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

Financial Institution Letter
FIL-4-2012
January 31, 2012

ALLOWANCE FOR LOAN AND LEASE LOSSES
Estimation Practices for Junior Liens on Residential Properties

Summary: The federal financial institution regulatory agencies have jointly issued supervisory guidance on loan loss allowance estimation practices for loans and lines of credit secured by junior liens on 1-4 family residential properties (junior liens). The guidance discusses the responsibilities of institution management and examiners and builds on existing supervisory guidance for home equity lending and the allowance for loan and lease losses (ALLL).

Statement of Applicability to Institutions Under $1 Billion in Total Assets: This Financial Institution Letter applies to all FDIC-supervised banks and savings associations, particularly those with significant holdings of junior liens.

Distribution:
FDIC-Supervised Banks (Commercial and Savings) and FDIC-Supervised Savings Associations

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

Related Topics:
Interagency Credit Risk Management Guidance for Home Equity Lending
Interagency Policy Statement on the Allowance for Loan and Lease Losses
Allowances for Loan and Lease Losses in the Current Economic Environment: Loans Secured by Junior Liens on 1-4 Family Residential Properties
Uniform Retail Credit Classification and Account Management Policy

Attachment:
Interagency Supervisory Guidance on Allowance for Loan and Lease Losses Estimation Practices for Loans and Lines of Credit Secured by Junior Liens on 1-4 Family Residential Properties

Contact:
FDIC Regional Accountant or Robert Storch, Chief Accountant, Division of Risk Management Supervision, 202-898-8906 or rstorch@fdic.gov

Note:
FDIC Financial Institution Letters (FILs) may be accessed from the FDIC's Web site at http://www.fdic.gov/news/news/financial/2012/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies may be obtained via the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (877-275-3342 or 703-562-2200).

Highlights:

- With respect to the ALLL estimation process for an institution's junior lien portfolio, management should:
  - Gather and consider reasonably available and relevant information about the collectibility of the portfolio, including information on the delinquency status of senior lien loans associated with the institution's junior liens.
  - Ensure adequate segmentation within the junior lien portfolio to appropriately estimate allowances for high-risk segments of the portfolio.
  - Support qualitative or environmental factor adjustments to historical loss rates by an analysis that relates the adjustments to the characteristics of and trends in the individual risk segments within the junior lien portfolio.
- Management also should ensure that income recognition practices related to junior liens do not overstate income and charge-offs are taken in accordance with the *Uniform Retail Credit Classification and Account Management Policy*.
- Examiners should evaluate an institution's junior lien loan loss allowance methodology and documentation and the appropriateness of the level of the ALLL for the junior lien portfolio, including whether management's estimation process has properly incorporated the practices described in the supervisory guidance.