Securities and Exchange
Commission Federal Deposit Insurance Corporation
Federal Reserve Board
Office of the Comptroller of the Currency
Office of Thrift Supervision

JOINT INTERAGENCY LETTER TO FINANCIAL INSTITUTIONS
July 12, 1999

Over the past several months, the banking regulators and the Securities and Exchange Commission ("SEC") (jointly as the "Agencies") have worked together to provide a consistent message on the allowance for loan losses. In a March 10, 1999 Joint Interagency Letter to Financial Institutions, the Agencies stated, "We recognize that today instability in certain global markets, for example, is likely to increase loss inherent in affected institutions' portfolios and consequently require higher allowances for credit losses than were appropriate in more stable times." On May 19, 1999, SEC Chairman Arthur Levitt reiterated this message and added, "Some have interpreted our efforts on bank reserves to suggest that the SEC thinks reserves are too high and should be lowered. That couldn't be further from the truth. . . I want to emphasize -- it is not our policy that institutions artificially lower reserves or ever have inadequate reserves."

As announced in the March 10, 1999 joint letter, efforts are ongoing to provide the banking industry and accounting profession with enhanced guidance on appropriate methodologies, disclosures, and supporting documentation for loan loss allowances. The Agencies have agreed to support and encourage the FASB process and the AICPA Allowance for Loan Losses Task Force in clarifying certain aspects of generally accepted accounting principles ("GAAP") related to loan loss allowances. In this regard, FASB Emerging Issues Task Force Topic D-80 includes guidance on certain loan loss accounting issues. In addition, the Joint Working Group of the Agencies (as described in the March 10, 1999 joint letter) is seeking input and guidance from the banking industry and accounting profession in providing additional disclosure and documentation guidance. This interagency letter, building on the prior interagency joint statements, is intended to reaffirm fundamental principles concerning the loan loss allowance and to highlight the future work of the Agencies in this area.

The Agencies have agreed on the following important aspects of loan loss allowance practices:

- Arriving at an appropriate allowance involves a high degree of management judgment and results in a range of estimated losses;

- Prudent, conservative, but not excessive, loan loss allowances that fall within an acceptable range of estimated losses are appropriate. In accordance with GAAP, an institution should record its best estimate within the range of credit losses, including when management's best estimate is at the high end of the range;

- Determining the allowance for loan losses is inevitably imprecise, and an appropriate allowance falls within a range of estimated losses;

- An "unallocated" loan loss allowance is appropriate when it reflects an estimate of probable losses, determined in accordance with GAAP, and is properly supported;

- Allowance estimates should be based on a comprehensive, well-documented, and consistently applied analysis of the loan portfolio; and

- The loan loss allowance should take into consideration all available information existing as of the financial statement date, including environmental factors such as industry, geographical, economic, and political factors.

The Agencies will continue to cooperate and communicate with respect to significant issues of policy through their Chief Accountants' meetings. In addition, the SEC staff will consult with the appropriate banking regulators as part of the SEC's process in determining whether to take a significant action in their review of the accounting for a financial institution's loan loss allowance.

As set forth in the March 10, 1999 joint letter, the Agencies agreed to provide by March 2000 additional guidance regarding documentation and disclosure issues. In addition, as indicated in that joint letter, certain other accounting issues will be addressed over the next two years through the efforts of the AICPA Allowance for Loan Losses Task Force. While this guidance is under development, financial institutions should follow GAAP, including the concepts set forth herein and the guidance included with Topic D-80, as they establish their loan loss allowances for financial reporting purposes.