S&R PERSPECTIVES

The Latest Fifth District Supervision and Regulation News & Events — Winter Issue 09

"Commercial real estate (CRE) loans have been a significant source of profit for many small and mid-size banks until the current crisis. Now, these loans cause stress to bank earnings and capital."
– Kevin Cole and Mike Milchanowski

Current Issues

Material Loss Reviews: Reasons for Recent Failures

By Stuart Desch

Throughout 2009, more than 140 financial institutions have failed across the United States. Many of these banking companies had heavy concentrations in commercial real estate, specifically acquisition, development and construction loans. The Material Loss Reviews conducted after the closing of the supervised banking entities by the respective regulatory agency's Inspector General identified a number of causes for the closures of these banking firms. Detailed in this article are some of the key themes highlighted in a sampling of the material loss reviews for companies previously operating in the Southeastern United States.

Failure to Diversify

Many firms adopted business strategies that created concentrations in both the type of loans and the geographic location. These depository institutions experienced rapid and aggressive loan growth despite inadequate loan underwriting practices and a lack of other loan portfolio and risk management controls.

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In The News

Assessing Structured Investments in the Current Environment

By Donna Thompson and Andrew Lowry

The current financial crisis, which began in 2007, has contributed to unprecedented declines in security prices and credit ratings on non-agency mortgage-backed securities partly because of eroding home values and rising default rates. Some securities that initially were rated investment grade by the rating agencies have been downgraded, oftentimes by more than one level, negatively impacting some institutions' performance and in many cases risk-based capital ratios. The purpose of this article is to highlight some of the more complex structured securities that have suffered during this downturn, as well as to remind institutions of regulatory expectations surrounding sound risk management practices for investment portfolios.

Over the past few years, many institutions had increased their exposure to certain types of investment securities such as non-agency mortgage-backed securities and collateralized debt obligations backed by pools of trust-preferred securities. As the

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Mac's World at the Fed

Inside this edition, the latest market trends related to recent bank failures and the importance of accurately assessing investments are discussed. Also in this issue, the increase in developed vacant lots in the 5th District and the impact on already stressed commercial real estate markets is covered.

Although not in this issue, executive compensation is a topic you can expect to hear more about in the coming months. It is important that executive compensation mechanisms are grounded in sound banking practices and that organizations are proactive in addressing any concerns related to this topic. The Federal Reserve Bank of Richmond has several staff members actively engaged in analyzing data supplied by the 28 largest financial institutions. In early 2010, the Federal Reserve Bank of Richmond will be working on examiner training related to this topic. We will also work to identify executive compensation best practices and will share any

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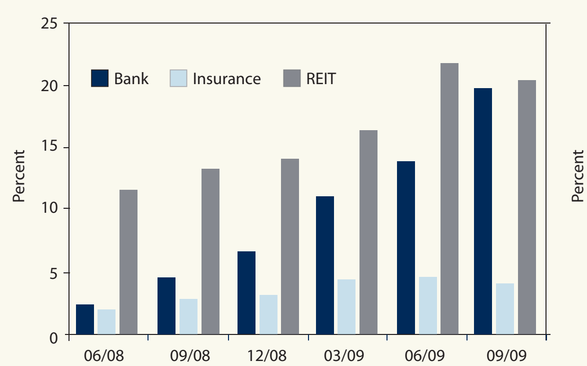
financial crisis unfolded, many of the institutions that invested in these securities found that some of these highly rated securities became increasingly illiquid and experienced credit deterioration, causing write-downs through earnings and in some cases negatively impacting risk-based capital ratios (*see S&R Perspectives Emerging Issues special edition, Risk-Based Capital for Direct Credit Substitutes*). As losses started to erode bonds towards the top of the capital structure, the re-securitization of residential mortgage-backed securities (re-REMICs) re-emerged and some institutions began adding positions in these securities. The aforementioned securities all share a common theme to be discussed in this article: they are considered structured credit securities[1], having undergone the asset securitization process.

The securitization process involves repackaging portfolios of cash flow-producing financial instruments into securities that are transferred to a third party. Structured finance techniques often distribute the cash flows into specific classes of securities, or tranches, in accordance with a specified prioritization of payment and allocation of losses. The risk associated with structured investments is heavily dependent upon their position in the securitization's capital structure (i.e., senior vs. mezzanine/junior positions) as well as the performance of the underlying collateral. Restructuring the cash flows into tranches creates the opportunity to accommodate different investor appetites, accomplished through the utilization of various forms of credit support, most notably, subordination. Subordination tranches are structured to absorb losses on the underlying collateral and serve as credit protection for senior classes. Other types of credit support for senior noteholders are provided through various structural provisions such as overcollateralization and coverage tests as well as embedded triggers for specific adverse events.

Collateralized debt obligations of trust preferred securities (TruPS CDOs)

TruPS CDOs are backed by pools of trust preferred securities issued primarily by U.S banks and thrifts. In light of ongoing financial pressures and the unprecedented level of deferral and default activity of the underlying debt, many TruPS CDOs have experienced sizeable erosion in performing collateral, as shown in Figure 1. While trust preferred securities can typically defer interest payments for up to five years without being considered in default, most TruPS CDO documents require deferring securities to be considered as defaulted securities for purposes of calculating structural provisions, such as overcollateralization tests. Many of the structural provisions embedded in these securitized structures have been triggered, thereby redirecting excess cash flows previously allocated to the junior tranches to the senior noteholders. According to an article from Credit*flux*[2], the average TruPS CDO now has exposure to 14.8 percent of deferring and defaulted underlying securities, up from 7.1 percent at year-end 2008. In addition, during the first half of 2009, Fitch Ratings noted $3.7 billion of defaults and deferrals (22 defaults and 109 deferrals) across the collateral pools of Fitch-rated TruPS CDOs compared to $3.3 billion in all of 2008. Looking at the pace of deferral activity, the level of default and deferrals expected for the second half of 2009 will likely approximate that of the first half. Given that trust preferred securities are deeply subordinated positions on issuers' balance sheets, TruPS CDO will likely have high loss severity rates if default occurs (i.e., loss given default). Besides the performance woes that these structures are experiencing, many TruPS CDOs employed interest rate hedging strategies at the onset of the deals, swapping the fixed coupons received by the CDO issuers on the underlying TruPS portfolios to floating rates (e.g., Libor). Due to the increase in underlying defaults and deferrals, these transactions are now negatively impacted by an unbalanced interest rate swap (i.e., pay fixed/receive floating), because the base of collateral assets on which the CDO issuers receive fixed interest has contracted due to deferrals and defaults, but the notional amount of the fixed interest payment due to the swap counterparty has not. Furthermore, relatively low LIBOR rates limit the amount of floating interest payments receivable from the swap counterparty. As a result, TruPS CDOs now owe their respective hedge counterparties increasingly large swap payments each quarter, further decreasing the amount of interest proceeds available to service the notes and excess interest to pay down senior noteholders in the event of a performance test failure.

Figure 1 ■ **Defaulted and Deferring Assets by TruPS CDO Type (%)**



Source: Intex, Citi Investment Research and Analysis

On October 23, 2009, Fitch assigned negative outlooks to 126 notes from 64 bank TruPS CDOs, reflecting the likelihood of increased defaults/deferrals over the next one- to two-year period. Fitch also noted that many of the deals have been subject to unsolicited offers for some of the underlying collateral in these deals to be purchased at deep discounts (to par value), highlighting further the ambiguities of these CDO structures. Many analysts suggest that as banks return to performing status (from deferral status), structural triggers like overcollateralization requirements may be cured and performance of the asset class may improve.

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Often, loan portfolio expansion tended to be concentrated in rapidly growing local marketplaces despite obvious warning signs that the areas were becoming overbuilt or were experiencing severe economic downturns. To compete, the banks provided loans that included high-risk terms such as high collateral dependency, interest-only provisions with balloon payments and a heavy reliance on interest reserves.

Lack of Board of Director and Bank Management Oversight

Directors and senior management teams at a number of banking firms did not provide effective oversight and failed to control risks in loan portfolios. In many instances, business plans governing activities were not kept current or followed. Often, loans were funded without adequate consideration of the borrower's ability to repay and/or the sufficiency of the underlying collateral. In some instances, management was not proactive in recognizing and downgrading loans that examiners cited as distressed. Further contributing to the lack of oversight, the directors did not ensure the timely implementation of corrective actions in response to bank examinations and audit recommendations.

Poor or No Risk Management Oversight

Numerous banking firms' management teams did not establish and implement sound risk management practices and/or controls to mitigate risk. Weaknesses in loan underwriting and credit administration, inappropriate use of interest reserves, delayed recognition of problem assets and an untested methodology for computing the allowance for loan loss reserves left many banks unprepared and unable to effectively manage the risks in their operations, especially in a deteriorating economic environment.

Imbalance of Risk and Return

Several depository institutions had compensation plans that rewarded staff for aggressive loan production without the appropriate emphasis on the quality of loans. In many cases, these incentive compensation programs contributed to the bank's rapid growth even though the loan administration process lacked effective credit quality controls. Additionally, loan officers were often well rewarded without consideration of the actual poor performance of the loan portfolio.

Lack of Adequate Liquidity Risk Management

Some banking institutions relied heavily on volatile, high-cost funding sources such as brokered deposits, time deposits of more than $100,000 and Federal Home Loan advances to support asset growth. Supervisory metrics suggested that the non-core funding dependence for many of these failed banking companies was well in excess of peer depository institutions. In many examples, the banks failed to establish necessary controls for effective liquidity management, including preparing an adequate contingency liquidity plan.

Stuart Desch is an assistant vice president with the Federal Reserve Bank of Richmond.

NOTES:

[1] Material Loss Reviews are conducted by the Inspector General of a Banking Agency following closure of the supervised financial institution.

Examiner's Corner

This section highlights trends noted by examiners conducting safety and soundness examinations of community banks within the Fifth Federal Reserve District.

Shareholder Dividends

Federal Reserve SR Letter 09-04 requires bank holding companies to inform and consult with Federal Reserve supervisory staff sufficiently in advance of declaring and paying a dividend that could raise safety and soundness concerns (e.g., declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid). A number of BHCs have recently declared dividends, which have not been earned during the current quarter, without consulting with Reserve Bank staff. This could be viewed as an "unsafe and unsound practice" and adversely affect the BHC's RFI rating. Guidance can be found at: http://fedweb.frb.gov/fedweb/bsr/srltrs/SR0904.shtm

Regulatory Reporting

Several recent examinations have found material errors in Call Reports and Federal Reserve Y-9C and Y-9LP reports. Systemic problems with regulatory reporting can have an adverse impact on the bank's rating for Risk Management. Accurate regulatory reports are essential for effective Federal Reserve oversight of the banking system.

Internal Risk Ratings

Banks are urged to review their internal loan risk rating definitions to ensure they are aligned with regulatory risk rating definitions. In several recent examinations, examiners have noted that internal definitions for Substandard and Special Mention loans did not reflect regulatory definitions. This has resulted in examiner downgrades to loan classifications and called into question the bank's methodology for determining the adequacy of the Allowance for Loan and Lease Losses.

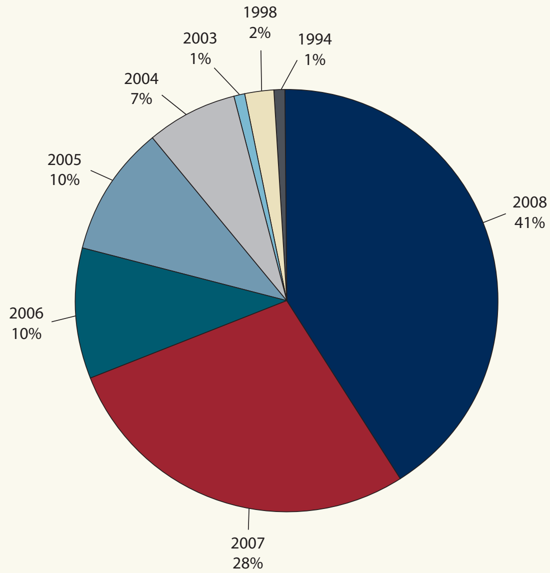
If you have questions about any of these or other topics please contact your Fifth District relationship manager, or email BKSRCommunications.RICH@rich.frb.org.

In The News (continued from Page 2)

Re-securitizations of real-estate mortgage investment conduits (re-REMICs)

As the level and speed in which non-agency residential mortgage backed securities (RMBS) were downgraded picked up, the market evidenced increased activity in re-securitizations of RMBS (or re-REMICs). Generally speaking, a re-REMIC is a restructuring of the cash flows of an existing RMBS into new tranches of various seniorities, increasing the credit support to the senior class through additional subordination. According to a US Banker article[3], approximately $90 billion in re-REMIC deals have been executed in 2009, the new senior securities were primarily sold to banks and insurance companies and the unrated bonds sold to hedge funds. While there are numerous reasons discussed in the market for conducting re-securitizations, the broad purpose is to create a new AAA-rated security with lower risk of downgrade, *potentially* more favorable risk-based capital treatment, and for liquidity or salability purposes. While some banking organizations have contemplated various structures for re-REMICing downgraded bonds in their investment portfolios, management should be aware that many of these structures may not result in risk-based capital relief. **Institutions are advised to discuss these transactions with their federal banking regulator and accounting firm before engaging in this activity**.

Figure 2 ■ **Downgrades of RMBS Re-REMICs**



Source: Chart represents breakout of Fitch downgrades of U.S. RMBS Re-REMICS taken on November 18,2009.

In addition, while the purchase of re-REMIC securities rated AAA may be marketed as being 'insulated' from credit problems and future ratings downgrades, institutions are cautioned to conduct robust due diligence prior to purchase as the performance of re-REMICs continues to be largely dependent on the performance of the underlying collateral and the state of the housing market. In particular, it is recommended that institutions monitor the collateral pool's observed performance as well as compare the assumptions used by the credit rating agencies to rate the new re-REMIC bond versus those used to rate the original triple-A rated bond. On November 18, 2009, FitchRatings downgraded 173 classes of re-REMIC bonds, primarily backed by classes from Alt-A transactions concentrated in the 2006-2008 vintages. More specifically and as evidenced in Figure 2, 41 percent of these downgraded U.S RMBS re-REMICs were re-securitized in 2008 and an additional 28 percent of the downgraded re-REMICs were re-securitized in 2007. Furthermore, of the 173 downgraded classes, 75 or 43 percent were originally rated triple-A that were downgraded to lower ratings, shown in Figure 3.

Other-than-temporary impairment (OTTI)

Management must ensure compliance with the Other-Than-Temporary-Impairment accounting guidance issued by the FASB (FASB ASC 320-10-35)[4] for determining whether a debt security is other-than-temporarily impaired and where the impairment loss is recorded in the financial statements. Generally if the fair value[5] of a held to maturity or available for sale debt security is less than its amortized cost basis at the balance sheet date, a bank must assess whether the impairment is other than temporary. If management has decided to sell the debt security or is likely to be required to sell the security before its forecasted recovery of its amortized cost basis, an OTTI exists and the entire impairment should be written down and recognized in earnings.

On the other hand, if management has no intent or is not more likely than not to be required to sell a security before its forecasted recovery, the OTTI is separated into (a) the amount representing credit loss, and (b) the amount representing all other factors (e.g., uncertainty premium, etc.). The OTTI related to the debt security's credit loss will be recognized in earnings whereas the OTTI related to other factors will be included as a separate component of other comprehensive income (OCI). The OTTI related to the security's credit loss should be measured as the difference between the present value of the expected cash flows and the amortized cost basis of the security. In determining expected future cash flows, an institution must carefully assess available information relative to the collectability of the security to estimate the credit impairment and forecasted recovery period, including factors provided in the accounting guidance which include but are not limited to the following: consideration of the severity and duration of the impairment, credit rating agency downgrades, near-term prospects of the issuer, etc. **Management must conduct regular OTTI reviews to comply with accounting standards and meet regulatory requirements**.

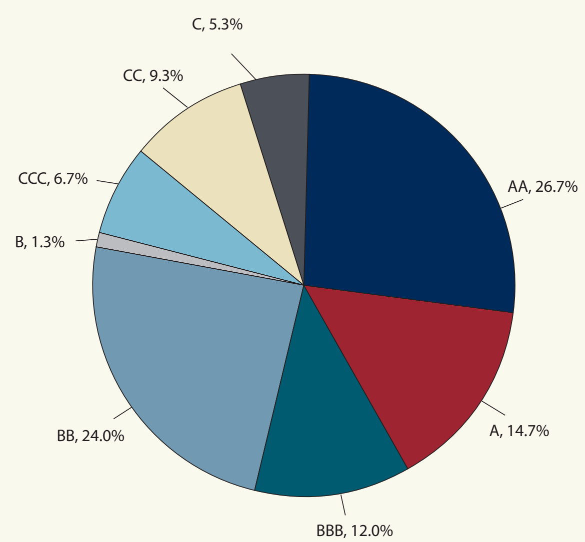
Risk Management Expectations

As the market's recent experience has evidenced, once highly rated structured securities have performed poorly and resulted in rating downgrades. While current yields on these structured securities appear on the surface to be an attractive investment opportunity, it is imperative that bank management thoroughly understand the risks embedded in these securities prior to making investment decisions. The evaluation of a securitized instrument cannot be confined to estimating the loss distribution of the asset pool alone. It is also necessary to model the distribution of cash flows from the asset pool to these tranches under different scenarios based on the exact priority of payments specified in the relevant transaction's documents, reflecting both subordination levels and the deal's structural features. Management's pre-purchase and ongoing analysis of structured investment securities should include, but not be limited to the following:

- Ability to identify, measure and manage credit-risk exposure(s);
- Understand the nature and performance of the underlying collateral pool;
- Understand underlying credit dynamics and current credit rating;
- Understand the specific positioning of a bond in the securitization's capital structure (i.e., senior or mezzanine class) – and how much credit support remains underneath the bond;
- Understand the prioritization of cash flows and loss allocation methodologies (i.e., cash flow waterfall);
- Understand the bond's "tranche thickness." In other words, the percent of the deal's overall capital structure comprised of the given tranche, and the implication of tranche thickness on loss given default;
- Understand whether or not structural provisions such as performance triggers have failed and if cash flows are being diverted to more senior noteholders;
- Understand model assumptions used to provide valuations;
- Ensure compliance with OTTI requirements and assess the level of defaults required to suffer a loss;
- Understand whether sufficient liquidity exists to retain the securities to recovery;
- Understand capital consequences for recourse and direct credit substitutes when external ratings deteriorate.

Supervisory expectations for risk management processes that financial institutions should establish related to market, credit, and liquidity risk of investment securities are discussed in SR 98-12, "Supervisory Policy Statement on Investment Securities and End-User Derivative Activities." This guidance reiterates the importance of a strong overall risk management process and specifically highlights the importance of board and senior management oversight of investment activities. In order to provide effective oversight, board members should be active participants in the risk management process by debating risk tolerance levels, challenging critical business and financial strategies, and holding management accountable for the risk-return performance of past decisions.

Figure 3 ■ **Downgraded AAA re-REMICs**



Source: Chart represents breakout of Fitch downgrades of U.S. RMBS Re-REMICS taken on November 18,2009.

While the Board may appoint and authorize committees to perform specific tasks and supervise certain phases of operations, use of the committee process does not relieve the board of its fundamental responsibilities for actions taken by those groups. The board of directors is responsible for ensuring that proper policies and limits are in place to govern investment activities, fully understanding the types of investment activities taking place, and remaining aware of portfolio activity and risk levels through regular reporting.

Policies and limits put in place must address relevant investment objectives, constraints, and guidelines for the acquisition and ongoing management of securities (and derivative instruments). These limits should account for the identification and management of not only individual securities purchases, but also the risk characteristics of the investment portfolio as a whole. Bank management is expected to enforce the policies and limits in place as well as implement a strong system of internal controls capable of identifying, monitoring, measuring, and controlling risks. To ensure proper oversight of complex structured investments, regular reporting to senior management and the board should include an assessment of all risk exposures as well include a discussion of underlying collateral type and performance, default rates and delinquencies, credit-enhancement, and subordination features at a minimum. Proper pre-purchase analysis is necessary to demonstrate clear identification and understanding of the risks inherent in complex or unusual securities. For relatively complex securities, pre-purchase analysis should address all relevant risks, including market, credit, liquidity, and operational risk. The level of due diligence conducted by bank management should be commensurate with the complexity of the instrument, the materiality of the investment in relation to capital, and the overall quality of the investment portfolio as a source of liquidity. Lastly, bank management should ensure that potential investments and embedded risks align with the stated objectives for the investment portfolio as a whole.

Donna Thompson, CFA, FRM is a supervisory examiner and Andrew Lowry is an examiner with the Federal Reserve Bank of Richmond.

NOTES:

[1] The term structured credit products is broadly defined to refer to all structured investment products where repayment is derived from the performance of the underlying assets or other reference assets or by third parties that serve to enhance or support the structure. Such products include, but are not limited to, asset- and mortgage-backed securities (ABS and

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recommendations with institutions in the Fifth District as soon as possible.

In addition, regulatory reform is an important and dynamic issue for the banking industry. As you may know, the House of Representatives recently passed sweeping reform of the banking regulatory system. While the outcome of the various regulatory reform proposals is uncertain, the Federal Reserve Bank of Richmond will make information available as soon as we receive it.

As always, please send any questions, comments or story ideas to **BKSRCommunications.RICH@rich.frb.org**.

Mac

In The News (continued from Page 5)

MBS), collateralized mortgage obligations (CMOs), and collateralized debt obligations (CDOs), including securities backed by trust preferred pools.

2. Credit*Flux*, Interest rate hedges add to TruPS CDOs' problems, July 28, 2009

3. USBanker, *Re-Remics Redux*, December 2009

4. With the issuance of FASB Statement No. 168 'The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162' the FASB Accounting Standards Codification™ (ASC) became the single source for authoritative US GAAP, and is effective for financial statements issued for interim and annual reporting periods beginning after September 15, 2009. **FASB ASC 320 10 35 (FASB ASC 320 Investments - Debt and Equity Securities, 10 Overall, 35 Subsequent Measurement) refers to the section of the ASC that contains relevant portions of FASB Staff Position (FSP) No. FAS 115-2 and FAS 124-2, 'Recognition and Presentation of Other-than-Temporary Impairments' that was issued in April of 2009**.

5. Fair value is defined in FASB ASC 820, Fair Value Measurements and Disclosure, formerly SFAS 157 'Fair Value Measurements'.

Richmond Fed Hosts Fraud Conference

By Elaine R. Yancey

FIN

FRAUD INFORMATION NETWORK

Annual Conference

Fraud specialists from around the Federal Reserve System (FRS) gathered in November for the annual Fraud Information Network (FIN) conference. The meeting is the capstone event for the group, which holds monthly conference calls to stay abreast of fraudulent activity and financial crimes occurring throughout the Federal Reserve System. Sponsored by the Board of Governors, FIN is an affinity group whose mission is to facilitate the use of FRS fraud specialists to address potential issues of fraud throughout the country, to serve as a communications resource on issues related to financial crimes, including trends and emerging issues, and to develop examiner knowledge on financial fraud.

Mortgage fraud and remote deposit capture were the focal point of this year's conference. Jacqueline Dreyer, a bank examiner and mortgage fraud specialist, updated the group on mortgage fraud trends and the status of the pending FFIEC Mortgage Fraud White Paper. Kiernan Conway, a senior real estate specialist, discussed appraisal fraud. Two perspectives on the popular remote deposit capture product were also provided, one by Assistant General Counsel Richard Fraher, who focused on legal and operational matters, and the other by John Leekley, who represents the industry and is the founder of RemoteDepositCapture.com. Other highlights included an FBI presentation relating to corruption and money laundering and another on insider fraud investigation practices and techniques of a regional bank.

Federal Reserve Bank of Richmond, Senior Vice President Mac Alfriend, who manages Supervision, Regulation and Credit and serves as chief credit risk officer, said the conference was a success and came at the right time, given economic conditions and the "perfect storm" for fraud. "We are very concerned about fraud right now and are working to educate our staff to recognize financial fraud," Alfriend said.

Elaine Yancey is a supervisory examiner and is the Federal Reserve advisor to the BSA Coalition.

Emerging Risks

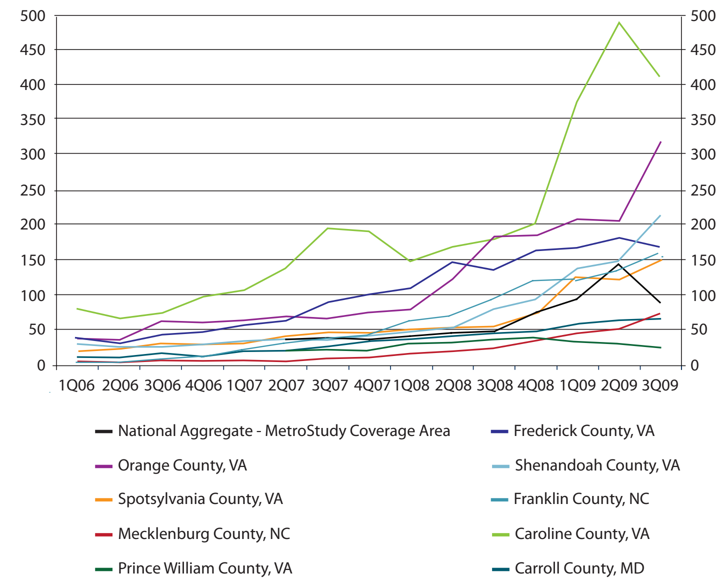
Vacant Developed Lots - More Stress for CRE Portfolios

by Kevin Cole and Mike Milchanowski

Commercial real estate (CRE) loans have been a significant source of profit for many small and mid-size banks until the current crisis. Now, these loans cause stress to bank earnings and capital. This article discusses one aspect of the problem - the large supply of vacant developed residential lots (VDLs) in certain areas. The abundance of VDLs in the current economic environment may lead to higher credit losses and administration costs for some banks.

To understand the problem, one can review data on VDLs compiled by Metrostudy.[1] The data reveal numerous counties throughout the Fifth District with a growing supply of VDLs over the past two years. Figure 1 includes Metrostudy statistics[2] on VDLs for a sample of Fifth District counties. Since the beginning of the financial crisis, the monthly VDLs supply increased steadily. According to the most recent data, the excess supply of VDLs in some counties could last for years. However, it is important to remember that the calculation for monthly supply (defined as the number of months a current supply of lots in a locale will last based on the area's annual housing starts) is subject to volatility due to changes in the number of housing starts in each local market.

Figure 1 ■ **Months Supply of Vacant Developed Lots [VDL]**



Source:Metrostudy

Federal banking regulatory agencies recognized the increasing CRE concentration risks and issued guidance in 2007, including the Federal Reserve System's SR 07-1: *Interagency Guidance on Concentrations in Commercial Real Estate*.[3] SR 07-1 was intended to alert banks to the rising levels of CRE concentrations relative to capital and the need for sound risk management practices. For banks with sizable portfolios of acquisition, development, and construction loans (which include loans on VDLs), underwriting and risk management practices should incorporate a reasoned analysis of current local market conditions to support the valuations of VDLs and specific capital exposure limits. The 2007 guidance provides quantitative supervisory screening criteria to identify institutions with CRE. The suggested criteria in the guidance are 100 percent for construction and land development loans as percent of total risk-based capital and 300 percent for CRE loans as percent of total risk-based capital.

Regulatory concerns over concentrations in CRE continued to rise as an increasing number of borrowers sought to refinance due to market conditions. Bankers raised concerns that supervisory policies and actions curtailed the availability of credit to sound borrowers. As a result, additional guidance was issued in October 2009, entitled SR 09-07 *Prudent Commercial Real Estate Loan Workouts*.[4] The guidance is intended to promote prudent loan workouts that are in the best interests of bankers, borrowers and the economy. While the new guidance does not provide a safe harbor to avoid asset quality downgrades and write-downs of non-performing VDL loans, it does clarify the 2007 guidance and emphasizes that banks do have some flexibility in dealing with troubled CRE credits. The guidance, which specifically mentions that it applies to loans for land development and construction, states the following:

> *Financial institutions that implement prudent loan workout arrangements after performing comprehensive reviews of the borrowers' financial conditions will not be subject to criticism for engaging in these efforts even if the restructured loans have weaknesses that result in adverse credit classification.*

Prudent CRE loan workouts depend upon a variety of factors. Bankers are in the best position to know their customers and need to evaluate what solution is in the best interest of the institution. Whether VDL loans can be paid from the eventual sale of the collateral is a question for bankers to address. Examiners will be looking for a market analysis that supports VDL loans and for compliance with the institution's risk management policies and procedures to ensure that real estate loan workout solutions are realistic.

Kevin Cole is a senior financial analyst and Mike Milchanowski is a senior banking research analyst with the Federal Reserve Bank of Richmond.

NOTES:

1. Metrostudy provides market data and analysis on the housing industry. The Metrostudy VDL survey does not include every state and county. The counties selected for Figure 1 present a geographically disperse sample of counties in the Fifth District with monthly supplies both above and below the Metrostudy aggregate average of all counties covered in the survey. Visit the Metrostudy website: **http://www.metrostudy.com/CorpWebsite/index.aspx** for additional details.
2. Definitions of terms used in Figure 1: VDLs are defined as "developed" once underground utilities are installed and paving is complete in front of the lots. Annual starts are calculated based upon the past 12-month rate.
3. The full text of the SR 07-01 is available at **http://fedweb.frb.gov/fedweb/bsr/srltrs/SR0701.htm**
4. The full text of the SR 09-07 is available at **http://fedweb.frb.gov/fedweb/bsr/srltrs/SR0907.shtm**

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Do You Know About The BSA Coalition?

The BSA Coalition was created in June of 2008 to serve as a forum for bankers and regulators to discuss and debate BSA/AML and fraud issues. The group now boasts nearly 150 members from six different states. Training offered by the group as well as **membership is FREE**. If you have questions about membership, visit the Web site, **www.bsacoalition.org** or contact sponsor Donna C. Kitchen of Hampton Roads Bankshares (252) 331-4003. If you have other questions about the Coalition, contact advisor Elaine R. Yancey of the Federal Reserve Bank of Richmond (804) 697-8313.

Reporting Updates

Reporting FDICIA 112 Filings Update and Reminder

Due: March 31, 2010

The FDIC's Final Rule implementing FDICIA 112 Section 36, "Early Identification of the Needed Improvements in Financial Management," became effective July 2, 1993. In general, the rule applies to banks and other insured depository institutions with $500 million or more in total assets as of December 31, 2008. Institutions whose assets exceed $500 million are expected to file a limited set of documents, while those with assets of more than $1 billion have additional filing requirements.

Banks required to file must submit their annual reports to their primary regulator within 90 days of the fiscal year-end. Along with the annual reports, the submission of your CPA's attestation on internal controls and management letter is required. In certain cases, the FDIC rule allows insured depository institutions to satisfy the reporting requirements by filing their annual reports on a consolidated holding company basis. However, the rule does not address the Federal Reserve Board's responsibility as the primary regulator of bank holding companies. Thus, bank holding companies that have institutions subject to the FDIC final rule and guidelines are requested to submit one copy of the required reports to the appropriate Federal Reserve Bank. These reports should be submitted to the Reserve Bank regardless of whether the holding company submitted them on a consolidated basis for their banking subsidiaries and regardless of the subsidiary bank charter.

On June 23, 2009, the FDIC Board of Directors approved a final rule amending FDICIA Part 363 – Annual Audit and Reporting Requirements. To reduce regulatory burden and provide certainty for merging institutions, the FDIC added guideline 5A, Institutions Merged Out of Existence, to explicitly provide relief from filing a Part 363 Annual Report to an institution that is merged out of existence after the end of its fiscal year, but before the deadline for filing its Part 363 Annual Report. However, a covered institution that is acquired after the end of its fiscal year, but retains its separate corporate existence rather than being merged out of existence, would continue to be required to file a part 363 Annual Report for that fiscal year. The FDIC issued a Financial Institution Letter (FIL) to all FDIC-insured depository institutions with $400 million in assets to advise them of the final rule.

If your institution qualifies for reporting, please submit the reports by March 31, 2010 to Business Support in care of Robert Greene; Federal Reserve Bank of Richmond; Supervision, Regulation, and Credit Department; P.O. Box 27622, Richmond, Virginia, 23261.

For more information:
www.fdic.gov/news/news/financial/2005/fil11905a.html
http://www.federalreserve.gov/BoardDocs/SRLetters/1996/sr9604.htm
http://www.fdic.gov/news/news/financial/2009/fil09033.html

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