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Inside

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Issue at a Glance

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Articles

An increasing number of financial institutions are entering deposit relationships with third-party payment processors that effect payment transactions for merchant clients. This activity can expose institutions to risks not present in other commercial customer relationships. This article explains the role of third-party payment processors, identifies warning signs that may indicate heightened risk in a payment processor relationship, and discusses the controls that should be in place to manage this risk.
(Revised July 2014)

Regular Features

The FDIC encourages banks to lend to creditworthy small businesses. The guaranty that accompanies a Small Business Administration (SBA) loan is increasingly attractive to banks looking to expand lending opportunities. Banks that wish to participate in SBA lending programs need to develop specialized expertise. This article reviews the SBA products lenders most often use and provides useful information for institutions about the technical requirements for underwriting, servicing, risk grading, liquidating and selling SBA loans. The article also provides information that may be helpful for examiners when reviewing bank SBA loan portfolios.

This feature provides an overview of recently released regulations and supervisory guidance.

Letter from the Director

As the economic recovery continues to take hold across the country, many banks are exploring ways to increase revenues and expand small business lending. Lending programs offered by the Small Business Administration (SBA) provide an opportunity for banks to lend to small businesses while benefiting from an SBA guaranty. "SBA Lending: Insights for Lenders and Examiners" provides useful information for institutions interested in participating in the SBA program. This article describes the technical underwriting, servicing, and liquidation requirements associated with SBA loan products and provides helpful information for examiners when reviewing bank SBA loan portfolios.

An increasing number of financial institutions are entering into deposit relationships with third-party payment processors that effect payment transactions for merchant clients. As described in "Managing Risks in Third-Party Payment Processor Relationships," this activity can expose institutions to risks not present in other commercial customer relationships. This article explains the role of third-party payment processors, identifies warning signs that may indicate heightened risk in a payment processor relationship, and discusses the controls that should be in place to manage this risk. The article concludes with an overview of supervisory remedies that may be used when it is determined a financial institution does not have an adequate program to monitor and mitigate the risks.

We hope you find the articles in this issue to be informative and useful. We encourage our readers to provide feedback and suggest topics for future issues. Please e-mail your comments and suggestions to SupervisoryJournal@fdic.gov.

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Managing Risks in Third-Party Payment Processor Relationships

During the past few years, the Federal Deposit Insurance Corporation (FDIC) has observed an increase in the number of deposit relationships between financial institutions and third-party payment processors and a corresponding increase in the risks associated with these relationships. Deposit relationships with payment processors can expose financial institutions to risks not present in typical commercial customer relationships, including greater strategic, credit, compliance, transaction, legal, and reputation risk. It was for this reason in 2008 that the FDIC issued *Guidance on Payment Processor Relationships* which outlines risk mitigation principles for this type of higher-risk activity.[1]

Although many payment processors effect legitimate payment transactions for a variety of reputable merchants, an increasing number of processors have been initiating payments for abusive telemarketers, deceptive online merchants, and organizations that engage in high risk or illegal activities. In the absence of adequate monitoring systems and controls, a financial institution could be facilitating unauthorized transactions or unfair or deceptive practices resulting in financial harm to the consumer. Therefore, it is essential that financial institutions and examiners recognize and understand the risks associated with these relationships.

This article explains the role of third-party payment processors and the risks they can present to financial institutions, identifies warning signs that may indicate heightened risk in a payment processor relationship, and discusses the risk mitigation controls that should be in place to manage this risk. The article concludes with an overview of supervisory remedies that may be used when it is determined that a financial institution does not have an adequate program in place for monitoring and addressing the risks associated with third-party payment processor relationships.

Background

The core elements of managing third-party risk are present in payment processor relationships (e.g., risk assessment, policies and procedures, due diligence, and oversight). Managing these risks can be particularly challenging as the financial institution does not have a direct customer relationship with the payment processor's merchant clients. Furthermore, the risks associated with this type of activity are heightened when neither the payment processor nor the financial institution performs adequate due diligence, such as verifying the identities and business practices of the merchants for which payments are originated and implementing a program of ongoing monitoring for suspicious activity.

For example, in a typical third-party payment processor relationship, the payment processor is a deposit customer of the financial institution which uses its deposit account to process payments for its merchant clients. The payment processor receives lists of payments to be generated by the merchant clients for the payment of goods or services and initiates the payments by creating and depositing them into a transaction account at a financial institution. In some cases, the payment processor may establish individual accounts at the financial institution in the name

[1] Financial Institution Letter (FIL) 127-2008, *Guidance on Payment Processor Relationships,* dated November 7, 2008. See: http://www.fdic.gov/news/news/financial/2008/fil08127.html.

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of each merchant client and deposit the appropriate payments into these accounts. The merchant may then be a co-owner of the deposit account and make withdrawals from the account to receive its sales proceeds, or the payment processor may periodically forward the sales proceeds from the account to the merchant. Alternatively, the payment processor may commingle payments originated by the merchant clients into a single deposit account in the name of the payment processor. In this case, the payment processor should maintain records to allocate the deposit account balance among the merchant clients.

Payment Types Used by Third-Party Payment Processors

Payment processors may offer merchants a variety of alternatives for accepting payments including credit and debit card transactions, traditional check acceptance, Automated Clearing House (ACH) debits and other alternative payment channels. The potential for misuse or fraud exists in all payment channels. However, the FDIC has observed that some of the most problematic activity occurs in the origination of ACH debits or the creation and deposit of remotely created checks.

Automated Clearing House Debits

The ACH network is a nationwide electronic payment network which enables participating financial institutions to distribute electronic credit and debit entries to bank accounts and settle these entries.

Common ACH credit transfers include the direct deposit of payroll and certain benefits payments. Direct debit transfers also may be made through the ACH network and include consumer payments for insurance premiums, mortgage loans, and other types of bills. Rules and regulations governing the ACH networks are established by NACHA - The Electronic Payments Association (formerly National Automated Clearing House Association)[2] and the Board of Governors of the Federal Reserve System.

Third-party payment processors initiate ACH debit transfers as payments for merchant clients by submitting these transfers, which contain the consumer's financial institution routing number and account number (found at the bottom of a check) to their financial institution to enter into the ACH networks. Telemarketers and online merchants obtain this information from the consumer and transmit it to the payment processor to initiate the ACH debit transfers. The risk of fraud arises when an illicit telemarketer or online merchant obtains the consumer's account information through coercion or deception and initiates an ACH debit transfer that may not be fully understood or authorized by the consumer.

As with all payment systems and mechanisms, the financial institution bears the responsibility of implementing an effective system of internal controls and ongoing account monitoring for the detection and resolution of fraudulent ACH transfers. If an unauthorized ACH debit is posted to a consumer's account, the procedures for resolving errors contained in the Federal Reserve Board's Regulation E,

[2] NACHA establishes the rules and procedures governing the exchange of automated clearinghouse payments. See http://www.nacha.org/c/achrules.cfm.

which governs electronic funds transfers,[3] provide the consumer 60 days after the financial institution sends an account statement to report the unauthorized ACH debit.[4] Regulation E requires the consumer's financial institution to investigate the matter and report to the consumer the results of the investigation within a prescribed time frame. In the case of an ACH debit, when a consumer receives a refund for an unauthorized debit, ACH rules permit the consumer's financial institution to recover the amount of the unauthorized payment by returning the debit item to the originating financial institution.

Remotely Created Checks

Remotely Created Checks (RCCs), often referred to as "demand drafts," are payment instruments that do not bear the signature of a person on whose account the payments are drawn. In place of the signature, the RCC bears the account holder's printed or typed name, or a statement that the accountholder's signature is not required or the account holder has authorized the issuance of the check. Similar to the initiation of an ACH debit transfer, an account holder authorizes the creation of an RCC by providing his financial institution's routing number and his account number. Examples of RCCs are those created by a credit card or utility company to make a payment on an account, or those initiated by telemarketers or online merchants to purchase goods or services.

The risk of fraud associated with RCCs is often greater than the risk associated with other kinds of debits that post to transaction accounts. For example, an illicit payment originator might obtain a consumer's account information by copying it from an authorized check or misleading the consumer into providing the information over the telephone or the Internet. Once the necessary information is obtained, the payment originator can generate unauthorized RCCs and forward them for processing. Similar to the responsibilities associated with the ACH network, the financial institution should implement an effective system of internal controls and account monitoring to identify and resolve the unauthorized RCC.

RCCs may be processed as a paper item through the customary clearing networks or converted to and processed as an ACH debit. However, check clearing and ACH rules differ as to the re-crediting of an accountholder for an unauthorized RCC and how losses are allocated by and between the participating financial institutions. RCCs processed as checks are governed by provisions of the Uniform Commercial Code (UCC) and the Expedited Funds Availability Act,[5] as implemented by Regulation CC. RCCs converted to ACH debits are governed by applicable ACH rules, the Electronic Fund Transfer Act, and Regulation E.

In response to heightened concern about the risk of fraud, in 2005 the Federal Reserve amended Regulation CC to transfer the liability for losses

[3] Provisions of the Federal Reserve Board's Regulation E establish the rights, liabilities, and responsibilities of participants in electronic fund transfer systems, such as automated teller machine transfers, telephone bill-payment services, point-of-sale terminal transfers, and preauthorized transfers from or to a consumer's account.

[4] 12 CFR Section 205.11.

[5] The Expedited Funds Availability Act (EFAA), enacted in 1987, addresses the issue of delayed availability of funds by banks. The EFAA requires banks to (1) make funds deposited in transaction accounts available to customers within specified time frames, (2) pay interest on interest-bearing transaction accounts not later than the day the bank receives credit, and (3) disclose funds-availability policies to customers.

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resulting from unauthorized RCCs.[6] At the same time, the Board also amended Regulation J (the Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire) to clarify that certain warranties, similar to those provided under the UCC, apply to RCCs collected through the Reserve Banks. In conjunction with Regulation CC, the amendments to Regulation J shifted the liability for losses attributed to unauthorized RCCs to the financial institution where the check is first deposited as this institution is in the best position to know its customer (the creator of the RCC) and determine the legitimacy of the deposits. The liability also creates an economic incentive for depository institutions to perform enhanced due diligence on those customers depositing RCCs. Furthermore, by providing the paying financial institution with the ability to recover against the financial institution presenting the unauthorized RCC, these regulatory changes should make it easier for customers to obtain re-credits.[7]

Types of High Risk Payments

Although many clients of payment processors are reputable merchants, an increasing number are not and should be considered "high risk." These disreputable merchants use payment processors to charge consumers for questionable or fraudulent goods and services. Often a disreputable merchant will engage in high pressure and deceptive sales tactics, such as aggressive telemarketing or enticing and misleading pop-up advertisements on Web sites. For example, consumers should be cautious when Web sites offer "free" information and ask consumers to provide payment information to cover a small shipping and handling fee. In some instances and without proper disclosure, consumers who agreed to pay these fees, often found their bank accounts debited for more than the fee and enrolled in costly plans without their full understanding and consent.[8] Still other disreputable merchants will use processors to initiate payments for the sale of products and services, including, but not limited to, unlawful Internet gambling and the illegal sale of tobacco products on the Internet.

Generally, high-risk transactions occur when the consumer does not have a familiarity with the merchant, or when the quality of the goods and services being sold is uncertain. Activities involving purchases made over the telephone or on the Internet tend to be riskier in that the consumer cannot fully examine or evaluate the product or service purchased. Similarly, the consumer may not be able to verify the identity or legitimacy of the person or organization making the sale.

[6] Effective July 1, 2006 [70 Fed. Reg. 71218-71226 (November 28, 2005)].

[7] Changes to Federal Reserve Bank Operating Circular No. 3 on the Collection of Cash Items and Returned Checks clarifies that electronically created images (including RCC items) that were not originally captured from paper are not eligible to be processed as Check 21 items (effective July 15, 2008), www.frbservices.org/files/regulations/pdf/operating_circular_3.pdf.

[8] Rules governing the use of telemarketing require verifiable authorization of payment for services. See the Federal Trade Commission Telemarketing Sales Rule [16 CFR 310]. See: http://www.ftc.gov/os/2002/12/tsrfinalrule.pdf.

Of particular concern, the FDIC and other federal regulators have seen an increase in payment processors initiating payment for online gaming activities that may be illegal. The Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) prohibits financial institutions from accepting payments from any person engaged in the business of betting or wagering with a business in unlawful Internet gambling (see the FDIC's Financial Institution Letter on the *Unlawful Internet Gambling Enforcement Act,* FIL-35-2010, dated June 30, 2010).[9]

High-Risk Payment Processor Relationship Warning Signs

Financial institutions and examiners should be aware of the warning signs that may indicate heightened risk in a payment processor relationship. One of the more telling signs is a high volume of consumer complaints that suggest a merchant client is inappropriately obtaining personal account information; misleading customers as to the quality, effectiveness, and usefulness of the goods or services being offered; or misstating the sales price or charging additional and sometimes recurring fees that are not accurately disclosed or properly authorized during the sales transaction. However, this may be somewhat difficult to determine in that it may be almost

[9] 12 CFR Part 233 – Regulation GG, Financial Institution Letter (FIL) 35-2010, *Unlawful Internet Gambling Enforcement Act,* dated June 30, 2010. See http://www.fdic.gov/news/news/financial/2010/fil10035.html.

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impossible for financial institutions and examiners to know if consumers are submitting complaints directly to the payment processor or the merchants. One way financial institutions and examiners can determine if consumers are making complaints or voicing their dissatisfaction is to review certain Web sites, such as those for regional Better Business Bureaus, or blogs intended to collect and share such information to alert other consumers.

Financial institutions with third-party payment processor relationships should consider monitoring the Internet for complaints that mention them by name. The financial institution's name typically appears on the face of a RCC or in the record of an ACH debit. As a result, consumers often associate the financial institution with the transaction and may complain about the institution facilitating the payment. Complaints also may be lodged with the depository financial institution by the financial institution of the consumer whose account was charged. As required by statute and federal regulation, the depository financial institution must acknowledge, research, and respond to each complaint made directly to them.

Another indication of the potential for heightened risk in a payment processor relationship is a large number of returns or charge backs. Consumers who are dissatisfied with goods or services delivered or provided, or consumers who feel they were deceived or coerced into providing their account information, can request their financial institution return the RCC or ACH debit to the depository financial institution as an unauthorized transaction. In addition, items may be returned if insufficient funds are available to cover the unauthorized items, resulting in the consumer's account being overdrawn. In these circumstances, the items often are returned as "NSF" rather than as "unauthorized." Accordingly, financial institutions with payment processor relationships should implement systems to monitor for higher rates of returns or charge backs, which can be evidence of fraudulent activity.

Another warning sign is a significant amount of activity which generates a higher than normal level of fee income. In an increasingly competitive market place, financial institutions are looking for ways to grow non-interest fee income, and this is especially true for troubled institutions. Although fee income from third-party payment processor relationships may benefit an institution's bottom line, it can indicate an increased level of risk. Side agreements may be established between payment processors and financial institutions, whereby the payment processor pays the institution a fee for each item deposited, generating a higher level of fee income. However, the greatest source of income from these relationships tends to be returned item fees. Financial institutions routinely charge deposit customers a fee for each returned item. Because payment processors may generate a high volume of returned items, the fee income associated with this activity is typically much higher.

As a caveat, financial institutions and examiners should be alert for payment processors that use more than one financial institution to process merchant client payments, or nested arrangements where a payment processor's merchant client is also doing third-party payment processing. Spreading the activity among several institutions may allow processors that engage in inappropriate activity to avoid detection. For example, a single institution may not detect high levels of returned items if they are spread among several financial institutions.

Payment processors also may use multiple financial institutions in case one or more of the relationships is terminated as a result of suspicious activity.

Finally, another troubling development is payment processors that purposefully solicit business relationships with troubled institutions in need of capital. Payment processors identify and establish relationships with troubled institutions as these institutions may be more willing to engage in higher-risk transactions in return for increased fee income. In some cases, payment processors have made a commitment to purchase stock in certain troubled financial institutions or guarantee to retain a large deposit with the institution, thereby providing additional, needed capital. Often, the targeted financial institutions are smaller, community banks that lack the infrastructure to properly manage or control a third-party payment processor relationship.

Risk Controls

A framework for prudently managing relationships with third-party payment processors was communicated in the FDIC's 2008 *Guidance on Payment Processor Relationships.*[10] Financial institutions in relationships with payment processors should establish clear lines of responsibility for controlling the associated risks. Such responsibilities include effective due diligence and underwriting, as well as ongoing monitoring of high-risk accounts for an increase in unauthorized returns and suspicious activity and maintenance of adequate balances or reserves to cover expected high levels of returned items. The relationship should be governed by a written contract between the financial institution and the third-party payment processor which outlines each party's duties and responsibilities. Implementing appropriate and effective controls over payment processors and their merchant clients will help identify those processors working with fraudulent telemarketers or other unscrupulous merchants and help ensure the financial institution does not facilitate such transactions.

Due Diligence and Underwriting

Due diligence and prudent underwriting standards are critical components of a risk mitigation program. Financial institutions should implement policies and procedures that reduce the likelihood of establishing or maintaining a relationship with payment processors through which unscrupulous merchants can access customers' deposit accounts.

Financial institutions that initiate transactions for payment processors should develop a processor approval program that extends beyond credit risk management. This program should incorporate an effective due diligence and underwriting policy that, among other things, requires background checks of payment processors and merchant clients. A processor approval program will help validate the activities, creditworthiness, and business practices of the payment processor and should, at a minimum,

[10] Financial Institution Letter (FIL) 127-2008, *Guidance on Payment Processor Relationships,* November 7, 2008, http://www.fdic.gov/news/news/financial/2008/fil08127.html.

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authenticate the processor's business operations and assess the entity's risk level. Any processor assessment should include:

- Reviewing the processor's promotional materials, including its Web site, to determine the target clientele.
- Determining if the processor re-sells its services to "Independent Sales Organizations" (companies contracted to procure new merchant relationships) or through "gateway arrangements" (selling excess capacity to third parties, which in turn sell services to other individuals unknown to the payment processor).
- Reviewing the processor's policies, procedures, and processes to determine the adequacy of due diligence standards for new merchants.
- Identifying the major lines of business and volume for the processor's customers.
- Determining whether the institution maintains appropriate balances or reserves for each individual merchant based on the type of client and the risk involved in the transactions processed and the expected volume of returned items.
- Reviewing corporate documentation, obtaining information on the processor from independent reporting services and, if applicable, documentation on principal owners.
- Visiting the processor's business operations center.
- Requesting copies of consumer complaints and the procedures for handling consumer complaints and redress.
- Obtaining information pertaining to any litigation and actions brought by federal, state, or local regulatory or enforcement agencies.
- Obtaining information about the history of returned items and customer refunds.

Financial institutions should require the payment processor to provide information on its merchant clients, such as the merchant's name, principal business activity, geographic location, and sales techniques. Additionally, financial institutions should verify directly, or through the payment processor, that the originator of the payment (i.e., the merchant) is operating a legitimate business. Such verification could include comparing the identifying information with public record, fraud databases and a trusted third party, such as a credit report from a consumer reporting agency or the state Better Business Bureau, or checking references from other financial institutions.

Ongoing Monitoring

Financial institutions are required to have a Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance program and appropriate policies, procedures, and processes in place for monitoring, detecting, and reporting suspicious activity.[11] However, non-bank payment processors generally are not subject to BSA/AML regulatory requirements and, therefore, some payment processors may be vulnerable to money laundering, identity theft, fraud schemes, and illicit transactions. The Federal Financial Institutions Examination Council BSA/AML Examination Manual urges financial institutions to effectively assess and manage risk with respect to third-party payment processors. As a result, a financial institution's risk mitigation program should include procedures for monitoring payment processor information, such as merchant data, transaction volume, and charge-back history.[12]

Appropriate Supervisory Responses

In those instances where examiners determine that a financial institution fails to have an adequate program in place to monitor and address risks associated with third-party payment processor relationships, formal or informal enforcement actions may be appropriate. Formal actions have included Cease and Desist Orders under Section 8(b) or 8(c) of the *Federal Deposit Insurance (FDI) Act*, as well as assessment of Civil Money Penalties under Section 8(i) of the FDI Act. These orders have required the financial institution to immediately terminate the high-risk relationship and establish reserves or funds on deposit to cover anticipated charge backs.

As appropriate, the examiner will determine if financial institution management has knowledge that the payment processor or the merchant clients are engaging in unfair or deceptive practices in violation of Section 5 of the Federal Trade Commission Act. In those cases where a financial institution does not conduct due diligence, accepts a heightened level of risk, and allows transactions for high-risk merchants to pass though it, it may be determined that the financial institution is aiding and abetting the merchants. This also could indicate a disregard for the potential for financial harm to consumers and, as a result, the financial institution may be subject to civil money penalties or required to provide restitution.

[11] Banks, bank holding companies, and their subsidiaries are required by federal regulations to file a Suspicious Activity Report if they know, suspect, or have reason to suspect the transaction may involve potential money laundering or other illegal activity, is designed to evade the Bank Secrecy Act or its implementing regulations, has no business or apparent lawful purpose, or is not the type of transaction in which particular customer would normally be expected to engage. See 12 CFR 353 (http://www.ffiec.gov/bsa_aml_infobase/pages_manual/regulations/12CFR353.htm) and 31 CFR 103.18 (http://www.ffiec.gov/bsa_aml_infobase/pages_manual/regulations/31CFR103.pdf.)

[12] See "Third-Party Payment Processors—Overview," from the Bank Secrecy Act/Anti-Money Laundering Examination Manual, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_063.htm.

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Conclusion

Deposit relationships with payment processors expose financial institutions to risks that may not be present in relationships with other commercial customers. To limit potential risks, financial institutions should implement risk mitigation policies and procedures that include appropriate oversight and controls commensurate with the risk and complexity of the activities. At a minimum, risk mitigation programs should result in the financial institution assessing its risk tolerance for this type of activity, verifying the legitimacy of the payment processor's business operations, and monitoring payment processor relationships for suspicious activity.

Financial institutions should act promptly if they believe fraudulent or improper activities have occurred related to a payment processor's activities. Appropriate actions may include filing a Suspicious Activity Report, requiring the payment processor to cease processing for that specific merchant, or terminating the financial institution's relationship with the payment processor. Should it be determined that a financial institution does not have an adequate program in place to monitor and address the risks associated with third-party payment processor relationships, an appropriate supervisory response will be used to require the financial institution to correct the deficiencies.

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From the Examiner's Desk: SBA Lending: Insights for Lenders and Examiners

This regular feature focuses on developments that affect the bank examination function. We welcome ideas for future columns. Readers are encouraged to e-mail suggestions to SupervisoryJournal@fdic.gov.

The FDIC encourages banks to lend to creditworthy small businesses, and Small Business Administration (SBA) loans provide an avenue for small business lending that is of interest to many institutions. To participate in SBA lending, lenders must be knowledgeable about the products, rules, and documentation specific to SBA loan programs. This article provides useful information that will help lenders successfully navigate the requirements related to underwriting, servicing, and selling SBA loans.

In the wake of the financial crisis, community banks are looking for ways to stabilize and increase revenue and expand lending opportunities to small businesses to help reinvigorate local economies. As a result, interest in Small Business Administration (SBA) lending programs is growing. Created in 1953, the SBA provides support to small businesses through entrepreneurial development, government contracting, advocacy, and access to capital. This article provides information that may be of use to bankers involved in SBA lending and examiners involved in reviewing these activities.

Small businesses are a critical driver in the U. S. economy and access to credit is an important component to support their operations. However, these firms often lack sufficient collateral to pledge or require longer repayment periods on loans than most lenders can prudently provide. The federal banking agencies recognize the importance of credit availability to creditworthy small businesses and other borrowers, and have issued industry guidance to encourage prudent lending.[1]

Addressing the current credit needs of local communities, combined with a goal by some institutions to reduce reliance on higher-risk land development and speculative single-family residential construction lending, have made commercial and industrial (C&I) lending - particularly to small businesses - increasingly attractive to smaller institutions. However, for some community banks, increasing C&I lending can present challenges to loan officers unfamiliar with this business line and can heighten the risk of loss to a bank's portfolio.

SBA lending, traditionally focused on C&I lending, offers a wide range of products and requires specialized expertise to manage the risks and minimize potential losses. SBA products are intended to minimize the risk and increase the profitability of small-business loans by encouraging lenders to loan against lower collateral values and offer longer repayment periods. The SBA guaranty, while an attractive feature, is conditional,[2] and a lender's ability to obtain the guaranty is subject to specific rules requiring considerable documentation (referred to henceforth as

[1] *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* (FIL-5-2010, February 12, 2010, http://www.fdic.gov/news/news/financial/2010/fil10005.html) and *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* (FIL-128-2008, November 12, 2008, http://www.fdic.gov/news/news/financial/2008/fil08128.html).

[2] However, when the guaranteed portion of an SBA loan is transferred to an investor in the secondary market, the SBA's guaranty becomes unconditional as it applies to the investor.

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"The Rules").[3] This article focuses on the SBA products lenders most often use and the requirements for underwriting, servicing, risk grading, liquidating, and selling SBA loans.

SBA Lending Products

The SBA is well known for the guaranty programs it administers, including 504 and 7(a) programs. (See Chart 1 for information on the volume of 504 and 7(a) loans outstanding since 2002.) The 504 Loan Program provides small businesses with long-term financing to acquire major fixed assets, such as real estate, machinery, and equipment. Typically, lenders will finance 50 percent of the acquisition with a senior lien. The business will provide at least 10 percent equity and the remaining balance is financed by a Certified Development Company (CDC) with a second lien. A CDC is a private, nonprofit corporation that contributes to local economic development. The CDC receives funding from a debenture that is 100 percent guaranteed by the SBA. The advantage under this program is that the CDC portion is a fixed, below market rate loan for 20 years.

The 7(a) Loan Program features a range of products, including standard, special-purpose, express, export, and rural business loans. These loans are funded by lenders and conditionally guaranteed by the SBA. Banks participate in 7(a) Loan Programs as a regular, certified, preferred, SBAExpress, or Patriot Express lender and must submit applications to the SBA to receive approval for these designations. Each designation provides lenders with varying degrees of authority and responsibility. The preferred, SBAExpress, and Patriot Express designations allow lenders to make loan approval decisions without prior review by the SBA; lenders must be approved for these designations every two years. The SBA makes all loan approval decisions under the regular and certified designations. The most widely used 7(a) programs are standard and SBAExpress loans.

As of May 2011, Standard 7(a) program loans are for a maximum of $5,000,000 with a guaranty of no more than $3,750,000 or 75 percent of the loan amount. Standard loan terms can be up to 25 years for real estate, up to 10 years for equipment, and up to 7 years for working capital.[4] Interest rates are based on published indices as well as the size and maturity of the loan.

The SBA Express program features an accelerated loan approval process. As of May 2011, the guaranty is 50 percent of the loan amount, and the maximum loan is $1,000,000.[5] The advantage is that lenders can use their own closing documents – rather than SBA closing documents – which saves time and expense. This program also allows lenders to fund lines of

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[3] These requirements are outlined in Standard Operating Procedures (SOPs), official notices, and procedural guides for each program (referred to in this article collectively as "The Rules"). SOPs cover policies and procedures for all guaranteed lending program and include SOP 50 10 (Credit/Underwriting), SOP 50 50 (Servicing), and SOP 50 51 (Liquidation). Notices provide information or update policy and procedures. The Rules are very detailed, and lenders should check regularly for updates. The Rules are subject to change, and a guaranty is subject to The Rules outstanding at origination. If The Rules have been updated since origination, examiners should refer to The Rules outstanding at origination.

[4] Terms are subject to change. For current terms, refer to the SBA Program Matrix at http://www.sba.gov/partners/lenders/7a-loan-program/terms-conmditions-eligibility.

[5] See footnote 4.

credit up to 7 years, which is not allowed under the standard program.

Requirements for underwriting, servicing, risk grading, and liquidating SBA loans often differ from those for conventional lending programs. As a result, lenders should identify and understand these requirements and develop an SBA lending program that includes opportunities for ongoing training.

Underwriting SBA Loans

The 7(a) Program is primarily designed to support loans that have a reasonable assurance of timely repayment but that may have weaker collateral protection. The Rules state the underwriting requirements, including:

> *Lenders must analyze each application in a commercially reasonable manner, consistent with prudent lending standards. On SBA-guaranteed loans, the cash flow of the Small Business Applicant is the primary source of repayment, not the liquidation of collateral. Thus, if the lender's financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available.* (SOP 50 10 5 (C), Chapter 4. See https://www.sba.gov/partners/lenders)

For example, a dentist may need working capital to open a practice. Based on a feasible business plan,[6] the cash flow for the practice may be acceptable, but only limited collateral may be available for protection. In this case, a lender may seek a guaranty to bolster collateral protection. In short, the guaranty does not make a risky loan viable and should not induce a lender to make a risky loan.

The Rules also outline the information required in a credit approval memorandum. The minimum requirements include:

- *A discussion of the owners' and managers' relevant experience in the type of business, as well as their personal credit histories.*
- *A financial analysis of repay-ment ability based on historical income statements and/or tax returns (if an existing business) and projections, including the reasonableness of the supporting assumptions.*
- *A site visit consistent with the lender's internal policy for similarly sized non-SBA guaranteed commercial loans. (See also Chapter 2, Paragraph IV.H.7.a)(2) of this Subpart and Paragraph II.C.4 of this Chapter.) (SOP 50 10 5(C),* Chapter 4. See https://www.sba.gov/partners/lenders).

If these requirements are not included in a lender's underwriting practices, the guaranty may be jeopardized, increasing the overall risk of the portfolio.

Following approval of the loan, the SBA provides a Loan Authorization to the lender. The Loan Authorization states the terms and conditions of the SBA's guaranty, including the

[6] Lenders should scrutinize cash-flow projections and should not accept projections without analyzing the feasibility of the underlying assumptions.

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required structure, collateral, terms, lien position and disbursement of funds. The lender is responsible for closing the loan in compliance with the Loan Authorization; not doing so may place the guaranty at risk.

Lenders must disburse the loan proceeds in accordance with the Loan Authorization and document each disbursement. The documentation must contain sufficient detail for the SBA to determine:

- *The recipient of each disbursement;*
- *The date and amount of each disbursement;*
- *The purpose of each disbursement; and*
- *Evidence to support disbursements, such as cancelled checks or paid receipts, to ensure that the borrower used loan proceeds for purposes stated in the Authorization. (SOP 50 10 5(C),* Chapter 7. See https://www.sba.gov/partners/lenders).

The underwriting process includes critical steps which lenders must follow, including verifying the eligibility of a business, scrutinizing cash-flow projections, verifying the borrower's and guarantor's statement of personal history, obtaining all available collateral, and properly documenting and funding disbursements.[7]

In addition, the underwriting process will benefit from the incorporation of these best practices: using SBA documentation software, centralizing the documentation preparation process, creating documentation checklists and credit approval reports specific to SBA lending, using attorneys with SBA experience for closings, and centralizing documentation review after closings.

Servicing SBA Loans

Once a loan is closed and disbursed, lenders must service 7(a) loans as carefully as they would the non-SBA portfolio. For example, throughout the life of a loan, lenders must ensure that documents requiring periodic renewals, such as hazard insurance and Uniform Commercial Code (UCC) -1 financing statements,[8] remain current. A lender is also required to submit a report to Colson Services Corp. (Colson Report) every month.[9] The Colson Report includes information about the next due date, status of the loan, undisbursed loan amount, guaranteed portion of principal and interest received, and the guaranteed portion of the outstanding balance.

Lenders can modify terms by extending maturities, implementing interest-only periods, and releasing collateral. The SBA encourages lenders to work with borrowers as concessions generally are within the framework of The

[7] Verifying the statement of personal history includes checking for prior tax liens, felony convictions, or defaults on any government debt, such as a student loan. Although the SBA will work with borrowers with limited collateral, it generally requires all available collateral be pledged to the loan. Disbursements include no funds to pay for purposes other than approved.

[8] A lender must file UCC -1 financing statement to perfect the lender's security interest in borrower assets. This document is in effect for five years unless a continuation statement is filed.

[9] Colson Services Corp. provides loan payment accounting and servicing to the SBA.

Rules. However, certain modifications require the SBA's approval. If a concession is granted because of a borrower's financial difficulties, the modified loan would be a troubled debt restructuring that should be appropriately accounted for and disclosed based on outstanding guidance for such restructurings, including the measurement of impairment under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 310, Receivables (formerly FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan"), and nonaccrual treatment. Small-business loans are not predominantly collateral dependent; as a result, impairment calculations should be consistent with the present value methodology.[10] In cases where the loan book value (Call Report balance) and the customer balance (contractual obligation) are different, lenders are required to report the customer balance in the Colson Report.

Common servicing missteps on SBA loans include not renewing appropriate documents, releasing collateral without prior SBA approval (when required), modifying credits inappropriately, or incorrectly assuming that the existence of the guaranty means that problem credits need not be reported as such. As with non-SBA loans, lenders should collect and analyze annual financial statements and consider incorporating the following best practices into their servicing processes and procedures: using SBA documentation software for the Colson Report, referring to the SBA Servicing and Liquidation Actions 7(a) Lender Matrix[11] before making any modifications, and documenting the reasons for any modifications in the credit files.

Risk Grades for SBA Loans

Lenders should risk grade the SBA portfolio using the same metrics applied to the non-SBA portfolio. SBA loans will tend to fall into higher-risk grade categories because of the longer amortizations, weak collateral protection, and general volatility[12] given that the majority of these loans are for less-established businesses. Lenders may mistakenly rely on the guaranty in assigning a lower risk grade to a higher-risk loan. Lenders must keep in mind that risk grades should reflect the underlying risk of SBA loans without consideration of the guaranty.

If adverse classification is warranted, examiners should consider the extent of the protection provided by the guaranty when determining the portion to be classified. If no deficiencies are identified with the underwriting, servicing, or liquidation documentation, adverse classifications generally will be limited to the unguaranteed portion. However, if deficiencies are identified, the guaranty is put at risk for reduction or denial by the SBA, and examiners should consider adversely classifying the entire loan.

[10] If an impaired small-business loan is collateral dependent, impairment should be measured based on the fair value of the collateral.

[11] The Matrix can be found at https://www.sba.gov/document/support--servicing-liquidation-actions-7a-lender-matrix.

[12] Bureau of Labor Statistics data show that only 49 percent of establishments survive at least 5 years; 34 percent survive at least 10 years; and 26 percent survive 15 years or more. U.S. Small Business Administration, "Frequently Asked Questions," http://www.sba.gov/sites/default/files/files/sbfaq.pdf.

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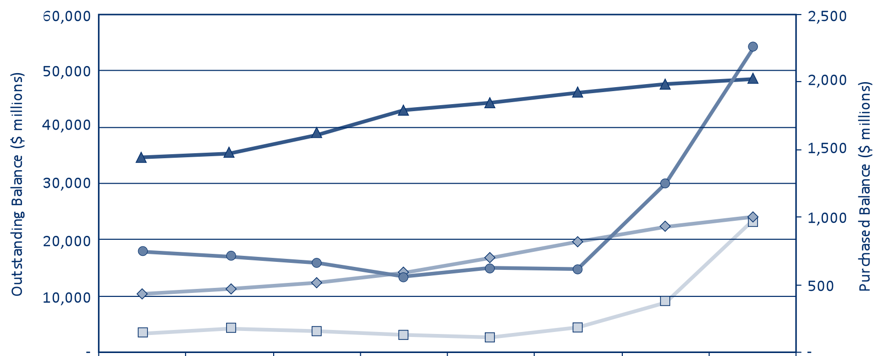
Liquidation of Collateral

Lenders should make every effort to work with borrowers before considering liquidation of collateral. When a business fails, the lender is responsible for documenting the liquidation of collateral for the highest possible recovery. This includes allowing the borrower to liquidate collateral for the lender,[13] or the lender taking possession to liquidate. If a loss[14] exists, the lender must file a 10 Tab package for the SBA to purchase the unpaid principal amount of the guaranteed portion of the loan; this package requires certain underwriting, servicing, and liquidation documentation.[15] (See Chart 1 for information on the volume of guarantees purchased by the SBA since 2002.)

Chart 1: Growth in SBA 7(a) and 504 Loan Volume Moderated in 2008 While Losses Accelerated.



	2002	2003	2004	2005	2006	2007	2008	2009
7(a) Outstanding	34,725	35,195	38,637	43,022	44,411	46,085	47,690	48,564
504 Outstanding	10,357	11,195	12,292	14,096	16,686	19,586	22,333	24,130
7(a) Purchased*	746	710	664	563	622	617	1,251	2,245
504 Purchased*	138	177	152	125	111	182	370	976

Source: SBA. Based on SBA fiscal year of October 1.
* Portion of lender losses purchased by SBA because of guaranty. The unguaranteed portion of lender losses not purchased is not available.

[13] In these cases, the lender is required to inventory the collateral and conduct site visits every 90 days.

[14] In addition to collateral shortfall, this includes 120 days of accrued interest and collections costs, such as reasonable attorney and appraisal fees.

[15] The 10 Tab package was developed by the SBA and contains mandatory documentation for all guaranty purchases. If a borrower files for bankruptcy protection, the lender may file a 10 Tab package before liquidating all collateral. If a business fails within 18 months of the origination of the loan, the SBA requires that the lender submit all underwriting, servicing, and liquidation documentation.

If the lender submits a complete 10 Tab package, the SBA generally will purchase the guaranteed portion within 45 business days. However, purchase of the guaranteed portion could take significantly longer if the 10 Tab package does not include all required information. As part of a SBA loan liquidation, lenders must conduct site visits, properly dispose of collateral, and accurately apply recoveries to SBA loans.[16] In addition, lenders should consider centralizing the completion of the 10 Tab package, using the SBA Servicing and Liquidation Actions 7(a) Lender Matrix before liquidation, and documenting all actions during liquidation.

Losses Associated with SBA Lending

Lenders could incur additional losses on SBA loans if they do not carefully follow appropriate underwriting, servicing, and liquidating processes. If deficiencies are identified with these processes, the SBA determines the impact these deficiencies have on losses. Depending on the severity of the deficiency, the SBA has the option of repairing the guaranty, which occurs when the SBA discounts or reduces the amount of the guaranty. For example, if a lender fails to file a lien on equipment that is a small percentage of total collateral protection, the SBA will deduct the value of the equipment from the unpaid principal amount of the guaranteed portion of the loan it will be purchasing. However, if the deficiency is considered significant, the SBA will deny the guaranty. For example, if the borrower's small business fails because the fire and the hazard insurance coverage had expired, the SBA will deny purchase. In many cases, the SBA may advise a bank to withdraw a 10 Tab package if a significant deficiency is identified, rather than formally denying the package.

[16] In some cases, lenders will fund other non-SBA guaranteed loans and attempt to apply recoveries to these loans before the SBA loan with senior lien position.

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Loan Sales

Following the origination of an SBA loan, lenders can hold loans to their maturity (hold model) or sell the guaranteed portion of loans to the secondary market (sale model). The hold model provides lenders with a long-term source of interest income. The sale model provides high levels of non-interest income but also requires high levels of loan originations.[17]

Accounting for Loan Sales

Under generally accepted accounting principles, a transfer of the guaranteed portion of an SBA loan must be accounted for in accordance with the FASB ASC Topic 860, Transfers and Servicing (formerly FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," as amended by FASB Statement No. 166, "Accounting for Transfers of Financial Assets"). ASC Topic 860 provides that, in order for a transfer of a portion of an entire financial asset to qualify for sale accounting, the portion first must meet the definition of a "participating interest" and then must meet all of the sales conditions set forth in this topic. Because of a recent policy change by the SBA that applies to the transfer of the guaranteed portion of an SBA loan at a premium, the transferred guaranteed portion and the lender's retained unguaranteed portion should now normally meet the definition of a "participating interest" on the transfer date. Assuming that is the case and if all of the conditions for sale accounting in ASC Topic 860 are met, the transfer of the guaranteed portion of an SBA loan at a premium as of the date of this article would now qualify as a sale on the transfer date, with immediate recognition of any gain or loss on the sale in earnings. However, if the transferred guaranteed portion of an SBA loan does not meet the definition of a "participating interest," the transfer of the guaranteed portion must be accounted for as a secured borrowing rather than a sale. This would be the case when a transfer of the guaranteed portion is at par and the transferring lender agrees to pass interest through to the party obtain-ing the guaranteed portion at less than the contractual interest rate, and the size of the spread between the contract rate and the pass-through rate is viewed as creating an interest-only strip. For further information, refer to the Supplemental Instructions for the Consolidated Reports of Condition and Income (Call Report) for first quarter 2011, which are attached to FIL-19-2011, April 6, 2011, https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11019.html, and the Glossary entry for "Transfers of Financial Assets" in the Call Report Instruction Book.

[17] For the purposes of this discussion of loan sales, transfers of guaranteed portions of SBA loans are presumed to be at a price in excess of par (i.e. at a premium) and to qualify for sale accounting as of the transfer date.

In the secondary market, guaranteed loans are liquid and command a premium. Investors buy these loans because the interest rates are generally high compared to the risk, as the only risk the investor incurs is prepayment risk. Loans with longer terms and higher yields realize higher premiums. The lender retains all servicing rights for sold loans and must follow the servicing requirements in The Rules. The lender receives a monthly minimum servicing fee of one percent on an annualized basis on the unpaid principal amount of the guaranteed portion of the loan that is sold at a premium. For example, for a hypothetical $1,000,000 loan originated with a 75 percent guaranty, the income might be broken down as follows:

<u>Loan</u>
1,000,000 x .75 = $750,000
<u>Servicing Fee</u>
$750,000 x .01 = $7,500 annually[18]
<u>Premium</u>
$750,000 x .10 = $75,000

The lender would realize $82,500 in the first year and $7,500 each subsequent year until the loan matures.[19] Because the benefits of servicing typically are expected to more than adequately compensate the lender for performing servicing, the lender also books an intangible servicing asset and is required to value the servicing asset correctly.[20] In many cases, the lender will rely on a consultant or accountant to provide quarterly valuations.

The sale model may be more prone to disruption or unexpected developments because of issues with loan restructurings and reliance on the level of originations. The secondary market is less receptive to loan modifications and restructurings because the SBA is required to repurchase the guaranteed portion of a loan after 60 days of non-payment.[21] The secondary market would rather see the loan repurchased than concede interest income for an extended period of time as a result of a restructuring involving a reduction in the stated interest rate on the loan.

In addition, under the sale model, the amount of premium income a lender receives is based on the number of originations. As a result, to reach origination and premium income goals, lenders may relax underwriting standards or tie employee performance reviews and compensation to the number of originations without adequately considering risk. It is critical that lenders underwrite these loans as if they were planning to hold them and place emphasis on originating prudent loans when developing employee performance and compensation plans. Incentive compensation arrangements, in particular, should balance financial rewards to the employee with the long-term health of the institution.[22]

It is critical that examiners understand what to look for when reviewing SBA loan portfolios. The next section provides information examiners need to consider when evaluating a lender's SBA program.

[18] This assumes that the loan does not amortize and principal remains constant. In most cases, the unpaid principal amount would decline as the loan is repaid, so even in the first year the servicing fee would be less than $7,500.

[19] See footnote 16.

[20] A servicing asset is initially measured at fair value. Each class of servicing assets should be subsequently measured using either the amortization method (with quarterly assessments of impairment based on fair value) or the fair value measurement method. For further information, see FASB ASC Topic 860 and the Glossary entry for "Servicing Assets and Liabilities" in the Call Report instruction book.

[21] Lenders retain responsibility for reimbursing the SBA for any repairs or denials on the loans repurchased.

[22] *Interagency Guidance on Sound Incentive Compensation Policies* (FDIC Press Release 138-2010, June 21, 2010, http://www.fdic.gov/news/news/press/2010/pr10138.html).

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Reviewing an SBA Portfolio

Experience suggests examiners should consider the following areas when risk focusing a review of a bank's SBA program:

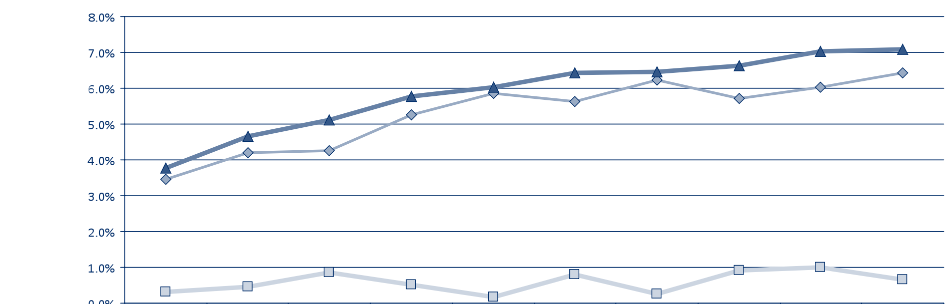
- *Review the lending policy.* If involved in SBA lending, the institution must address this type of lending in its Lending Policy. The Policy could borrow language from or reference The Rules to help ensure all relevant areas are covered. The Policy should include the types of SBA programs in which the bank will engage, any asset limits on specific SBA programs, the normal trade area for SBA lending, and any credit concentration limitations.
- *Review the internal risk-grade process.* Evaluate how accurately management identifies and measures risks in SBA loans. To ensure lenders are not grading loans too highly because of the SBA guaranty, an internal loan review system specific to the SBA loan portfolio must be designed and implemented. This system should verify that initial grades are appropriate and any grade changes are made when needed. The risk grading system for SBA loans can be part of a lender's overall internal loan review system, but should effectively capture the specific risks that SBA loans pose to the institution.
- *Review ongoing training.* The Rules are extensive and updated regularly. As a result, lenders should receive comprehensive training before engaging in SBA lending and enroll in ongoing training to remain current on any updates. Training is offered by the SBA, trade associations such as the National Association of Government Guaranteed Lenders (NAGGL),[23] consultants, and attorneys.
- *Review the SBA audit report.* The SBA performs on-site audits for all lenders with $10 million or more in outstanding SBA loans. These audits are performed at least every two years and address portfolio performance, SBA management and operations, credit administration, and compliance. If a lender cannot provide a copy of the audit report, the examiner should contact the lender's SBA District Office.
- *Review the quarterly Lender Portal report.* The SBA tracks various portfolio performance ratios, such as past-due, liquidation, and delinquency rates. Based on portfolio performance, the SBA assigns a Lender Risk Rating of "1" to "5" ("1" representing optimal performance). Lenders rated "1" are considered strong in every respect, a "2" rating is considered good, lenders rated "3" are considered average, a "4" rating is considered below average, and lenders rated "5" are considered well below average. All lenders have access to their Lender Portal report, but must first register on the SBA Web site at http://www.sba.gov/content/lender-portal-login. If a lender cannot provide a copy of the Lender Portal report, the examiner should contact the lender's SBA District Office.
- *Review the number of repairs, denials, and withdrawals of guarantees for the lender.* This information should be available from the lender.

[23] NAGGL is the most prominent trade association for SBA lenders. For more information on this trade group's activities, go to http://www.naggl.org.

- *Review for any industry credit concentrations.* Examiners should perform more in-depth reviews of portfolios with high industry concentrations. Bank management should monitor credit concentrations by North American Industry Classification System (NAICS) codes, and this information should be made available to the examiner. Industries have different SBA failure rates and repurchase rates. For example, from October 1, 2000 to September 30, 2009, SBA loans to the veterinary services industry had the lowest combined failure and repurchase rates while the shellfish fishing industry ranked highest among the larger industries (see Charts 2 and 3).[24]

- *Review for general concentrations.* In general, concentrations of credit add a dimension of risk that should be monitored, measured, and controlled by management. Common risk factors such as

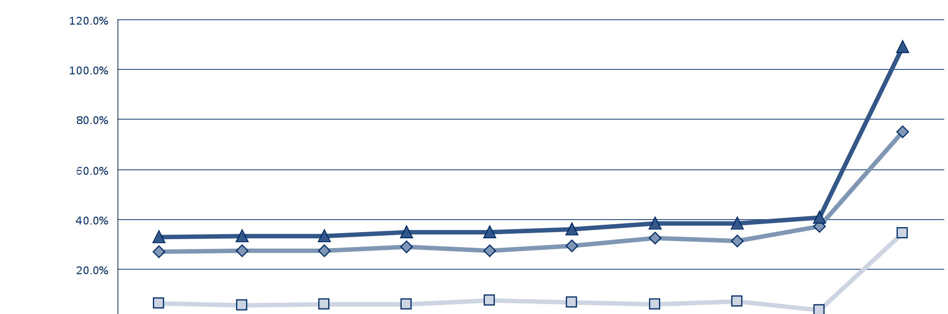
Chart 2: Industries with the Least Risk for SBA Lending



	Veterinary Services	Offices of Dentists	Broilers and Other Meat Type	Hotels (except Casino	Funeral Homes and Funeral	Offices of Optometrists	Continuing Care Retirement	Support Activities for Oil and Gas	Offices of Physical, Occupational	Offices of Physicians (except
Repurchase %	0.3%	0.4%	0.9%	0.5%	0.2%	0.8%	0.2%	0.9%	1.0%	0.7%
Failure %	3.5%	4.2%	4.3%	5.2%	5.9%	5.6%	6.2%	5.7%	6.0%	6.4%
Combined %	3.8%	4.6%	5.1%	5.8%	6.0%	6.4%	6.5%	6.6%	7.0%	7.1%

Source: 2010 NAICS Coleman Report

Chart 3: Industries with the Highest Risk for SBA Lending



	Radio, Television, and Other	Other Clothing Stores	Women's Clothing Stores	Cosmetics, Beauty Supplies, and	Automotive Transmission Repair	All Other General Merchandise	Women's, Children's, and Infants'	Family Clothing Stores	Mortgage and Nonmortgage Loan Brokers	Shellfish Fishing
Repurchase %	6.1%	5.6%	5.9%	5.7%	7.5%	6.5%	5.8%	7.1%	3.5%	34.2%
Failure %	26.8%	27.5%	27.4%	29.1%	27.4%	29.4%	32.4%	31.2%	37.3%	74.9%
Combined %	32.9%	33.1%	33.2%	34.8%	34.9%	35.9%	38.2%	38.2%	40.7%	109.1%

Source: 2010 NAICS Coleman Report

[24] Information from the 2010 NAICS Coleman Report. Larger industries have disbursed loan volumes that exceed the average during the period. For more information, go to http://www.colemanpublishing.com.

From the Examiner's Desk

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borrower affiliation, industry, and geographic location should be considered when assessing portfolio risk and establishing concentration limits. Excessive or unmonitored exposures would require heightened scrutiny during the examination process.

- *Review the Loan Authorization of a credit.* Evaluate how well management has documented the authorization requirements and determine if supporting documentation for disbursements satisfies the Loan Authorization. Weak practices in this area should be noted in examination findings.

Conclusion

SBA-guaranteed loans present opportunities for banks to expand their lending to small businesses. However, lending to small businesses, even with an SBA guaranty, is not without risk. Small disruptions in cash flow can significantly affect the viability of the business and, therefore, the performance of the loan. Small businesses that require SBA loan guarantees carry additional risk due to other weaknesses that may disqualify them from conventional lending, such as insufficient collateral and longer amortizations. Lenders must take particular care to understand the technical and detailed requirements for SBA underwriting, servicing, and liquidation processes.

In addition, loan risk grades should be determined without regard to the protection afforded by the SBA guaranty. Lenders should appropriately identify the risks in SBA loans and not assign unrealistic risk grades inconsistent with those assigned to non-SBA loans. The guaranty does not provide additional support for weaker cash flow loans, improve risk grades, or make risky loans viable.

Examiners' review of SBA portfolios is intended to help ensure prompt identification of shortcomings or weaknesses in an institution's SBA lending program. Together, examiners and lenders can work to correct and strengthen existing policies and procedures.

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Overview of Selected Regulations and Supervisory Guidance

This section provides an overview of recently released regulations and supervisory guidance, arranged in reverse chronological order. Press Release (PR) and Financial Institution Letter (FIL) designations are included so the reader can obtain more information.

ACRONYMS and DEFINITIONS	
FDIC	Federal Deposit Insurance Corporation
FRB	Federal Reserve Board
FFIEC	Federal Financial Institutions Examination Council
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
NCUA	National Credit Union Administration
Banking agencies	FDIC, FRB, and OCC
Federal bank and thrift regulatory agencies	FDIC, FRB, OCC, and OTS
Federal financial institution regulatory agencies	FDIC, FRB, OCC, OTS, and NCUA

Subject	Summary
FDIC Issues Consumer Tips on How to "Shop and Save" on Loans, Credit Cards and Deposit Accounts (PR-87-2011, May 16, 2011)	The FDIC issued tips to help consumers shop for a variety of bank products and services. Consumers should evaluate their needs, contact multiple institutions, and read the fine print before making a decision. The advice was published as a special edition of the ***FDIC Consumer News*** entitled "Shop and Save...at the Bank: A Buyer's Guide to Finding the Right Loan, Credit Card or Deposit Account." See http://www.fdic.gov/news/news/press/2011/pr11087.html
Proposed Rule on Retail Foreign Exchange Transactions (PR-86-2011, May 12, 2011, FIL-36-2011, May 12, 2011, *Federal Register*, Vol. 76, No. 95, p. 28358, May 17, 2011)	The FDIC issued a Notice of Proposed Rulemaking that would impose requirements on FDIC-supervised insured depository institutions (IDIs) that engage in foreign currency futures, options on futures, and options with retail customers. The IDIs with trades covered by the proposed rule would be subject to requirements in six areas: disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation. Comments were due by June 16, 2011. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11036.pdf
FDIC Pilot Securitization of Performing Commercial Mortgage Loans from 13 Failed Institutions (PR-81-2011, May 3, 2011)	The FDIC closed on a sale of securities as part of a securitization backed by approximately $394.3 million of performing commercial and multi-family mortgages from 13 failed banks. The investors for the Class A senior certificates represented a variety of organizations, including banks, insurance companies and money managers, which paid par for the senior certificates. The Class B mezzanine and Class C subordinate classes were purchased by an affiliate of LNR Partners, LLC. This pilot transaction marks the first time the FDIC has sold commercial mortgage loans in a securitization since the beginning of the recent financial crisis. See http://www.fdic.gov/news/news/press/2011/pr11081.html

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Subject	Summary
Proposed Rule for an Amendment to the FDIC Rules Reflecting Repeal of Prohibition on Paying Interest on Demand Deposits (FIL-23-2011, April 21, 2011, *Federal Register*, Vol. 76, No. 73, p. 21265, April 15, 2011)	The FDIC Board issued a proposed rule amending the FDIC's regulations to reflect a provision in the *Dodd-Frank Wall Street Reform and Consumer Protection Act* repealing the statutory prohibition against the payment of interest on demand deposits, effective July 21, 2011. Therefore, the FDIC proposes to rescind Part 329 and transfer the definition of "interest" found at Part 329 to Part 330. Comments on the proposed rule were due by May 16, 2011. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11023.html
Consolidated Reports of Condition and Income (Call Reports) (FIL-22-2011, April 21, 2011)	Changes to the definition of core deposits, non-core liabilities, and short-term non-core liabilities for Uniform Bank Performance Report calculation purposes took effect March 31, 2011. These updated definitions will benefit community banks by reflecting the $250,000 deposit insurance limit that became permanent in 2010. The assessment-related revisions proposed for June 30, 2011, primarily will affect institutions with at least $10 billion in total assets. New data to be reported by community banks in Schedule RC-O, Other Data for Deposit Insurance and FICO Assessments of the Call Reports generally would be limited to average consolidated total assets and average tangible equity (with tangible equity defined as tier 1 capital). The impact of these new items on most community banks with less than $1 billion in total assets should be nominal. Comments on the proposed revisions were due by May 16, 2011. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11022.html
FDIC Report Examines How An Orderly Resolution of Lehman Brothers Could Have Been Structured Under the Dodd-Frank Act (PR-76-2011, April 18, 2011)	The FDIC released a report on how the FDIC could have structured an orderly resolution of Lehman Brothers Holdings Inc. under the orderly liquidation authority of Title II of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* had that law been in effect in advance of Lehman's failure. The report concludes that the powers provided to the FDIC under the Dodd-Frank Act could have promoted systemic stability while recovering substantially more for creditors than the bankruptcy proceedings at no cost to taxpayers. See http://www.fdic.gov/news/news/press/2011/pr11076.html
FDIC Statement on Enforcement Orders Against Large Servicers Related to Foreclosure Practices (PR-69-2011, April 13, 2011)	The three primary federal regulators of the nation's 14 largest mortgage servicers published final enforcement orders against the institutions based on the findings of a review of their foreclosure policies and practices. Although the FDIC is not the primary federal regulator for any of the largest mortgage servicers, it participated in an interagency horizontal review, at the invitation of the primary regulators, as the back-up regulator to protect the interests of the deposit insurance fund and to provide resources and support for the review. See http://www.fdic.gov/news/news/press/2011/pr11069.html
Joint Proposed Rule to Implement Requirements Regarding Resolution Plans and Credit Exposure Reports (PR-68-2011, April 12, 2011)	The FDIC and the Federal Reserve Board issued a proposed rule to implement the requirements in Section 165(d) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* regarding resolution plans and credit exposure reports. Each nonbank financial company and bank holding company with assets of $50 billion or more is required to report periodically to the Board, the FDIC, and the Financial Stability Oversight Council its plan for orderly resolution and the nature and extent of credit exposures to, or from, each company. Comments on the proposed rule were due by June 10, 2011. See http://www.fdic.gov/news/news/press/2011/pr11068.html

Subject	Summary
Joint Proposed Rule to Establish Margin and Capital Requirements for Swap Dealers, Major Swap Participants, Security-based Swap Dealers, and Major Security-based Swap Participants (PR-67-2011, April 12, 2011, FIL-21-2011, April 13, 2011)	The banking agencies, the Farm Credit Administration, and the Federal Housing Finance Agency issued a proposed rule to establish margin and capital requirements for swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants as required by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. The proposed rule would require swap entities to collect minimum amounts of initial margin and variation margin from counterparties to non-cleared swaps and non-cleared, security-based swaps. The amount of margin required under the proposed rule would vary based on the relative risk of the counterparty and the swap or security-based swap. The proposed margin requirements would apply to new, non-cleared swaps or security-based swaps entered into after the proposed rule's effective date. The proposed rule would require regulated swap entities to comply with existing capital standards, as they already address non-cleared swaps and non-cleared, security-based swaps. Comments on the proposed rule are due by June 24, 2011. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11021.html
FDIC Updated Deposit Insurance Fund Loss and Reserve Ratio Projections and Proposed Guidelines on Assessment Rate Adjustments (PR-66-2011, April 12, 2011, *Federal Register*, Vol. 76, No. 73, p. 21256, April 15, 2011)	The FDIC updated its loss, income, and reserve ratio projections for the Deposit Insurance Fund over the next several years. The projected cost of FDIC-insured institution failures from 2011 through 2015 is $21 billion, compared to estimated losses of $24 billion for banks that failed in 2010. Although these loss projections are subject to considerable uncertainty, under these projections and current assessment rates, the fund should become positive this year and reach 1.15 percent of estimated insured deposits in 2018. The FDIC Board also voted to issue proposed guidelines governing assessment rate adjustments under the new large bank pricing system that went into effect beginning the second quarter of 2011. The new system is designed to capture risk at the time the institution assumes the risk, differentiate risk among large institutions during good banking conditions based on how they would fare during economic downturns, and account for the losses the FDIC may incur if a large institution fails. Comments on the proposed guidelines were due by May 31, 2011. See http://www.fdic.gov/news/news/press/2011/pr11066.html
Proposed Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions (FIL-20-2011, April 12, 2011, Federal Register, Vol. 76, No. 73, p. 21256, April 15, 2011)	The FDIC Board issued proposed guidelines describing the process the FDIC would follow to determine whether to make an adjustment to the score used to calculate the assessment rate for a large or highly complex institution, determine the size of any adjustment, and notify an institution of an adjustment. Comments were due by May 31, 2011. See http://www.fdic.gov/news/news/financial/2011/fil11020.html
Joint Proposed Rule on Risk Retention Proposal (PR-62-2011, March 31, 2011)	The banking agencies, the U.S. Department of Housing and Urban Development, the Federal Housing Finance Agency, and the U.S. Securities and Exchange Commission issued a joint proposed rule that would provide options for meeting the risk-retention requirements of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. The options include retention of risk by holding at least 5 percent of each class of asset-backed securities (ABS) issued in a securitization transaction (also known as vertical retention); retention of a first-loss residual interest in an amount equal to at least 5 percent of the par value of all ABS interests issued in a securitization transaction (horizontal retention); an equally divided combination of vertical and horizontal retention; retention of a representative sample of the assets designated for securitization in an amount equal to at least 5 percent of the unpaid principal balance of all the designated assets; and for commercial mortgage-backed securities, retention of at least a 5 percent first-loss residual interest by a third party that specifically negotiates for the interest, if certain requirements are met. Comments were due by June 10, 2011. See http://www.fdic.gov/news/news/press/2011/pr11062.html

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Subject	Summary
Joint Proposed Rule on Incentive Compensation (PR-61-2011, March 30, 2011, *Federal Register*, Vol. 76, No. 72, p. 21170, April 14, 2011)	The federal financial institution regulatory agencies, the Federal Housing Finance Agency, and the U.S. Securities and Exchange Commission issued a proposed rule to implement Section 956 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. The proposed rule would require compensation practices at regulated financial institutions to be consistent with three key principles. Incentive compensation arrangements should appropriately balance risk and financial rewards, be compatible with effective controls and risk management, and be supported by strong corporate governance. Comments were due by May 31, 2011. See http://www.fdic.gov/news/news/press/2011/pr11061.html
Joint Proposed Rule on Resolution Plans and Credit Exposure Reports for Covered Systemic Organizations (PR-60-2011, March 29, 2011)	The FDIC Board and Federal Reserve Board (FRB) issued a joint Notice of Proposed Rulemaking for holding companies with assets of $50 billion or more and other covered non-bank financial companies supervised by the FRB to file and report resolution plans and credit exposure reports as required in Title I, Section 165 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. Resolution Plans would have to be submitted within 180 days of the effective date of the final regulation, and Credit Exposure Reports would have to be filed 30 days after the end of each calendar quarter. Comments were due by June 10, 2011. See http://www.fdic.gov/news/news/press/2011/pr11060.html
Guidance on Accepting Accounts from Foreign Embassies, Consulates, and Missions (FIL-17-2011, March 24, 2011)	The FDIC, in conjunction with the federal banking agencies and the Financial Crimes Enforcement Network, issued supplemental guidance regarding account services for foreign embassies, consulates, and missions (foreign missions). This guidance applies to the limited number of FDIC-supervised financial institutions that already offer foreign mission account relationships and any FDIC-supervised financial institutions considering establishing such relationships. The guidance supplements the June 2004 *Guidance on Accepting Accounts from Foreign Governments, Foreign Embassies, and Foreign Political Figures.* Financial institutions are expected to conduct appropriate risk assessments and implement requisite controls and oversight systems to effectively manage risks associated with the account relationship. See http://www.fdic.gov/news/news/financial/2011/fil11017.html
Proposed Rule to Set Claims Process Under the Dodd-Frank Act's Orderly Liquidation Authority Provisions (PR-56-2011, March 15, 2011, *Federal Register*, Vol. 76, No. 56, p. 16324, March 23, 2011)	The FDIC Board approved a Notice of Proposed Rulemaking (NPR) to further clarify application of the orderly liquidation authority contained in Title II of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), "Orderly Liquidation Authority" (OLA). The NPR builds on the interim rule approved by the FDIC on January 18, 2011, and establishes a framework for the priority payment of creditors and procedures for filing a claim with the receiver and, if necessary, pursuing the claim in court. The NPR also clarifies additional issues important to the implementation of the OLA, including how compensation will be recouped from senior executives and directors responsible for the failure of the firm. The NPR, along with the interim final rule, will provide clarity on how OLA key components are implemented and ensure the liquidation process under Title II reflects the Dodd-Frank Act's mandate of transparency in the liquidation of covered financial companies. Comments were due by May 23, 2011. See http://www.fdic.gov/news/news/press/2011/pr11056.html
Overdraft Payment Program Supervisory Guidance: Staff Teleconference on Implementation (FIL-16-2011, March 15, 2011)	FDIC staff hosted a teleconference on March 29, 2011, to discuss the 2010 Overdraft Payment Program Supervisory Guidance issued in November 2010 (FIL-81-2010) that reaffirmed existing supervisory expectations with respect to overdraft payment programs and provided specific guidance with respect to automated overdraft payment programs. See http://www.fdic.gov/news/news/financial/2011/fil11016.html

Subject	Summary
Free Nationwide Seminars for Bank Officers and Employees on Deposit Insurance Coverage (FIL-14-2011, March 3, 2011)	The FDIC will conduct ten telephone seminars for bank officers and employees that will provide comprehensive training on deposit insurance coverage rules and regulations. The seminars will be conducted between March 23 and December 7, 2011, and are free to employees and officers of FDIC-insured banks and savings associations. See http://www.fdic.gov/news/news/financial/2011/fil11014.html
Financial Institution Feedback on FDIC Examination Findings (FIL-13-2011, March 1, 2011)	The FDIC is encouraging financial institutions to provide feedback on FDIC examinations and reports of examination. This Financial Institution Letter addresses what an institution can do if it disagrees with examination findings. An institution can address concerns through communication with the examiner, field office management, or the appropriate regional office staff. Division-level informal reviews also are available. If informal efforts are not successful, an institution may pursue a formal supervisory appeal. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11013.html
Consolidated Reports of Condition and Income (Call Reports) Revisions for March 2011 (FIL-9-2011, February 14, 2011)	The Federal Financial Institutions Examination Council approved revisions to the reporting requirements for the Consolidated Reports of Condition and Income that took effect as of March 31, 2011. The revisions will help the federal financial institution regulatory agencies better understand a bank's credit and liquidity risk exposures, primarily through enhanced data on loans, deposits, and securitization activities. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11009.html
Assessments Final Rule (PR-28-2011, February 7, 2011, FIL-8-2011, February 9, 2011)	The FDIC Board approved a final rule on assessments. The rule implements changes mandated by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). The rule redefines the deposit insurance assessment base, makes assessment rate adjustments, adopts new rate schedules, implements the Dodd-Frank Act Deposit Insurance Fund dividend provisions, and revises the risk-based assessment system for all large insured depository institutions, generally those with at least $10 billion in total assets. Except for the future assessment rate schedules, all changes took effect April 1, 2011. See http://www.fdic.gov/news/news/financial/2011/fil11008.html
Interagency Notice of Proposed Rulemaking Incentive-based Compensation Arrangements (PR-27-2011, February 7, 2011, FIL-7-2011, February 9, 2011, *Federal Register*, Vol. 76, No. 72, p. 21170, April 14, 2011)	The federal financial institution regulatory agencies, the U.S. Securities and Exchange Commission, and the Federal Housing Finance Agency announced a Notice of Proposed Rulemaking that implements Section 956 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, which applies only to financial institutions with total consolidated assets of at least $1 billion. Section 956 prohibits incentive-based compensation arrangements that encourage inappropriate risk taking and are deemed to be excessive, or may lead to material losses. Comments were due by May 31, 2011. See http://www.fdic.gov/news/news/financial/2011/fil11007.html
Proposed Rule Requiring Certain Bank Staff to Complete FDIC-Provided Training on Deposit Insurance Coverage (PR-26-2011, February 7, 2011, FIL-6-2011, February 9, 2011, *Federal Register*, Vol.76, No. 29, p. 7740, February 11, 2011)	The FDIC Board approved a Notice of Proposed Rulemaking to require certain employees of insured depository institutions (IDIs) to complete training on the fundamentals of FDIC deposit insurance coverage and provide customers at deposit account opening with the FDIC's publication *Deposit Insurance Summary*, if the customer will have more than $250,000 at the IDI. The proposed rule also will require every IDI to provide a link on its Web site to the FDIC's Electronic Deposit Insurance Estimator. Comments were due April 12, 2011. See http://www.fdic.gov/news/news/financial/2011/fil11006.html

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Subject	Summary
Proposed Changes in Reporting Requirements for OTS-Regulated Savings Associations and Savings and Loan Holding Companies (PR-20-2011, February 3, 2011, *Federal Register*, Vol. 76, No. 26, p. 7082, February 8, 2011)	The federal bank and thrift regulatory agencies announced proposed changes to reporting requirements for savings associations and savings and loan holding companies regulated by the Office of Thrift Supervision. The proposed changes include a change from quarterly Thrift Financial Reports to quarterly Consolidated Reports of Condition and Income. Comments were due by April 11, 2011. See http://www.fdic.gov/news/news/press/2011/pr11020.html
Coverage, Disclosure, and Regulatory Reporting Revisions for Interest on Lawyers Trust Accounts (PR-8-2011, January 18, 2011, FIL-2-2011, January 21, 2011)	The FDIC Board issued a final rule on January 18, 2011, to implement the December 29, 2010 amendment to the Federal Deposit Insurance Act to include Interest on Lawyer Trust Accounts within the definition of a "noninterest-bearing transaction account" for purposes of the temporary, unlimited deposit insurance coverage afforded to such accounts by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. The amendment affected year-end 2010 regulatory reporting. See https://www.fdic.gov/news/inactive-financial-institution-letters/2011/fil11002.html
Hotline for Small Businesses Regarding Availability of Credit (PR-5-2011, January 13, 2011)	As a result of the *Overcoming Obstacles to Small Business Lending Forum* held on January 13, 2011, the FDIC announced the availability of a dedicated, toll-free hotline for small businesses. The toll-free number is 1-855-FDIC-BIZ. The FDIC also created a dedicated Web site for small businesses: www.fdic.gov/smallbusiness. See http://www.fdic.gov/news/news/press/2011/pr11005.html
Forum on Overcoming Obstacles to Small Business Lending (PR-4-2011, January 11, 2011)	The FDIC held the *Overcoming Obstacles to Small Business Lending Forum* on January 13, 2011. The forum explored ways for making credit more accessible to the small business sector by bringing together policymakers, regulators, small business owners, lenders and other stakeholders to identify key issues and focus on solutions. See http://www.fdic.gov/news/news/press/2011/pr11004.html
Initial Registration Period Under the Secure and Fair Enforcement for Mortgage Licensing Act's Mortgage Loan Originator Provisions (PR-19-2011, January 31, 2011, FIL-1-2011, January 4, 2011)	Under the Secure and Fair Enforcement for Mortgage Licensing Act and the federal financial institution regulatory agencies (including the Farm Credit Administration) final rules, residential mortgage loan originators must register with the registry, obtain a unique identifier from the registry, and maintain their registrations. The agencies announced that the Nationwide Mortgage Licensing System and Registry began accepting federal registrations on January 31, 2011. Further information regarding the registry and the registration process is available at the registry's Web site: http://mortgage.nationwidelicensingsystem.org/fedreg/Pages/default.aspx. See http://www.fdic.gov/news/news/financial/2011/fil11001.html
Consolidated Reports of Condition and Income (Call Reports) for Fourth Quarter 2010 (FIL-94-2010, December 30, 2010)	The banking agencies announced reporting changes which took effect fourth quarter 2010. Banks are to report the quarter-end dollar amount and number of noninterest-bearing transaction accounts (as defined in the *Dodd-Frank Wall Street Reform and Consumer Protection Act*) of more than $250,000 and data on reverse mortgages. The update also includes revised instructions for reporting estimated uninsured deposits. See https://www.fdic.gov/news/inactive-financial-institution-letters/2010/fil10094.html

Subject	Summary
Community Reinvestment Act Annual Asset-Size Threshold Adjustment (PR-280-2010, December 21, 2010, FIL-93-2010, December 29, 2010, *Federal Register*, Vol. 75, No. 250, p. 82217, December 30, 2010)	The federal bank and thrift regulatory agencies announced the joint final rule amending the Community Reinvestment Act to make the annual adjustment to the asset-size threshold used to define "small bank" and "intermediate small bank" under the Act. Small bank" or "small savings association" means a bank that, as of December 31 of either of the prior two calendar years, had assets of less than $1.122 billion. "Intermediate small bank" or "intermediate small savings association" means a small bank with assets of at least $280 million as of December 31 of both of the prior two calendar years, and less than $1.122 billion as of December 31 of either of the prior two calendar years. These asset-size threshold adjustments took effect on January 1, 2011. The agencies published the adjustments in the ***Federal Register*** on December 30, 2010. See https://www.fdic.gov/news/inactive-financial-institution-letters/2010/fil10093.html
Underwriting Standards for Small Business Loans Originated Under the Small Business Lending Fund Program (FIL-90-2010, December 23, 2010)	The federal bank and thrift regulatory agencies issued guidance regarding prudent underwriting standards for small business loans made under the Small Business Lending Fund Program created as part of the *Small Business Jobs Act of 2010*. Prudently underwritten small business loans should reflect all relevant credit factors, including capacity of the income from the business to adequately service the debt; value and quality of the collateral; overall creditworthiness of the borrower; level of equity invested in the business; any secondary sources of repayment; and any additional collateral or credit enhancements (such as guarantees or key-person insurance). See http://www.fdic.gov/news/news/financial/2010/fil10090.html
Proposed Rule on Advanced Capital Adequacy Framework—Basel II; Establishment of a Risk-Based Capital Floor (PR-266-2010, December 14, 2010, FIL-88-2010, December 16, 2010, *Federal Register*, Vol. 75, No. 250, p. 82317, December 30, 2010)	The banking agencies jointly issued this Notice of Proposed Rulemaking to amend the advanced risk-based capital adequacy standards (advanced approaches rules) to be consistent with certain provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the Dodd-Frank Act), and amend the general risk-based capital rules to provide limited flexibility consistent with Section 171(b) of the Dodd-Frank Act for recognizing the relative risk of certain assets generally not held by depository institutions. Comments were due February 28, 2011. See https://www.fdic.gov/news/inactive-financial-institution-letters/2010/fil10088.html
Proposed Rule on Risk-Based Capital Standards: Market Risk (PR-270-2010, December 15, 2010, FIL-87-2010, December 16, 2010, *Federal Register*, Vol. 76, No. 7, p. 1890, January 11, 2011)	The banking agencies jointly issued aNotice of Proposed Rulemaking on possible modifications to the risk-based capital standards for market risk. The proposed rule would incorporate improvements to the current trading book regime as proposed by the Basel Committee on Banking Supervision in *Revisions to the Basel II Market Risk Framework* published in July 2009 and *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects* published in July 2005. Comments were due April 11, 2011. See https://www.fdic.gov/news/inactive-financial-institution-letters/2010/fil10087.html
FDIC Board Sets a Two Percent Designated Reserve Ratio as Part of a Comprehensive Plan for Fund Management (PR-265-2010, December 14, 2010)	The FDIC Board voted on a final rule to set the insurance fund designated reserve ratio at two percent of estimated insured deposits. The comprehensive, long-range management plan is designed to reduce the pro-cyclicality in the existing risk-based assessment system by allowing moderate, steady assessment rates throughout economic and credit cycles; and maintaining a positive fund balance even during a banking crisis by setting an appropriate target fund size and a strategy for assessment rates and dividends. See http://www.fdic.gov/news/news/press/2010/pr10265.html

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Subject	Summary
Prudent Management of Agricultural Credit Through Farming and Economic Cycles (FIL-85-2010, December 14, 2010)	The FDIC issued guidance on agricultural credit, recognizing the agricultural sector remains susceptible to shocks from a number of sources, including volatile commodity prices. Financial institutions engaged in agricultural lending must remain diligent in enforcing sound underwriting principles and establishing effective risk management procedures to help mitigate risks. Where agricultural borrowers are struggling to make payments, the FDIC recognizes that constructively working with borrowers often benefits the financial institution and the borrower. See https://www.fdic.gov/news/inactive-financial-institution-letters/fil10085.html
Appraisal and Evaluation Guidelines (PR-261-2010, December 2, 2010, FIL-82-2010, December 2, 2010)	The federal financial institution regulatory agencies issued the *Interagency Appraisal and Evaluation Guidelines* (Guidelines) to update and replace existing supervisory guidance to reflect changes in appraisal and evaluation practices. The Guidelines build on longstanding, prudent standards for valuing real property and clarify that an analytical method or technological tool, such as an automated valuation model, cannot be substituted for an appraisal when the transaction requires an appraisal. See http://www.fdic.gov/news/news/financial/2010/fil10082.html
Overdraft Payment Programs and Consumer Protection Final Overdraft Payment Supervisory Guidance (PR-257-2010, November 24, 2010, FIL-81-2010, November 24, 2010)	The FDIC issued final guidance which reaffirms existing supervisory expectations with respect to overdraft payment programs generally and provides specific guidance with respect to automated overdraft payment programs. The FDIC expects the institutions it supervises to closely monitor and oversee any overdraft payment programs offered to consumers, including taking appropriate measures to mitigate risks, incorporating the best practices outlined in the 2005 *Joint Guidance on Overdraft Protection Programs*, and effectively managing third-party arrangements. Management should be especially vigilant with respect to product over-use that may harm consumers, rather than providing protection against occasional errors or funds shortfalls for which the programs were intended. See http://www.fdic.gov/news/news/financial/2010/fil10081.html
Financial Institutions Are Encouraged to Work With Schools to Promote Youth Financial Education (PR-251-2010, November 15, 2010, FIL-80-2010, November 17, 2010)	On November 15, 2010, FDIC Chairman Sheila C. Bair signed a partnership agreement with U.S. Department of Education Secretary Arne Duncan and National Credit Union Administration Chairman Debbie Matz to promote and enhance financial education and access for low- to moderate-income students and families. For additional information on partnerships to promote youth financial education, institutions can contact the FDIC Outreach and Program Development Section at communityaffairs@fdic.gov. See http://www.fdic.gov/news/news/financial/2010/fil10080.html

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