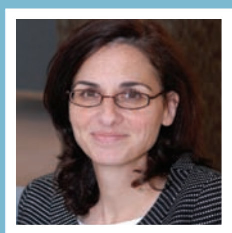
S&R PERSPECTIVES

The Latest Fifth District Supervision and Regulation News & Events

Summer Issue 10

> "Given the recent improvement in financial market conditions, the discount window is returning to its traditional role as a contingency funding source."
> – Greg Robinson

Jennifer's Notes



Welcome to the summer 2010 edition of S&R Perspectives and my first issue as editor in chief. It is an interesting time to be in banking and in banking supervision. As the industry continues to struggle with the after effects of the financial markets crisis and the deep recession, Congress recently completed its financial and regulatory reform activities. The financial reform legislation is certain to have important ramifications for the business model of banking. This will present challenges that we, bankers and regulators alike, must face together. Within the Federal Reserve, we are pleased to remain part of the supervisory landscape in the U.S. and recognize and are thankful for the efforts by bankers, banking commissioners and industry associations that made that happen. We are ready to assist as the industry heals, responds to the legislation and continues to play its critical role in the economy. For the latest information on the Federal Reserve Bank of Richmond's efforts on financial reform, please visit our public

(continued on page 3)

Emerging Issues UPDATE

Troubled Debt Restructurings – Increased Examiner Focus, GAAP Updates and Frequently Asked Questions

By David C. Schwartz, C.P.A. & David W. Powers, C.P.A.[1]

This article is part of an ongoing series on Troubled Debt Restructurings, and is a continuation of a fall 2009 article, "Troubled Debt Restructurings on the Rise," which discussed the accounting guidance related to TDR identification. The article provides an update on recent changes to generally accepted accounting principles (GAAP) that impact TDR identification and highlights some frequently asked questions examiners typically encounter, which will be continued in the fall edition of S&R Perspectives.

Properly identifying and accounting for troubled debt restructurings (TDRs) is imperative as it will have a direct impact on the earnings and the risk profile of a bank. Given the importance of proper identification and reporting, the rise in new trial period plans being implemented, and the percentage of banks within the District reporting TDRs (see charts on page 4), banks should expect to have discussions with examiners related to the proper identification and accounting for

(continued on page 2)

In The News

Discount Window Returns to Traditional Lending Role

By Greg Robinson

The Federal Reserve discount window served a critical role over the last two years, providing billions of dollars in funding to depository institutions during the economic crisis. Given the recent improvement in financial market conditions, the discount window is returning to its traditional role as a contingency funding source. While many Fifth District depository institutions already find the discount window to be a valuable back-up liquidity provider, for those depository institutions not familiar with the discount window programs, here is a brief review:

- All depository institutions are eligible to establish access to the discount window.
- Depository institutions are determined to be eligible for specific discount window credit programs based on their financial condition, primarily their composite rating and capital levels.
- Primary credit is available to generally sound depository institutions. The primary credit program is referred to as a "no questions asked" facility, meaning as long as borrowing documents are in

(continued on page 7)

TDRs . **Banks should ensure that TDR guidance is considered if and when these trial period modifications become permanent. All banks should consider reviewing their policies and procedures related to TDR identification to ensure proper GAAP and regulatory reporting requirements are being followed.**

Updated Accounting Guidance

As noted above, the article "Troubled Debt Restructurings on the Rise" (**http://www.richmondfed.org/banking/supervision_and_regulation/newsletter/pdf/srperspectives_2009fall.pdf**) provides a useful reference when determining whether certain restructurings fall under TDR guidance and should be referenced for additional information. Since the article's publication two items of note have occurred: (1) FASB's Accounting Standards Codification™ (ASC) became effective and (2) FASB released Accounting Standards Update (ASU) 2010-18 "Update No. 2010-18—Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (A consensus of the FASB Emerging Issues Task Force)."

Changing Where TDR related GAAP is Located – FASB ASC

With the implementation of SFAS 168 "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles-A replacement of FASB Statement No. 162," Codification became the single source of authoritative, nongovernmental U.S. GAAP. Although the ASC does not change GAAP, it has changed how we reference GAAP. As such, the references to GAAP in the prior article can now be located in the following sections of the ASC:

Prior GAAP Guidance	ASC Reference[2]
Statement of Financial Accounting Standards No. 15 "Accounting by Debtors and Creditors for Troubled Debt Restructurings"	ASC 310-40 "Receivables – Troubled Debt Restructurings by Creditors"
	ASC 470-60 "Debt – Troubled Debt Restructurings by Debtors"
EITF 02-4 "Determining Whether a Debtor's Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15"	ASC 470-60-55 "Debt – Troubled Debt Restructurings by Debtors – Implementation Guidance"

Clarifying TDR Guidance for Purchased Impaired Loan Pools Accounted for as a Single Asset

In April 2010, FASB issued ASU 2010-18 "Update No. 2010-18—Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (A consensus of the FASB Emerging Issues Task Force)," which addressed the range of practices that emerged in the industry in accounting for restructurings of these loans. The new guidance reaffirmed that the pool as opposed to the individual loans is the "unit of account" for acquired loans with credit deterioration accounted for in a pool, and that individual loans should not be removed from the pool once it is established unless the loan is sold, foreclosed upon, satisfied through an exchange of assets, or charged off. Therefore, restructured loans accounted for in a pool of purchased impaired loans may not be accounted for under TDR guidance. **Banks should review their policies and procedures to determine if changes are necessary when this GAAP update becomes effective for annual or interim reporting periods beginning after July 15, 2010.**

TDR Frequently Asked Questions

As noted above, the proper identification and accounting for TDRs is imperative as it will have a direct impact on the earnings and the risk profile of a bank. Given this importance, the recent changes in GAAP and the increased focus of examiners on TDRs, **we encourage banks to consider reviewing their policies and procedures related to TDR identification to ensure proper GAAP and regulatory reporting requirements are being followed**. To aid readers in this work we conclude this article with some frequently asked questions (FAQs) that examiners have observed while in the field.

Note: FAQs and related responses represent the authors' interpretation of GAAP and/or regulatory guidance and may not necessarily reflect the views of the Federal Reserve Bank of Richmond or the Federal Reserve System.

Market and Effective Interest Rates

1. **What should be considered a market rate of interest?**

   This question is often a point of confusion due to the false assumption that a market rate of interest is simply a rate that is currently being offered in the marketplace. The analysis around a market rate of interest, although taking this point into account, also considers what rate would be available to a non-troubled borrower of the bank with similar credit quality for debt of the same terms. A good litmus test is asking yourself the following question: Would this rate, for debt of similar terms, be available to *new* borrowers of the bank with similar credit qualities? If you answered no, the rate being offered is likely not a "market rate."

   A common exception to this rule that may preclude the restructuring from being considered a TDR, is if the creditor reduces the effective interest rate on the debt primarily to reflect a decrease in market interest rates or a decrease in the risk. This can be done to maintain a relationship with a debtor that can readily obtain funds from other sources at the current market interest rate. Caution should be taken in attempting to apply this exception to transactions where the banking relationship is noted as the reason for the concessionary rate *while* the debtor is experiencing financial difficulties.

2. **What is the effective interest rate for a restructured loan and why is this important?**

   ASC 310-40-35-12 (Receivables – Troubled Debt Restructurings by Creditors – Subsequent Measurement) notes that a troubled debt restructuring does not result in a new loan but instead represents part of a creditor's ongoing effort to recover its investment in the original loan. The effective interest rate for a loan restructured in a TDR is based on the contractual

(continued on page 4)

Jennifer's Notes

website, **http://www.richmondfed.org/research/issues_in_financial_regulation/**.

On April 1, I assumed the leadership role of Senior Vice President over Supervision, Regulation and Credit. My first thirty days were filled with department transitions and time sensitive meetings on a wide array of topics that only reminded me of the very large shoes Mac Alfriend has challenged me to fill. I am humbled and excited by the opportunity to lead our very talented and diverse supervision staff - a group of hardworking individuals that remain committed to the important work we do in this very challenging environment - and to oversee the District's supervisory programs. I have also started to get to know many of you through various outreach forums and one-on-one meetings. I look forward to doing more of this and to building strong, beneficial working relationships with you.

Through our newsletter, we discuss banking topics and highlight trend information that surfaces during the supervisory process. In this edition of S&R perspectives, we continue our efforts to demystify troubled debt restructurings, discuss the Federal Reserve discount window and its evolving role, and share with you some perspectives on banks' current posture toward small business lending, as well as several other interesting topics. In this and future editions, we will include links to recent guidance updates and releases. I encourage you to review new guidance and contact your Federal Reserve Bank of Richmond relationship officer with any questions or concerns. For the latest information on new guidance, be sure to visit the Board of Governors' banking information website **http://www.federalreserve.gov/bankinforeg/default.htm**.

To maximize the benefit of this newsletter, it is important that we continue to cover emerging issues that are most important to our Fifth District readers; if you have comments about this edition, would like to submit a topic idea or would just like to introduce yourself, please contact me by emailing **bksrcommunications.rich@rich.frb.org.** I would love to hear from you!

Jennifer

Examiner's Corner

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

Risks

Some analysts believe that the next major hurdle facing bankers will be interest rate risk. During economic recoveries, interest rates have historically risen. Higher rates may affect not only bank net interest margins, but also investment valuations and the ability of borrowers to service variable rate debt. Currently, some banks are experiencing contracting margins as deposits have grown while loan demand has been weak.

In addition, loans for finished commercial properties may well present the next major credit problem for banks. Nationally at year-end, hotel loans reflected the highest level of delinquency at 10 percent, followed by loans for multi-family properties at 8 percent. Vacancies for all types of commercial properties remain elevated. Increasing cap rates and shrinking cash flow can have a disastrous effect on property values and borrower equity, and many borrowers and lenders will be severely challenged when maturing loans require refinancing in 2010 through 2012, possibly at higher interest rates. These factors, in turn, can affect the performance of commercial mortgage-backed securities.

Capital Strategies

The combination of reduced profitability and the need for much larger loan loss provisions has adversely affected capital measurements for a number of banks. Difficulty in obtaining new equity has compelled some institutions to pursue a strategy of shrinking assets, as well as shifting the balance sheet composition from higher risk-weighted assets to lower risk-weighted assets, in order to improve risk-based capital ratios.

Restructured Loans

Lenders have had some degree of success in returning portions of problem loans from nonaccrual to accrual status through workout strategies that entail separating the loan into two legally enforceable notes (bifurcation). One note would be reasonably assured of repayment under prudently modified terms and might be restored to accrual status after a reasonable period of satisfactory performance (usually six months). The second note, which is not reasonably assured of repayment, would be classified and charged off, as appropriate. Guidance is provided in SR Letter 09-07 Prudent Commercial Real Estate Loan Workouts, (**http://www.federalreserve.gov/boarddocs/srletters/2009/SR0907.htm**).

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**.

terms and rate of the original loan, adjusted by fees and costs, and not the rate in the restructuring agreements. It is important to properly calculate this rate as it is the rate prescribed by GAAP to discount cash flows in the impairment analysis of a credit.

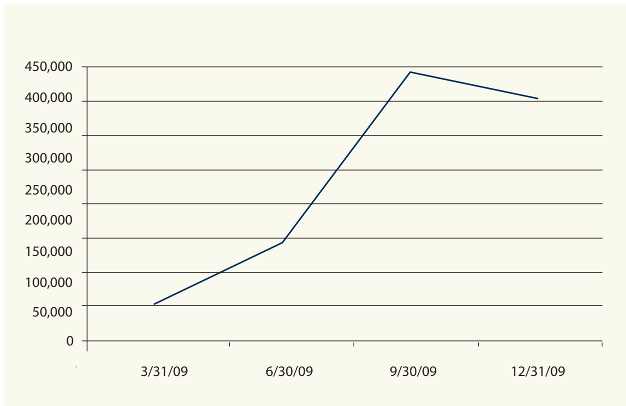
TDR Identification

3. **How have banks handled determining if a restructuring constitutes a TDR?**
   Although there are a variety of practices employed to help evaluate whether a restructuring is considered a TDR, a number of banks take a checklist approach to determine if, (1) a concession has been granted, and (2) if the debtor is experiencing financial difficulties. It is important that these checklists are not used as a final determinant but instead as a guide, as judgment must be used in making a TDR determination.

4. **How can a creditor determine if a debtor is experiencing financial difficulties?**
   ASC 470-60-55 (Debt - Troubled Debt Restructurings by Debtors) provides guidance for determining whether a debtor is experiencing financial difficulties for TDR purposes. It is important to note this guidance is written from the perspective of the debtor and not the creditor. **The application of this guidance by a creditor may not be considered authoritative GAAP,** nonetheless it can be helpful to creditors in making this determination. Although judgment must be used in making this determination, these items could be used as indicators of financial difficulties (*this is not meant to be all-inclusive and exceptions do apply, please consult the ASC*):

- The debtor is currently in default on any of its debt;
- The debtor has declared or is in the process of declaring bankruptcy;
- There is significant doubt as to whether the debtor will continue to be a going concern;

Figure 1 ■ **New Trial Period Plans***

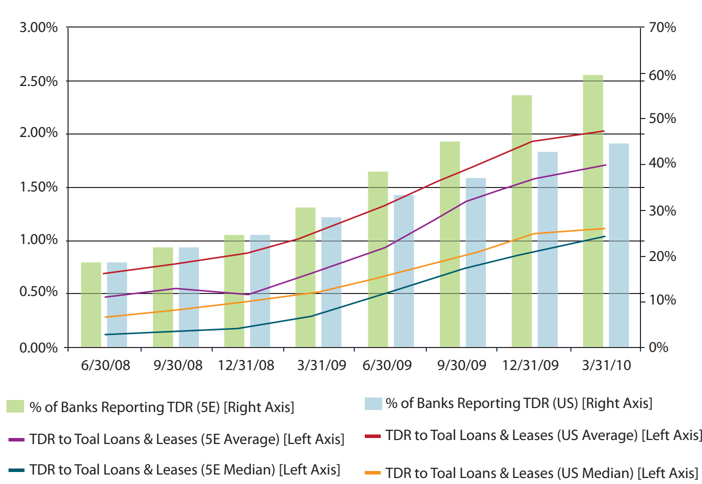


* Includes HAMP and Other New Trial Period Plans; Data based on performance data on first-lien residential mortgages serviced by national banks and federally regulated thrifts; data collected from nine national banks and three thrifts.

Source: OCC and OTS Mortgage Metrics Report, Disclosure of National Bank and Federal Thrift Mortgage Loan Data – Fourth Quarter 2009

- Currently, the debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange;
- Based on estimates and projections that only encompass the current business capabilities, the debtor forecasts that its entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity;
- Absent the current modification, the debtor cannot obtain funds from sources other than the existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a non-troubled debtor.[3]

Figure 2 ■ **TDR Trends in the Fifth District & Nationally**



Source: Call Reports filed by all commercial banks

Note: *5E* represents the 5th District only; US represents all of the US, including the 5th District; Median & average figures include only those banks reporting TDRs in the given quarter.

Notwithstanding the above, the ASC provides two factors that, if *both* present, would provide determinative evidence that the debtor is *not* experiencing financial difficulties:

- The debtor is currently servicing the old debt and can obtain funds to repay the old prepayable debt from sources other than the existing creditors (without regard to the current modification) at an effective interest rate equal to the current market interest rate for a non-troubled debtor, ***and***;
- The creditors agree to restructure the old debt solely to reflect a decrease in current market interest rates for the debtor or positive changes in the creditworthiness of the debtor since the debt was originally issued.

Note that if either of the above two factors were present this may be an indicator of not having financial difficulties but is not determinative.[3]

5. **How can a creditor determine if a concession has been granted by a creditor for economic or legal reasons?**
   ASC 310-40-15 'Receivables - Troubled Debt Restructurings by Creditors – Scope and Scope Exceptions' provides guidance on how to determine if a concession has been granted by a creditor. This guidance should be consulted in making this determination, however in brief, any of the following actions *may* be considered a concession *(this is not meant to be all-inclusive and exceptions do apply, please consult the ASC)*:

- The debtor transferred to the creditor receivables from third parties, real estate, or other assets to fully or partially satisfy a debt (including a transfer resulting from foreclosure or repossession);
- The debtor issued or granted an equity interest to the creditor to fully or partially satisfy a debt unless the equity

(continued on page 5)

interest is granted pursuant to existing terms for converting the debt into an equity interest;

- Reduction (absolute or contingent) of:
  - the stated interest rate for the remaining original life of the debt;
  - the face amount or maturity amount of the debt as stated in the instrument or other agreement;
  - accrued interest.
- Extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;
- Substitution of debt of another business entity, individual, or government entity, or adding a joint debtor;
- Other modification of terms that the creditor would not have otherwise considered for a non-troubled debtor.[4]

Although the preceding items may be concessions, the following questions needs to be considered, as an affirmative answer to any of these questions may result in a conclusion that a concession has not been granted:

- Does the fair value of cash, other assets, or an equity interest accepted by a creditor from a debtor in full satisfaction of its receivable at least equal the creditor's recorded investment in the receivable?
- Did the creditor reduce the effective interest rate on the debt primarily to reflect a decrease in market interest rates or a decrease in the risk so as to maintain a relationship with a debtor that can readily obtain funds from other sources at the current market interest rate?
- Did the debtor issue in exchange for its debt new marketable debt having an effective interest rate based on its market price that is at or near the current market interest rates of debt with similar maturity dates and stated interest rates issued by non-troubled debtors?[4]

6. **What types of restructurings should be evaluated for possible TDR considerations?**
   Although it is good risk management practice to evaluate all restructurings for possible TDR implications, the following list highlights those that may fall under TDR guidance (*this is not meant to be all-inclusive and exceptions do apply, please consult the ASC*):

- Loan modification programs for existing borrowers (including mortgages) that include one or more of the following:
  - Extension of maturity date(s) at stated interest rates that are lower than the current market rate for new debt with similar risk;
  - Reduction of principal or accrued interest;
  - Reduction of stated interest rates for the remaining original life of the debt.
- Substitution or addition of debtors;
- Programs with financing terms available only to new customers who purchase properties or projects for sale by distressed borrowers of the bank, when said terms are more favorable than would otherwise be available to other customers of the bank of similar credit quality;
- Rollover or refinancing of existing borrowers to more favorable terms than would be otherwise available to non-troubled borrowers of similar credit quality;
- Transfer of assets to partially or fully satisfy the debt;
- Granting of equity interest to fully or partially satisfy the debt unless the equity interest is granted pursuant to existing terms for converting the debt into an equity interest.

Frequently asked questions will be continued in the fall edition of S&R Perspectives.

David C. Schwartz is a Credit Risk Specialist and David W. Powers is an Accounting Policy Specialist both with the Federal Reserve Bank of Richmond. They can be reached at **david.schwartz@rich.frb.org** *and* **david.powers@rich.frb.org**, *respectively.*

NOTES:

1. With special thanks to Linda V. Ditchkus of the Federal Reserve Board and Archa M. Chadha of the Federal Reserve Bank of Chicago for contributing their loan accounting expertise and guidance.

2. FASB offers free of charge access to the Basic View of the ASC at http://asc.fasb.org/home.

3. FASB's ASC 470-60-55 "Debt – Troubled Debt Restructurings by Debtors – Implementation Guidance and Illustrations."

4. FASB's ASC 310-40-15 "Receivables – Troubled Debt Restructurings by Creditors – Scope and Scope Exceptions."

Current Issues

Contingency Planning

By Jim Lucas

What happens when disaster strikes and business activities are compromised? Who can you call to help you prepare for the unexpected? Regional Partnership Council First (RPC First) or any of its regional partners. Two regional organizations operate within the Fifth Federal Reserve District; NCRFirst, which covers the Washington D.C. metropolitan area and works in partnership with Virginia 1st, which covers the Commonwealth of Virginia.

"*Virginia 1st is a non-profit organization dedicated to addressing homeland security and emergency management issues affecting financial institutions. It seeks to increase the resilience of Virginia's financial community through a coordinated response effort.*"[1] The membership is a coalition of financial organizations including banks, credit unions and other service providers that stand ready to provide critical financial services under emergency conditions.

Virginia 1st has become a strategic partner with the Virginia Department of Emergency Management. Its members have received official credentials, which are recognized by the Federal Emergency Management Agency (FEMA), the Commonwealth, and local authorities, to operate within a disaster area. Some members of Virginia 1st have made reciprocal agreements to share facilities with other members during times of emergency, improving the odds for delivering critical financial services. The coalition conducts meetings with emergency management authorities, participates in disaster simulations, and receives periodic updates from the Department of Homeland Security, among other activities. Its regulatory partnerships include the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation, and the Federal Reserve Bank of Richmond. A coalition meeting will take place in October (date to be announced) at the Federal Reserve Bank of Richmond. This will be a great opportunity to learn more about Virginia 1st.

For more information about contingency planning activities for financial institutions in the Fifth District, visit: **www.rpcfirst.org**.

NOTES:

1. Virginia 1st, Virginia's Financial Industry Business Continuity Planning Coalition Promotional Pamphlet, March 16, 2010.

Outreach Update

By John Wiatt

The following is an excerpt from remarks provided by John M. Wiatt, III, at The State of Small Business – Addressing the Financing Needs of Small Business – A Federal Reserve System Series held in Chapel Hill, N.C., on April 20, 2010.

It is important to define a small business loan. According to the Consolidated Report of Condition, a small business loan is defined as a loan with an original amount of $1 million or less that is secured by nonfarm, nonresidential properties or a commercial and industrial (C&I) loan plus smaller farmland secured credits.

So, the question that I am often asked is, "Have banks tightened their lending standards at the expense of generating new loans?" At first glance, it certainly would appear so, but I would like to offer a few other observations.

Financial institutions are currently redeploying their resources

The broad economy is in the throes of the worst downturn in several decades. Banks are facing annual net losses, depleting capital blocks, and rising and lingering asset quality problems. Human resource talent needed to manage the large number of nonperforming relationships and to liquidate foreclosed assets is limited and expensive. Many banks have shifted their senior credit personnel from frontline lending to the workout function. The focus today in the weaker banks, and there are many, is capital preservation and loan workout – NOT portfolio growth. The stronger banks, on the other hand, are eager to book sound loans, but many of those institutions report that demand is low.

The Race to the Bottom Phenomenon

This simply means that within a given market, the least risk-averse bank or the bank which operated under the least amount of regulatory scrutiny had a disproportionately high degree of influence over the underwriting standards of competing institutions. During the economic expansion period of 2004, 2005, and 2006, to maintain and attract customers, banks with sound codified lending standards systematically breached their own standards in the name of loan retention and loan growth. The policy exceptions mounted over time during a period of rapidly rising real estate prices and investment security values. As a result, secondary and tertiary sources of repayment in the form of real estate collateral and guarantor assets markedly improved during 2004, 2005 and 2006. My observation, and that of others in the field, suggests that lenders have not necessarily tightened their lending standards, but rather at present, firmly adhere to the standards that have been policy all along. The one exception may be in the acquisition, development and construction (ADC) segment, where many bankers are operating under a moratorium. During the 2004 to 2006 time period, lenders routinely reported that if they did not relax their standards, an existing customer would take his business across the street, and the customer had the commitment letter in hand as evidence of that option. As the policy exceptions mounted, the exceptions became the bank's de facto underwriting standard.

Banks with the weakest risk management structures have failed

Over the past several years, we have seen more than 200 community bank failures. These banks represent the institutions with the weakest risk management processes or in other words, the banks with the loosest credit standards. As these institutions cease to exist, the availability of credit also diminishes; specifically, the availability of credit to the least creditworthy borrowers.

The pool of discretionary income has diminished

At nearly ten percent unemployment, the pool of discretionary income is smaller than during the peak of the economic cycle. Once creditworthy, small businesses that depend on discretionary income may no longer qualify for credit. When the economy was peaking, these discretionary income-dependent businesses did not appear as risky to the banks. In a recession, this type of business, especially one with a weakened balance sheet, reduced income, and declining real estate collateral values, may no longer be deemed as creditworthy.

The dichotomy between hard collateral and soft collateral

The small business loan category as defined earlier may be divided into two segments – real estate (RE) secured and C&I. Of note, within all state member banks in the Fifth District with assets under $5 billion, C&I loans represent only 11.2 percent of total loans. Traditionally, bankers have preferred real estate. Real estate is immobile and historically, it has appreciated in value. Real estate is easily located, generally not difficult to value with an appraisal, and can be liquidated at the right price point. On the other hand, soft collateral, such as inventory, receivables, and equipment has not been as desirable. Inventory is mobile and can become obsolete. Receivables are intangible, difficult to track and may be difficult to collect. Equipment can be mobile and it depreciates in value. The lenders' perceptions may change due to this downturn, but I suspect they will not. Within the C&I segment are asset-based loans. So why is there so little asset-based lending (ABL) in our community banks? ABL, when monitored and controlled properly, can be expensive in terms of labor and time. It is a volume-driven business segment because of:

- Receipt, verification and analysis of borrowing base certificates;
- Lock box arrangements;
- Telephone and field audits;
- Lender knowledge of the borrower's business, cash flow cycle, inventory management system, etc.

In addition to the question concerning the availability of credit is the question regarding the volume of loan demand.

(continued on page 8)

Prosecutor Dissects Terrorism Case at Federal Reserve Conference

By Elaine Yancey

The story of how the federal government prosecuted an Islamic charity suspected of having ties to Middle East terrorism gave Fifth District bankers and law enforcement officials an inside look at how terrorism can be funded in our country.

Barry Jonas, a former Justice Department trial attorney, discussed the Holy Land Foundation case at the 2010 BSA Coalition Anti-Money Laundering Conference, held June 16 at the Federal Reserve Bank of Richmond.

Jonas, a veteran prosecutor, most recently based in the Department of Justice's Counterterrorism Section of the National Security Division, specializes in terrorism financing cases. Before joining the Counterterrorism Section, he worked 11 years prosecuting white collar cases.

Jonas commented that the Holy Land Foundation charity, founded in 1988 and, at the time, the largest Islamic charity in the United States, was providing funding to the social wing of Hamas. Hamas is a Palestinian Islamic organization with a paramilitary and socio-political wing committed to the destruction of Israel. Monies from the Foundation were used to support families of suicide bombers, prisoners, and others who were involved in terrorist activities. The Holy Land Foundation, based in Dallas, was required to close in 2001 when it was declared by the U. S. Government to be a "specially designated terrorist" organization.

Jonas said revenues generated by Hamas' social segment provided extensive health, social welfare, religious, cultural and educational services to its members. The provision of these services, and the failure by the Palestinian Authority to provide similar services, helped to indoctrinate its members into the culture of terrorism.

During the conference, Jonas was asked if information provided by the financial industry, including Suspicious Activity Reports, was helpful. He indicated that it was and that banks were cooperative. The importance of due diligence and knowing your customer was highlighted by Donna Kitchen, sponsor of the BSA Coalition.

Kitchen urged bankers to continue efforts to understand their customers' identities and to assess the risk associated with those customers. She commented that while due diligence sometimes presents challenges, it is a critical component to understanding the BSA/AML risk profile of an institution.

The 2010 BSA Coalition Anti-Money Laundering Conference was the capstone training event for the group, which also holds periodic training conference calls. The Federal Reserve serves as an advisor to the BSA Coalition as part of the Bank's ongoing efforts to improve understanding and communication about BSA, anti-money laundering, anti-terrorist financing and fraud issues. The group's website, **www.bsacoalition.org**, contains information and links to other sites designed to facilitate BSA/AML compliance and to increase awareness about **common and emerging frauds**.

Elaine Yancey is a supervisory examiner in Supervision, Regulation and Credit and is the Federal Reserve advisor to the BSA Coalition.

In The News (continued from Page 1)

place and adequate collateral is pledged, occasional, short-term use of discount window credit is granted with little administrative burden. Primary credit is extended at a rate above the target federal funds rate set by the Federal Open Market Committee.

- Secondary credit is available to depository institutions that do not qualify for primary credit. Secondary credit, if granted, is very short term with the expectation of a timely return to market funding sources or to facilitate the orderly resolution of a troubled depository institution. Secondary credit is not a minimal administration facility, as the Reserve Bank will need to obtain sufficient financial information to ensure program compliance. The secondary credit rate is 50 basis points above the primary credit rate.
- Seasonal credit is available up to nine months at a market rate to smaller depository institutions that can demonstrate a clear pattern of recurring intra-year funding fluctuations. Such depository institutions are normally located in agricultural or tourism communities.
- All discount window extensions of credit must be fully collateralized. Acceptable collateral includes most securities and loan types.

As the discount window returns to its pre-crisis role, what does this mean to Fifth District depository institutions?

- The terms for borrowings had been extended to up to 90 days since March 2008. Now the typical maximum maturity for primary credit loans has been shortened to overnight.
- The primary credit spread was lowered to a spread of 25 basis points above the target federal funds rate since March 2008.This spread is now 50 basis points.
- The Term Auction Facility, an auctioning of discount window credit to eligible depository institutions, has provided billions in liquidity since December 2007. This program has now been discontinued.

If you have any questions about the changes to the discount window lending programs or would like to discuss establishing discount window access, Credit Risk Management staff can be reached at 1-800-526-2036. Additionally, our website is **www.frbdiscountwindow.org**. The website provides downloadable borrowing documents, frequently asked questions, and information on acceptable collateral.

Newsletter Advisory Committee Members

Laura Blanton
Jennifer Burns
Monica Coles
Anne Gossweiler
Meg Johnson
Rhiannon Liker
Ailsa Long
Jim Lucas
Christin Patel
Winifred Patterson
Rick Pearman
Tim Pudner
Mike Riddle
Diane Rose
Jim Strader
Donna Thompson
Elaine Yancey

Outreach Update (continued from Page 6)

Less not more

As sales decline in a down market, businesses typically reduce inventory, lay off employees and delay capital expenditures. Consequently, some small businesses require less credit as their balance sheet shrinks due to lower inventory levels and fewer receivables and their expenditures, such as payroll, decline.

Sources of seed capital have disappeared

In any new venture, sound underwriting requires that the potential borrower have an equity stake in the business. The typical sources of seed capital for the small business entrepreneur include:

- Equity in home;
- Monies from family and friends;
- Savings and retirement accounts;
- Credit card.

In general, all of these sources have been adversely impacted by the downturn. Many aspiring small business owners simply do not have access to the seed capital, and bankers are not going to finance 100 percent of a start-up venture.

There are many factors affecting the supply of and demand for credit. The notion that community banks *en masse* have amended their underwriting standards to restrict credit to creditworthy borrowers is not supported by examiner observation.

Furthermore, examiners neither encourage nor discourage any particular category of loan as long as it is structured appropriately, complies with sound policy, risk management practices, laws, and regulations and repayment of principal and interest is reasonably assured. Finally, the bank examiners are keenly aware that their assessments may have significant impact on both the banks and the employees of the bank. Given that jobs are on the line and even the viability of the bank itself, the examiners take this responsibility very seriously.

John Wiatt is a supervisory examiner in credit risk with the Federal Reserve Bank of Richmond.

Recent Guidance

SR 10-12
Interagency Supervisory Guidance on Bargain Purchases and FDIC- and NCUA-Assisted Acquisitions

SR 10-11
Interagency Examination Procedures for Reviewing Compliance with the Unlawful Internet Gambling Enforcement Act of 2006

SR 10-10
Interagency Guidance on Correspondent Concentration Risk

SR 10-9
Release of the Revised Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering Examination Manual

SR 10-8
Suspicious Activity Report Filing Requirements for Banking Organizations Supervised by the Federal Reserve

SR 10-7
Comments to the Basel Committee on Banking Supervision Regarding Proposals to Strengthen the Resiliency of the Banking Sector

SR 10-6
Interagency Policy Statement on Funding and Liquidity Risk Management

CA 10-5
Interagency Examination Procedures Regarding the Duties of Furnishers of Information

CA 10-4
Submission of Consumer Credit Card Agreements

CA 10-3
Lapse of FEMA's Authority to Issue Flood Insurance Contracts

Regulatory Reform RESOURCES

Issues in Regulatory Reform

Regulatory Reform Legislation

Quick Links

Click the links below to view more information

Bankers Education

Community Banking Forum

External SRC Events

Board of Governors

E-Apps

Federal Reserve Bank of Richmond

Fifth District Indicators

Median Summary Statistics for Fifth District Commercial Banks (as of 3/2/2010)			
	Fifth District Commercial Banks		
	2009 Q4	2009 Q3	2008 Q4
Capital			
Total Equity Capital/Total Assets	9.61	9.84	9.68
Tier One Leverage Ratio	9.20	9.34	9.28
Total Risk Based Capital Ratio	13.53	13.58	13.06
Earnings			
Return on Average Assets	0.23	0.28	0.44
Net Interest Margin	3.62	3.56	3.71
Provision for Loan Losses/Average Assets	0.74	0.60	0.44
Balance Sheet Structure			
Total Loans/Total Deposits	87.22	88.78	95.08
Federal Home Loan Bank Advances/Total Liabilities	4.58	4.68	6.81
CDs Greater than $100,000/Total Deposits	21.82	21.63	19.76
Total Commercial Real Estate Loans/Total Equity	218.31	225.63	236.19
Total Construction and Land Development/Total Equity	91.03	95.27	109.32
Residential First Mortgages/Total Loans	21.96	21.94	21.34
Credit Quality			
Past Due Loans 30-89 Days/Total Loans	1.38	1.37	1.37
Past Due Loans 90+ Days/Total Loans	0.03	0.05	0.04
Nonaccrual Loans/Total Loans	1.91	1.58	1.01
Other Real Estate Owned/Total Loans	0.42	0.37	0.15
Loan Loss Reserve/Total Loans	1.50	1.43	1.30

** All Numbers Are Percentages. State member banks are commercial banks headquartered in the Fifth District that are state chartered and are members of the Federal Reserve System. Fifth District banks include all commercial banks headquartered in the Fifth District (nationally chartered, state chartered that are members of the Federal Reserve, and state chartered that are not members of the Federal Reserve).*

Fifth District Indicators

Aggregate Banking Statistics For 2009 Q4 (as of 3/2/2010)					
	Fifth District Commercial Banks				
	Number of Institutions	Total Assets	Total Loans	Total Liabilities	Total Equity
Virginia State Member Banks	66	$ 37,232,656	$ 28,141,415	$ 33,300,876	$ 3,910,948
Virginia Commercial Banks	106	$ 392,781,911	$ 211,665,108	$ 341,942,051	$ 50,807,643
West Virginia State Member Banks	11	$ 5,825,862	$ 4,253,705	$ 5,279,646	$ 506,476
West Virginia Commercial Banks	55	$ 18,414,475	$ 13,158,080	$ 16,643,736	$ 1,691,100
North Carolina State Member Banks	6	$ 29,575,834	$ 21,463,926	$ 26,085,241	$ 3,490,593
North Carolina Commercial Banks	75	$ 2,219,498,972	$ 1,254,507,252	$ 1,955,694,271	$ 258,646,860
South Carolina State Member Banks	1	$ 748,471	$ 569,198	$ 686,345	$ 62,126
South Carolina Commercial Banks	67	$ 48,568,806	$ 34,320,018	$ 44,175,032	$ 4,393,716
Maryland State Member Banks	14	$ 9,535,006	$ 6,925,964	$ 8,604,777	$ 930,230
Maryland Commercial Banks	49	$ 23,569,550	$ 17,163,243	$ 21,293,651	$ 2,275,899
DC State Member Banks	0	$ -	$ -	$ -	$ -
DC Commercial Banks	5	$ 1,490,849	$ 978,854	$ 1,332,294	$ 158,555
Total Fifth District State Member Banks	98	$ 82,917,829	$ 61,354,208	$ 73,956,885	$ 8,900,373
Total Fifth District Commercial Banks	357	$ 2,704,324,563	$ 1,531,792,555	$ 2,381,081,035	$ 317,973,773
** All Dollar Amounts are in thousands.*					