

**Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Board of Governors of the Federal Reserve System
Office of Thrift Supervision**

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UNIFORM AGREEMENT ON THE CLASSIFICATION OF ASSETS AND APPRAISAL OF SECURITIES HELD BY BANKS AND THRIFTS¹

This Joint Statement of the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision (the Agencies) sets forth uniform supervisory standards on the classification of assets and appraisal of securities held by banks and thrifts.

I. The Classification of Assets in Bank and Thrift Examinations

Classification units are designated as "Substandard," "Doubtful," and "Loss." A Substandard Asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. An asset classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Amounts classified Loss should be promptly charged off.

II. The Appraisal of Securities in Bank and Thrift Examinations

In an effort to streamline the examination process and achieve as much consistency as possible, examiners will use the published ratings provided by nationally recognized statistical ratings organizations (NRSROs) as a proxy for the supervisory classification definitions. Examiners may, however, assign a more or less severe classification for an individual security depending upon a review of applicable facts and circumstances.

A. Investment quality debt securities

Investment quality debt securities are marketable obligations in which the investment characteristics are not distinctly or predominantly speculative. This group generally includes investment securities in the four highest rating categories provided by nationally recognized statistical rating organizations (NRSROs) and unrated debt securities of equivalent quality.

Since investment quality debt securities do not exhibit weaknesses that justify an adverse classification rating, examiners will generally not classify them. However, published credit ratings occasionally lag demonstrated changes in credit quality and examiners may, in limited cases, classify a security notwithstanding an investment grade rating. Examiners may use such

¹ Revises examination procedures established in 1938 and revised July 15, 1949, and May 7, 1979.

discretion, when justified by credit information the examiner believes is not reflected in the rating, to properly reflect the security's credit risk.

B. Sub-investment quality debt securities

Sub-investment quality debt securities are those in which the investment characteristics are distinctly or predominantly speculative. This group generally includes debt securities, including hybrid equity instruments (e.g., trust preferred securities), in grades below the four highest rating categories, unrated debt securities of equivalent quality, and defaulted debt securities.

In order to reflect asset quality properly, an examiner may in limited cases "pass" a debt security that is rated below investment quality. Examiners may use such discretion for example when the institution has an accurate and robust credit risk management framework and has demonstrated, based on recent, materially positive, credit information, that the security is the credit equivalent of investment grade.

C. Rating differences

Some debt securities may have investment quality ratings by one (or more) rating agencies and sub-investment quality ratings by others. Examiners will generally classify such securities, particularly when the most recently assigned rating is not investment quality. However, an examiner has discretion to "pass" a debt security with both investment and sub-investment quality ratings. The examiner may use that discretion if, for example, the institution has demonstrated through its documented credit analysis that the security is the credit equivalent of investment grade.

D. Split/partially-rated securities

Some individual debt securities have ratings for principal, but not interest. The absence of a rating for interest typically reflects uncertainty regarding the source and amount of interest the investor will receive. Because of the speculative nature of the interest component, examiners will generally classify such securities, regardless of the rating for the principal.

E. Non-rated debt securities

The Agencies expect institutions holding individually large non-rated debt security exposures, or having significant aggregate exposures from small individual holdings, to demonstrate that they have made prudent pre-acquisition credit decisions and have effective, risk-based standards for the ongoing assessment of credit risk. Examiners will review the institution's program for monitoring and measuring the credit risk of such holdings and, if the assessment process is considered acceptable, generally will rely upon those assessments during the examination process. If an institution has not established independent risk-based standards and a satisfactory process to assess the quality of such exposures, examiners may classify such securities, including those of a credit quality deemed to be the equivalent of subinvestment grade, as appropriate.

Some non-rated debt securities held in investment portfolios represent small exposures relative to capital, both individually and in aggregate. While institutions generally have the same supervisory requirements (as applicable to large holdings) to show that these holdings are the credit equivalent of investment grade at purchase, comprehensive credit analysis subsequent to purchase may be impractical and not cost effective. For such small individual exposures, institutions should continue to obtain and review available financial information, and assign risk ratings. Examiners may rely upon the bank's internal ratings when evaluating such holdings.

F. Foreign debt securities

The Interagency Country Exposure Review Committee (ICERC) assigns transfer risk ratings for cross border exposures. Examiners should use the guidelines in this Uniform Agreement rather than ICERC transfer risk ratings in assigning security classifications, except when the ICERC ratings result in a more severe classification.

G. Treatment of declines in fair value below amortized cost on debt securities

Under generally accepted accounting principles (GAAP), an institution must assess whether a decline in fair value² below the amortized cost of a security is a "temporary" or "other-than-temporary" impairment. When the decline in fair value on an individual security represents "other-than-temporary" impairment, the cost basis of the security must be written down to fair value, thereby establishing a new cost basis for the security, and the amount of the write-down must be reflected in current period earnings. If an institution's process for assessing impairment is considered acceptable, examiners may use those assessments in determining the appropriate classification of declines in fair value below amortized cost on individual debt securities.

Any decline in fair value below amortized cost on defaulted debt securities will be classified as indicated in the table below. Apart from classification, for impairment write-downs or charge-offs on adversely classified debt securities, the existence of a payment default will generally be considered a presumptive indicator of "other-than-temporary" impairment.

H. Classification of Other Types of Securities

Some investments, such as certain equity holdings or securities with equity-like risk and return profiles, have highly speculative performance characteristics. Examiners should generally classify such holdings based upon an assessment of the applicable facts and circumstances.

² As currently defined under GAAP, the fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices are the best evidence of fair value and must be used as the basis for measuring fair value, if available.

III. Summary Table of Debt Security Classification Guidelines

The following table outlines the uniform classification approach the agencies will generally use when assessing credit quality in debt securities portfolios:

General Debt Security Classification Guidelines

<i>Type of Security</i>	<i>Classification</i>		
	<i>Substandard</i>	<i>Doubtful</i>	<i>Loss</i>
Investment quality debt securities with "temporary" impairment	---	---	---
Investment quality debt securities with "other-than-temporary" impairment	---	---	Impairment
Sub-investment quality debt securities with "temporary" impairment ³ .	Amortized Cost	---	---
Sub-investment quality debt securities with "other-than-temporary" impairment, including defaulted debt securities	Fair Value	---	Impairment

NOTE: Impairment is the amount by which amortized cost exceeds fair value.

The General Debt Security Classification Guidelines do not apply to private debt and equity holdings in a small business investment company or Edge Act Corporation. The Uniform Agreement does not apply to securities held in trading accounts, provided the institution demonstrates through its trading activity a short-term holding period or holds the security as a hedge for a valid customer derivative contract.

IV. Credit Risk Management Framework for Securities

When an institution has developed an accurate, robust, and documented credit risk management framework to analyze its securities holdings, examiners may choose to depart from the General Guidelines in favor of individual asset review in determining whether to classify those holdings. A robust credit risk management framework entails appropriate pre-acquisition credit due diligence, by qualified staff that grades a security's credit risk based upon an analysis of the repayment capacity of the issuer and the structure and features of the security. It also involves the on-going monitoring of holdings to ensure that risk ratings are reviewed regularly and updated in a timely fashion when significant new information is received.

The credit analysis of securities should vary based on the structural complexity of the security, the type of collateral, and external ratings. The credit risk management framework should reflect the size, complexity, quality, and risk characteristics of the securities portfolio, the risk appetite and policies of the institution, and the quality of its credit risk management staff, and should reflect changes to these factors over time. Policies and procedures should identify the extent of credit analysis and documentation required to satisfy sound credit risk management standards.

³ For sub-investment quality available-for-sale (AFS) debt securities with "temporary" impairment, amortized cost rather than the lower amount at which these securities are carried on the balance sheet, i.e., fair value, is classified Substandard. This classification is consistent with the regulatory capital treatment of AFS debt securities. Under GAAP, unrealized gains and losses on AFS debt securities are excluded from earnings and reported in a separate component of equity capital. In contrast, these unrealized gains and losses are excluded from regulatory capital. Accordingly, the amount classified Substandard on these AFS debt securities, i.e., amortized cost, also excludes the balance sheet adjustment for unrealized losses.