but non-compliance appears imminent.

3. A country has been classified previously, but recent debt service performance indicates classification no longer is warranted. For instance, the country is complying with the terms of IMF and rescheduling programs. However, sustained resumption of orderly debt service needs to be demonstrated.