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11-12-2008

## Interagency Statement on Meeting the Needs of Creditworthy Borrowers

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# Joint Press Release

November 12, 2008

## Interagency Statement on Meeting the Needs of Creditworthy Borrowers

Board of Governors of the Federal Reserve System

Federal Deposit Insurance Corporation

Office of the Comptroller of the Currency

Office of Thrift Supervision

For release at 10:00 a.m. EST

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The Department of the Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve have recently put into place several programs designed to promote financial stability and to mitigate procyclical effects of the current market conditions. These programs make new capital widely available to U.S. financial institutions, broaden and increase the guarantees on bank deposit accounts and certain liabilities, and provide backup liquidity to U.S. banking organizations. These efforts are designed to strengthen the capital foundation of our financial system and improve the overall functioning of credit markets.

The ongoing financial and economic stress has highlighted the crucial role that prudent bank lending practices play in promoting the nation's economic welfare. The recent policy actions are designed to help support responsible lending activities of banking organizations, enhance their ability to fund such lending, and enable banking organizations to better meet the credit needs of households and business. At this critical time, it is imperative that all banking organizations and their regulators work together to ensure that the needs of creditworthy borrowers are met. As discussed below, to support this objective, consistent with safety and soundness principles and existing supervisory standards, each individual banking organization needs to ensure the adequacy of its capital base, engage in appropriate loss mitigation strategies and foreclosure prevention, and reassess the incentive implications of its compensation policies.

### *Lending to creditworthy borrowers*

The agencies expect all banking organizations to fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers. Moreover, as a result of problems in financial markets, the economy will likely become increasingly reliant on banking organizations to provide credit formerly provided or facilitated by purchasers of securities. Lending to creditworthy borrowers provides sustainable returns for the lending organization and is constructive for the economy as a whole.

It is essential that banking organizations provide credit in a manner consistent with prudent lending practices and continue to ensure that they consider new lending opportunities on the basis of realistic asset valuations and a balanced assessment of borrowers' repayment capacities. However, if underwriting standards tighten excessively or banking organizations retreat from making sound credit decisions, the current market conditions may be exacerbated, leading to slower growth and potential damage to the economy as well as the long-term interests and profitability of individual banking organizations. Banking organizations should strive to maintain healthy credit relationships with businesses, consumers, and other creditworthy borrowers to enhance their own financial well-being as well as to promote a sound economy. The agencies have directed supervisory staffs to be mindful of the procyclical effects of an excessive tightening of credit availability and to encourage banking organizations to practice economically viable and appropriate lending activities.

### *Strengthening capital*

Maintaining a strong capital position complements and facilitates a banking organization's capacity and willingness to lend and bolsters its ability to withstand uncertain market conditions. Banking organizations should focus on effective and efficient capital planning and longer-term capital maintenance. An effective capital planning process requires a banking organization to assess both the risks to which it is exposed and the risk management processes in place to manage and mitigate those risks; evaluate its capital adequacy relative to its risks; and consider the potential impact on earnings and capital from economic downturns. Further, an effective capital planning process requires a banking organization to recognize losses on bank assets and activities in a timely manner; maintain adequate loan loss provisions; and adhere to prudent dividend policies.

In particular, in setting dividend levels, a banking organization should consider its ongoing earnings capacity, the adequacy of its loan loss allowance, and the overall effect that a dividend payout would have on its cost of funding, its capital position, and, consequently, its ability to serve the expected needs of creditworthy borrowers. Banking organizations should not maintain a level of cash dividends that is inconsistent with the organization's capital position, that could weaken the organization's overall financial health, or that could impair its ability to meet the needs of creditworthy borrowers. Supervisors will continue to review the dividend policies of individual banking organizations and will take action when dividend policies are found to be inconsistent with sound capital and lending policies.

### *Working with mortgage borrowers*

The agencies expect banking organizations to work with existing borrowers to avoid preventable foreclosures, which can be costly to both the organizations and to the communities they serve, and to mitigate other potential mortgage-related losses. To this end, banking organizations need to ensure that their mortgage servicing operations are sufficiently funded and staffed to work with borrowers while implementing effective risk-mitigation measures.

Given escalating mortgage foreclosures, the agencies urge all lenders and servicers to adopt systematic, proactive, and streamlined mortgage loan modification protocols and to review troubled loans using these protocols. Lenders and servicers should first determine whether a loan modification would enhance the net present value of the loan before proceeding to foreclosure, and they should ensure that loans currently in foreclosure have been subject to such analysis. Such practices are not only consistent with sound risk management but are also in the long-term interests of lenders and servicers, as well as borrowers.

Systematic efforts to address delinquent mortgages should seek to achieve modifications that result in mortgages that borrowers will be able to sustain over the remaining maturity of their loan. Supervisors will fully support banking organizations as they work to implement effective and sound loan modification programs. Banking organizations that experience challenges in implementing loss mitigation efforts on their mortgage portfolios or in making new loans to borrowers should work with their primary supervisors to address specific situations.

### *Structuring compensation*

Poorly-designed management compensation policies can create perverse incentives that can ultimately jeopardize the health of the banking organization. Management compensation policies should be aligned with the long-term prudential interests of the institution, should provide appropriate incentives for safe and sound behavior, and should structure compensation to prevent short-term payments for transactions with long-term horizons. Management compensation practices should balance the ongoing earnings capacity and financial resources of the banking organization, such as capital levels and reserves, with the need to retain and provide proper incentives for strong management. Further, it is important for banking organizations to have independent risk management and control functions.

The agencies expect banking organizations to regularly review their management compensation policies to ensure they are consistent with the longer-run objectives of the organization and sound lending and risk management practices.

The agencies will continue to take steps to promote programs that foster financial stability and mitigate procyclical effects of the current market conditions. However, regardless of their participation in particular programs, all banking organizations are expected to adhere to the principles in this statement. We will work with banking organizations to facilitate their active participation in those programs, consistent with safe and sound banking practices, and thus to support their central role in providing credit to support the health of the U.S. economy.

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Last Update: November 12, 2008