
OPS NOTES

May2012

Issue: 2012-5

Topic: **Loan Workouts and Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans**

Summary

NCUA has amended its regulations to require federally insured credit unions (FICUs) to maintain written policies that address the management of loan workout arrangements and nonaccrual policies for loans, consistent with industry practice or Federal Financial Institutions Examination Council (FFIEC) requirements. The final rule includes guidelines, set forth as an interpretive ruling and policy statement (IRPS) and incorporated as an appendix to the rule, that will assist FICUs in complying with the rule, including the regulatory reporting of troubled debt restructured loans (TDR loans or TDRs) in FICU Call Reports.

The effective date for this rule is **July 2, 2012**. The compliance date is extended to **October 1, 2012** for the rule's requirements to adopt written policies addressing loan workouts and nonaccrual practices and to **December 31, 2012** to collect nonaccrual status data.

Final Rule and IRPS

Lending Policies

The final rule requires FICUs to adopt policies that govern loan workout arrangements and nonaccrual practices. A FICU's written nonaccrual standards must include the discontinuance of interest accrual on loans that are past due by 90 days or more and requirements for returning such loans, including MBLs workouts, to accrual status.

To set NCUA's supervisory expectations and assist FICUs in compliance, the final rule includes an appendix to Part 741, which thoroughly addresses the loan workout account management and reporting standards FICUs must implement in order to comply with the rule. It also explains how FICUs report their data collections related to TDRs on Call Reports.

Appendix C to Part 741, Interpretive Ruling and Policy Statement on Loan Workouts, Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans

Written Loan Workout Policy and Monitoring Requirements

The final rule requires the FICU board and management to adopt and adhere to an explicit written policy and standards that control the use of loan workouts, and establish controls to ensure the policy is consistently applied. The loan workout policy and practices should be commensurate with each credit union's size and complexity, and must be in line with the credit union's broader risk mitigation strategies.

The policy must do the following:

- Define eligibility requirements (i.e. under what conditions the FICU will consider a loan workout), including establishing limits on the number of times an individual loan may be modified. [**Note:** Broad-based credit union programs commonly used as a member benefit and implemented in a safe and sound manner limited to only accounts in good standing, such as Skip-a-Pay programs, are **not** intended to count toward these limits.]
- Ensure the FICU makes loan workout decisions based on the borrower's renewed willingness and ability to repay the loan.
- Establish sound controls to ensure loan workout actions are appropriately structured, including a prohibition against any authorizations of additional advances to finance unpaid interest and credit union fees. The policy *may* allow a FICU to make advances to cover third-party fees, such as force-placed insurance or property taxes. The FICU, however, cannot finance any related commissions it may receive from the third party.
- Ensure adequate controls and monitoring by the board of directors and management. Decisions to re-age, extend, defer, renew, or rewrite a loan, like any other revision to contractual terms, must be supported by the FICU's management information systems.
- Ensure appropriate documentation showing the FICU's personnel communicated with the borrower, the borrower agreed to pay the loan in full, and the borrower has the ability to repay the loan under the new terms.

If FICUs engage in restructuring activity on a loan that results in restructuring a loan more often than once a year or twice in five years, examiners will have higher expectations for the documentation of the borrower's renewed willingness and ability to repay the loan. Examiners will ask FICUs to provide evidence that their policy of permitting multiple restructurings improve collectability.

NCUA does **not** intend for these minimum requirements to be an all-inclusive list.

Regulatory Reporting of Workout Loans Including TDR Past Due Status

The final IRPS mandates that the past due status of all loans should be calculated consistent with loan contract terms, including amendments made to loan terms through a formal restructure. The IRPS eliminates the current, dual, and often manual delinquency tracking burden on FICUs managing and reporting TDR loans, while instituting a nonaccrual policy on TDR loans apart from past due status. The Call Report instructions will be modified accordingly.

Additionally, the final IRPS institutes revised Call Report data collections related to loan workouts will focus data collection on TDR loans. Additional data elements will be included as necessary to effectively monitor and measure TDR activity and corresponding risk to the NCUSIF.

Loan Nonaccrual Policy

The final rule and IRPS require a FICU to adopt written nonaccrual policies that specifically address the discontinuance of interest accrual on loans past due by 90 days or more, as well as the requirements for returning such loans (including member business loan workouts) to accrual status.

a. Nonaccrual Status

Under the IRPS, FICUs may **not** accrue interest on any loan upon which principal or interest has been in default for a period of 90 days or more, unless the loan is both “well secured” and “in the process of collection.” Additionally, FICUs must place loans in nonaccrual status if maintained on a Cash (or Cost Recovery) basis because of deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected.

b. Restoration to Accrual Status (not including Member Business Loan Workouts)

Under the IRPS, a nonaccrual loan may be returned to accrual status when:

- Its past due status is less than 90 days, GAAP does not require it to be maintained on the Cash or Cost Recovery basis, and the credit union is plausibly assured of repayment of the remaining contractual principal and interest within a reasonable period;
- When it otherwise becomes well secured and in the process of collection; or
- The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of income under the interest method specified therein.

In restoring all loans to accrual status, if any interest payments received while the loan was in nonaccrual status were applied to reduce the recorded investment in the loan the application of these payments to the loan's recorded investment must not be reversed (and interest income must not be credited). Likewise, accrued but uncollected interest reversed or charged off at the point the loan was placed on nonaccrual status cannot be restored to accrual; it can only be recognized as income if collected in cash or cash equivalents from the member.

c. Restoration to Accrual Status on Member Business Loan Workouts

The final IRPS requires a formally restructured member business loan workout to remain in nonaccrual status until the FICU can document a current credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. The evaluation must include consideration of the borrower's sustained historical repayment performance for a reasonable period prior to the date on which the loan is returned to accrual status.

A sustained period of repayment performance would be a minimum of six (6) consecutive timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents. In returning the member business workout loan to accrual status, sustained historical repayment performance for a reasonable time prior to the restructuring may be taken into account. Such a restructuring must improve the collectability of the loan in accordance with a reasonable repayment schedule and does not relieve the FICU from the responsibility to promptly charge off all identified losses.