FDIC

Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, D.C. 20429-9990

Financial Institution Letter
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ALLOWANCE FOR LOAN AND LEASE LOSSES
Residential Mortgages Secured by Junior Liens

Summary: When estimating credit losses on each group of loans with similar risk characteristics, an institution should consider its historical loss experience on the group, adjusted for changes in trends, conditions, and other relevant factors in the current economic environment that affect repayment of the loans in the group as of the allowance evaluation date. The need to consider all significant factors that affect collectibility is especially important for loans secured by junior liens on 1-4 family residential properties (junior lien loans) in areas where there have been declines in the value of such properties. See the attached "Allowances for Loan and Lease Losses in the Current Economic Environment: Loans Secured by Junior Liens on 1-4 Family Residential Properties."

Distribution:
FDIC-Supervised Institutions

Suggested Routing:
Chief Executive Officer
Chief Financial Officer
Chief Credit Officer

Related Topics:
- Interagency Statement on the Allowance for Loan and Lease Losses
- Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions

Attachment:
Allowances for Loan and Lease Losses in the Current Economic Environment: Loans Secured by Junior Liens on 1-4 Family Residential Properties

Contact:
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Highlights:

- At least quarterly, each institution must analyze the collectibility of its loans held for investment and maintain an allowance for loan and lease losses (ALLL) at a level that is appropriate and determined in accordance with generally accepted accounting principles.

- An appropriate ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired and on groups of loans with similar risk characteristics that are collectively evaluated for impairment.

- After determining the appropriate historical loss rate for each group of junior lien loans with similar risk characteristics, management should consider those current qualitative or environmental factors that are likely to cause the estimated credit losses on these loans as of the ALLL evaluation date to differ from the group's historical loss experience.

- Failure to timely recognize estimated credit losses could delay appropriate loss mitigation activity, such as restructuring junior lien loans to more affordable payments or reducing principal on such loans to facilitate refinancings. Examiners will continue to evaluate the effectiveness of an institution's loss mitigation strategies for loans as part of their assessment of the institution's overall financial condition.