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*Katrina's Wake: Restoring Financial Services*

William D. Jackson and Barbara L. Miles, Government and Finance Division

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**Abstract.** In the wake of Hurricane Katrina, damage to the financial infrastructure appears to be largely confined to small depository institutions. Directives stemming from the 9/11 attacks require most banking and securities firms to maintain off-site redundancy for significant personnel and daily data backups. The damaged area is sufficiently wide, however, and the possibility of long-term loan delinquency sufficiently high, that greater harm may yet surface. To date, most depository institutions are functioning to some degree and, despite concerns over large withdrawals, regulators say they do not expect any to fail as a result of the damage. Regulators are working with banks and credit unions to provide considerable relief to customers hard-hit by the storm. Some lenders have announced customer relief programs ranging from waivers of ATM fees and increases in cash electronic withdrawal limits to cessation of foreclosure procedures and automatic forbearance for mortgage payments for the months of September through November. Congress has been briefed by the major regulators, and hearings were held by the House Financial Services Committee on September 14, 2005. In addition, there are some calls for (1) an emergency increase in deposit insurance ceilings to reassure major depositors that their funds are safe, (2) legislation providing temporary relief from antimoney-laundering and know-your-customer requirements in aid of check cashing and other needs, and (3) provisions for government-sponsored enterprises (GSEs) to make affordable housing allocations to victims..

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# CRS Report for Congress

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## Katrina's Wake: Restoring Financial Services

William D. Jackson and Barbara L. Miles  
Specialists in Financial Institutions  
Government and Finance Division

### Summary

In the wake of Hurricane Katrina, damage to the financial infrastructure appears to be largely confined to small depository institutions. Directives stemming from the 9/11 attacks require most banking and securities firms to maintain off-site redundancy for significant personnel and daily data backups. The damaged area is sufficiently wide, however, and the possibility of long-term loan delinquency sufficiently high, that greater harm may yet surface. To date, most depository institutions are functioning to some degree and, despite concerns over large withdrawals, regulators say they do not expect any to fail as a result of the damage.

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This report will be updated to reflect new developments.

Beginning August 29, 2005, Hurricane Katrina disrupted both power and communications in parts of Mississippi, Alabama, and Louisiana. Cash could not be withdrawn; checks could not be cashed; and debit and credit card networks — including an unknown number of ATMs — were down. In addition, facilities of a number of financial institutions were destroyed by wind, or made inaccessible by water. The latter included the New Orleans branch of the Federal Reserve Bank of Atlanta, which supplies check and cash services to southern Louisiana and the nearby Gulf Coast.

Such effects, however, are mostly short term, and regulators have experience in ameliorating the problems caused by physical destruction. The Atlanta Federal Reserve instituted armored car deliveries of currency to operating bank locations, moved check clearing operations to Atlanta, and maintained the discount window to assist all depositories in meeting their needs for liquidity, among other actions.<sup>1</sup> By September 7, in a briefing with House Financial Services Committee members, financial regulators were able to report that the financial system was functioning well in the crisis, with banks coming to the aid of other banks in handling cash and checks, and a variety of regulatory relief initiatives beginning to take hold. Many protective protocols put in place following the terrorist attacks of 9/11 and the hurricanes of 2004 appear to have proved their worth. Those protocols, which were required of all but the smallest depository institutions, included maintaining critical personnel and data storage (with at least daily backups) at sites at least 20 miles distant from a bank's headquarters.<sup>2</sup> Apparently, in almost every case, backing up data has worked despite loss of electricity.

As of September 20, the Federal Deposit Insurance Corporation (FDIC) reported that it had heard from all 280 insured depository institutions in the Gulf area, and that most were operating, with 95% of branches in the affected area open.<sup>3</sup> The National Credit Union Administration (NCUA) had earlier said that all 139 federally insured credit unions in affected areas were operational, counting those operating via back-up sites.<sup>4</sup> Industry representatives testified about resumption of operations before the House Subcommittee on Financial Institutions and Consumer Credit on September 14, 2005.<sup>5</sup>

## Regulatory Actions and Advisories

Joint guidance provided by federal bank regulators — the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Reserve Board, and the Federal Deposit Insurance Corporation — advised a temporary easing of regulations, although each financial institution is left to decide on its own how to follow this guidance, and emergency procedures are to remain consistent with safe and sound banking practices.<sup>6</sup> Specific actions permitted under the federal guidance include

- waiving ATM fees for customers and noncustomers;
- increasing ATM daily cash withdrawal limit;
- easing restrictions on cashing out-of-state and non-customer checks;
- waiving overdraft fees as a result of paycheck interruption;
- waiving early withdrawal penalties on time deposits;

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<sup>1</sup> See [<http://www.frbatlanta.org>].

<sup>2</sup> See CRS Report RL31873, *Homeland Security: Banking and Financial Infrastructure Continuity*, by William D. Jackson.

<sup>3</sup> “Tallying Katrina’s Impact Could Take Years,” *American Banker*, Sep. 20, 2005.

<sup>4</sup> See [[http://www.ncua.gov/news/press\\_releases/2005/NR05-0916.htm](http://www.ncua.gov/news/press_releases/2005/NR05-0916.htm)].

<sup>5</sup> See [<http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=415>].

<sup>6</sup> See [<http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050901/default.htm>].

- waiving availability restrictions on insurance checks;
- allowing loan customers to defer or skip some payments;
- waiving late fees for credit card and other loan balances due to interruption of mail or customers' inability to access funds;
- easing credit card limits and credit terms for new loans; and
- delaying delinquency notices to the credit bureaus.

For credit unions, NCUA issued a temporary ruling waiving restrictions under which they normally operate. Emergency services — including check cashing, and ATM access — can be provided to nonmembers.<sup>7</sup> Members may receive services at other institutions. NCUA can use its insurance authority to guarantee loans to affected credit unions.

These agencies have also formed a working group to coordinate emergency responses on both state and national levels to “provide institutions with clear, timely, and consistent information on areas of concern.” It is associated with the Federal Financial Institutions Examination Council.<sup>8</sup>

## Depository Institutions

The view of most regulators is that the banking system, both in terms of safety and soundness and in terms of financial infrastructure, is well on the way to overcoming the short-term difficulties presented by Katrina. The system-wide view may miss serious problems at individual institutions, particularly smaller banks whose business activities were concentrated in the hurricane area. Banks whose depositors have an urgent need for cash, and whose loan collateral is believed to lie under water or otherwise to have been destroyed, could face at least temporary financial distress, if not failure. Federal Reserve actions can maintain liquidity, but there is some anecdotal evidence that major depositors are withdrawing their funds from smaller banks out of concern that the banks may fail and they may lose amounts that are above the deposit insurance ceiling. Since no bank can withstand a serious “run” on deposits, some bankers have called for a temporary increase in the deposit insurance ceiling to reassure depositors during the emergency.<sup>9</sup>

Another concern is that the need to provide emergency services to hurricane victims may conflict with anti-money laundering regulations intended to keep drug lords and terrorists from using the banking system. The Gulf is said to have largely reverted to a cash economy,<sup>10</sup> and large cash transactions are normally subject to stringent reporting and know-your-customer requirements. In addition, many evacuees lack the records or forms of identification that a bank would usually require. While regulators have issued advisories that appear to suspend or relax rules concerning money laundering, customer identification, and other requirements,<sup>11</sup> they have also left banks some discretion in following those advisories. Some bankers have expressed concern that if

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<sup>7</sup> See [[http://www.ncua.gov/news/press\\_releases/2005/NR05-0831-2.htm](http://www.ncua.gov/news/press_releases/2005/NR05-0831-2.htm)].

<sup>8</sup> See [<http://www.ffiec.gov/press/pr091905.htm>].

<sup>9</sup> “Storm-Hit Bankers Carry Plea to FDIC,” *American Banker*, Sep. 7, 2005, p.1.

<sup>10</sup> “Matter of Perspective,” *American Banker*, Sep. 12, 2005, p.1.

<sup>11</sup> See [<http://www.fdic.gov/news/news/financial/2005/fi19105.html>].

they expedite major cash transactions (those of \$10,000 or more) by not completing the anti-money-laundering paper work, or if they open an account for a displaced Katrina victim with only minimal information, they may later be penalized for poor discretion. There have been calls for temporary relief from these regulatory requirements.<sup>12</sup>

Finally, it is not clear that all existing financial institutions will ultimately survive the disaster. The most important reason is the loss of assets in the area. Homes and businesses that provide much of the loan collateral for smaller institutions are gone and may not be revived, or insurance may not be adequate to make the loans whole. In addition, many customers of the banks are gone and may never return. Either loss could well prove sufficient to end profitability of some banks.

Banks and the finance units of the nation's automakers are offering some relief to borrowers affected by Hurricane Katrina. For example, Bank of America, J.P. Morgan Chase, and Wells Fargo are letting their customers defer payments on mortgages and home-equity lines for up to 90 days.<sup>13</sup> General Motors, Ford Motor, and DaimlerChrysler<sup>14</sup> are offering payment relief for customers who took out loans via their financing units.

Bankers also have some incentive to send longer-term funds into affected areas. Under the Community Reinvestment Act (CRA), banking businesses are graded on their socially-directed loans, investments, and services. Coincidentally, effective September 1, 2005, the scope of application of this act was expanded concerning community development. The definition of community development now includes activities that revitalize or stabilize distressed or underserved rural areas and designated disaster areas. Federal or state governments designate disaster areas, which would include those severely damaged in the hurricane, thus allowing banks anywhere in the nation to meet their CRA obligations by assisting in the recovery. Assistance to displaced evacuees qualifies.<sup>15</sup>

## Mortgage Lenders

Fannie Mae and Freddie Mac buy residential mortgages and either hold them ("in portfolios") or repackage them into mortgage-backed securities for sale. Both GSEs have large numbers of mortgages secured by residences in the hurricane zone. Both have announced that they will continue to make interest and principal payments due to holders of mortgage-backed securities in a timely manner, despite likely disruptions of payments from homeowners in the affected areas.

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<sup>12</sup> "Matter of Perspective," *American Banker*, Sep. 12, 2005, p.1.

<sup>13</sup> See [<http://www.bankofamerica.com/newsroom/press/press.cfm?PressID=press.20050901.03.htm>], [[http://www.wellsfargo.com/jump/hurricane\\_relief.jhtml](http://www.wellsfargo.com/jump/hurricane_relief.jhtml)], and [<http://investor.shareholder.com/jpmorganchase/press/releasedetail.cfm?ReleaseID=172182>].

<sup>14</sup> See [<http://www.generalmotors.com>], [<http://teamusa.ford.com/>], and [<http://www.daimlerchrysler.com/dccom/0,,0-5-7145-1-538484-1-0-0-0-0-9-0-0-0-0-0-0-0,00.html>].

<sup>15</sup> See CRS Report RS20197, *Community Reinvestment Act: Regulation and Legislation*, by William D. Jackson. This policy is applied to Katrina explicitly at [<http://www.occ.treas.gov/HurricaneQA.htm#Comm>].

**Fannie Mae**<sup>16</sup> has announced that its relief provisions include directing its primary lenders and mortgage servicers to suspend mortgage payments for up to three months, and reduce payments to up to 18 months (or longer in severe cases). All such assistance is on a case-by-case basis and will take into account uninsured losses, extended unemployment, and extraordinary expenses related to the storm and its aftermath. It has also told lenders to suspend any reporting of delinquent mortgages to credit bureaus where the delinquencies are attributable to the disaster and are encouraged to waive penalties or late fees against borrowers with disaster-damaged properties.

**Freddie Mac**<sup>17</sup> has announced an immediate suspension for three months of mortgage payments for all borrowers in affected areas (unless the homeowner indicates otherwise) and lender discretion to reverse any September payments back to the borrowers' accounts. Freddie Mac has stopped any late payment collection activities or foreclosures underway before the disaster. Lenders are to suspend reporting of delinquent mortgages to credit bureaus, and may not assess late charges or other penalties for storm-damaged properties during the three-month period. After the three-month period, lender/servicers are to decide on a case-by-case basis if properties warrant additional forbearance or reduced payments (for up to nine more months). Workouts are also available beyond one year. Freddie's Multifamily Division is additionally offering a 90-day moratorium on apartment loans affected by Katrina.

**The Federal Home Loan Banks (FHLBs)** are lenders to the banks that are members of the FHLB system. The most immediately affected Bank is the Federal Home Loan Bank of Dallas, which covers Louisiana and Mississippi. While the Dallas FHLB does not directly buy and sell mortgages, it does claim bank assets (mainly mortgages) as collateral for the loans it makes to its member banks. The Dallas FHLB has announced that it is making special disaster relief funding available to the affected areas in its jurisdiction, as has the Cincinnati FHLB for evacuees moved into its area.<sup>18</sup> Specifically, the Dallas FHLB will lend funds to the local member banks below its cost of funds to assist in recovery efforts in all federally designated disaster areas. The funding is available from overnight to as long as thirty years. In turn, FHLB system member banks make low-cost loans available to individuals and families with incomes up to 165% of area medians whose homes or businesses Katrina damaged or destroyed.

**FHA**-insured loans are run via the Department of Housing and Urban Development (HUD). The department has had long-standing policies to deal with a Presidential Major Disaster Declaration, remaining in effect for one year after the declaration, on a county-by-county basis. It can allow for 100% financing to reconstruct or replace destroyed property; relaxation of income requirements for borrowers; mortgage modifications; forbearance; waivers of late charges; and a 90-day moratorium on foreclosures for the covered mortgages. The **Department of Veterans Affairs**, separately, has requested a 90-day moratorium on foreclosures for its VA borrowers, and

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<sup>16</sup> See [<http://www.fanniemae.com/newsreleases/2005/3593.jhtml;jsessionid=LCQWW1M0SDMAZJ2FQSHSFGQ?p=Media&s=News+Releases>].

<sup>17</sup> See [[http://www.freddiemac.com/news/archives/corporate/2005/20050908\\_hurricanekatrina.html](http://www.freddiemac.com/news/archives/corporate/2005/20050908_hurricanekatrina.html)].

<sup>18</sup> "FHLBs to Give \$20M," *American Banker*, Sep. 22, 2005.

additional forbearance such as waiving late charge payments and suspending bad credit reports.<sup>19</sup> The **Small Business Administration** is making physical and economic disaster loans, which may include home as well as business and commercial realty loans.<sup>20</sup>

## Securities

Katrina's impact on securities investors appears to be much smaller than on banks and their customers. New Orleans is not a market center, and the securities industry has been subject to data backup rules since the pre-2000 preparations for Y2K. The Securities and Exchange Commission (SEC) took steps to ease compliance deadlines and to ensure that individuals with sudden financial needs are able to contact securities firms.<sup>21</sup>

The National Association of Securities Dealers (NASD), which lost its New Orleans office, provided guidance to its broker/dealer members, including

- emergency office relocations;
- books and records;
- handling customers funds and securities; and
- customer communications.

As for stock and bond prices themselves, the markets have exhibited resiliency, with stock index prices showing little change from pre-hurricane patterns. Interest rates on long-term securities actually fell during the period. If aid receipts are insufficient to overcome economic shocks, holders of municipal bonds issued by affected jurisdictions may face losses, but these should not have a major impact on the bond market as a whole. Louisiana is actually planning to sell a new series of bonds to aid recovery projects.

## Hotlines for Further Information

The following are official sources of information on matters addressed in this report, at least as points of first contact, for affected parties and government bodies.

Banks: Federal Deposit Insurance Corporation, 1-877-275-3342.

Credit Unions: National Credit Union Administration, 1-800-827-6282.

Mortgages: Department of Housing and Urban Affairs, 1-888-297-8685.

Stocks and Bonds: Securities and Exchange Commission, 1-800-SEC-0330.

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<sup>19</sup> See [<http://www.homeloans.va.gov/katrina.htm>].

<sup>20</sup> See [[http://www.sba.gov/disaster\\_recov/basics/faqs.html](http://www.sba.gov/disaster_recov/basics/faqs.html)].

<sup>21</sup> U.S. Securities and Exchange Commission, "SEC Announces Assistance to Katrina Victims," press release, Sept. 2, 2005, at [<http://www.sec.gov/news/press/2005-125.htm>].