



**BOARD OF GOVERNORS**  
OF THE  
**FEDERAL RESERVE SYSTEM**

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

**SR 11-15**

**December 21, 2011**

**TO THE OFFICER IN CHARGE OF SUPERVISION  
AT EACH FEDERAL RESERVE BANK**

**SUBJECT: Disposal of Problem Assets through Exchanges**

**Applicability to Community Banking Organizations:** This letter applies to all state member banks, bank holding companies and their nonbank subsidiaries, and savings and loan holding companies that engage in asset exchange transactions, including those with \$10 billion or less in consolidated assets.

Financial institutions are increasingly exploring strategies to dispose of or reduce nonperforming assets and other real estate owned (OREO). Some of these strategies include so-called “asset exchanges,” whereby third parties or marketing agents have offered to purchase problem assets from institutions and replace them with performing assets. While such transactions, if properly executed with reputable counterparties and subjected to the appropriate level of due diligence, could achieve the objective of reducing nonperforming assets on financial institutions’ balance sheets, Federal Reserve staff have been made aware of transactions that may present significant risk to institutions and could compromise their safety and soundness. To date, these transactions have been encountered primarily at smaller community banks.

The Federal Reserve is issuing the attached guidance, including an example of an asset exchange transaction, to highlight the potential risks associated specifically with transactions which may reduce problem assets in the short term, but where a lack of appropriate, up-front due diligence may result in heightened risks over the longer term. In addition, inappropriate assumptions used in determining the fair value of the purchased assets may result in institutions being required to recognize losses shortly after inception of the transaction.

For questions about credit and regulatory issues, please contact Donald Gabbai, Senior Supervisory Financial Analyst, Credit, Market & Liquidity Risk Policy, at (202) 452-3358, or Mary Aiken, Manager, Credit, Market & Liquidity Risk Policy, at (202) 452-4534; for questions about accounting treatment, please contact Matthew Kincaid, Senior Accounting Policy Analyst,

Accounting Policy & Disclosure, at (202) 452-2028. In addition, questions may be sent via the Board's public website.<sup>1</sup>

Maryann F. Hunter  
Deputy Director

Attachments:

- A. Disposal of Problem Assets through Exchanges*
- B. Asset Exchange Example*

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<sup>1</sup> See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.