FFIEC Statement on the Impact of Drought Conditions on Financial Institutions

Attention: Chief Executive Officer of Each Tenth District State Member Bank and Bank Holding Company


In Brief: This Federal Financial Institutions Examination Council (FFIEC) statement applies to all banking organizations with borrowers or customers that have been adversely impacted by severe drought. Specifically, the statement encourages these financial institutions to use prudent methods in order to work with customers as they recover from drought conditions.

Highlights: As a result of the 2012 drought, crop yields have declined significantly. Livestock and dairy producers have also been negatively impacted due to higher grain prices. The FFIEC strongly encourages financial institutions to work constructively with borrowers impacted by drought conditions, noting that prudent loan modification efforts can help to stabilize borrowers. The statement highlights several alternatives that may be considered.

If drought conditions persist, some agricultural borrowers may be faced with carryover debt that requires a comprehensive review of their financial condition and implementation of a prudent loan workout arrangement. FFIEC supports financial institutions’ efforts to help agricultural borrowers recover and be better positioned to honor their obligations as conditions improve. According to the statement, examiners will consider the unusual circumstances institutions and their borrowers are facing, and institutions that implement prudent loan workout arrangements will not be subject to criticism for engaging in these efforts. Institutions should be mindful that all modifications of existing loans, however, should be individually evaluated to determine if they require reporting as troubled debt restructurings.


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Internet: A copy of SR 12-13 and the FFIEC Statement are available on the board’s web site at: http://www.federalreserve.gov/bankinforeg/srletters/srI213.htm
TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

SUBJECT: FFIEC Statement on the Impact of Drought Conditions on Financial
Institutions

**Applicability to Community Banking Organizations:** This guidance applies to state member banks, bank holding companies, and savings and loan holding companies with agriculture-related customers and borrowers affected by drought conditions, including those institutions with $10 billion or less in consolidated assets.

The Federal Reserve, along with the other members of the Federal Financial Institutions Examination Council (FFIEC),¹ is issuing the attached statement to regulated financial institutions to encourage them to work with their customers and borrowers who have been adversely affected by severe drought conditions across much of the Midwest and southern portions of the United States.

As discussed in the statement, these drought conditions have resulted in lower crop yields and higher feed prices that have had a negative impact on some agriculture-related borrowers’ ability to service their debt. Therefore, regulated financial institutions are encouraged to consider prudent modifications to these borrowers’ production and other loans to aid them in recovering from drought conditions. Further, the Federal Reserve has instructed its examiners that financial institutions engaged in prudent loan workouts should not be subject to criticism even if a restructured loan has weaknesses resulting in an adverse classification.

Federal Reserve Banks are asked to distribute this letter to regulated financial institutions in their districts that may be affected by these drought conditions, as well as to supervisory and examination staff. Questions about this letter may be directed to Donald Gabbai, Senior Supervisory Financial Analyst, at (202) 452-3358; or Mary Aiken, Manager, at (202) 721-4534,

¹ The FFIEC member organizations include the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Consumer Financial Protection Bureau, and the State Liaison Committee.
Credit, Market and Liquidity Risk Policy, in the Division of Banking Supervision and Regulation. In addition, questions may be sent via the Board’s public website.²

Michael S. Gibson
Director

Attachment

• *FFIEC Statement on the Impact of Drought Conditions on Financial Institutions*

The Federal Financial Institutions Examination Council ("FFIEC") is issuing this 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.

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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 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.

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.