

Federal Reserve Bank of San Francisco
101 Market Street, San Francisco, California 94105

October 23, 2012

To State Member Banks, Bank
Holding Companies, Financial Holding
Companies, Savings and Loan Holding Companies,
and Foreign Banking Offices
in the Twelfth Federal Reserve District

SR 12-13: FFIEC Statement on the Impact of Drought Conditions on Financial Institutions

On October 16, 2012, The Federal Financial Institutions Examination Council¹ (“FFIEC”) issued a statement to assist financial institutions and their customers (members, in the case of credit unions) affected by severe drought conditions across much of the Midwest and southern portions of the United States. As a result of the 2012 drought, crop yields have declined significantly and, in some areas, crops have failed completely. Livestock and dairy producers also have been affected as the reduced grain harvest has led to higher feed prices. Benefits from crop insurance programs will mitigate the negative financial consequences for a number of farmers this year. However, a continuation of drought conditions could adversely affect the agricultural sector’s credit performance going forward.

The FFIEC is strongly encouraging financial institutions in areas affected by drought conditions to work constructively with borrowers. The effects of natural disasters on the agricultural sector are often transitory, and prudent loan modification efforts can help stabilize borrowers, benefit the long-term interests of financial institutions and their stakeholders, and contribute to the health of local economies. In this regard, financial institutions may consider alternatives for borrowers who can demonstrate they are hurt by the drought; such alternatives may include:

- expediting lending decisions when possible, consistent with safe-and-sound credit practices;
- extending or restructuring borrower debt obligations, consistent with prudent loan workout standards;
- easing credit terms or fees for loans, consistent with prudent loan workout standards; and
- considering loan programs offered by the U.S. Department of Agriculture's Farm Service Agency or the U.S. Small Business Administration.

If drought conditions persist, some agricultural borrowers may need to carry over a portion of operating lines of credit that cannot be retired because of lower crop yields. Financial institutions should perform a comprehensive review of an affected borrower’s financial condition in an effort to implement prudent loan workout arrangements.

The FFIEC will support efforts to originate and prudently modify loans that help agricultural borrowers recover financially and be better positioned to honor obligations as conditions improve. When conducting examinations and other supervisory activities, examiners will consider the unusual circumstances financial institutions are facing in the affected areas.

Financial institutions that implement prudent loan workout arrangements will not be subject to criticism for engaging in these efforts even if the restructured loans have weaknesses that result in adverse classification or credit risk grade.

¹ The Federal Financial Institutions Examination Council is comprised of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corp., the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the State Liaison Committee.

Financial institutions should ensure that modifications of existing loans are evaluated individually to determine whether they require financial reporting as troubled debt restructurings (TDRs). This evaluation should be based on the facts and circumstances of each borrower and loan; this requires judgment since not all modifications are TDRs. Financial institutions should refer to the instructions for the Consolidated Reports of Condition and Income (for banks and savings associations) and the 5300 Call Report (for credit unions); Accounting Standards Codification Subtopic 310-40, "Receivables – Troubled Debt Restructurings by Creditors;" and other supervisory guidance for the accounting and reporting of TDRs.

Additional Information

You may access the original Board of Governors press release at:
<http://www.federalreserve.gov/bankinfo/reg/srletters/sr1213.htm>

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's website, at <http://www.frbsf.org/banking/letters>.

For additional information, please contact:

Federal Reserve Bank of San Francisco
Banking Supervision and Regulation
Risk Monitoring & Analysis Group
(213) 683-2814