

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 741

RIN 3133-AE01

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

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Proposed rule with request for comments.

**SUMMARY:** NCUA proposes to amend 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 proposed rulemaking 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 NCUA Board

(Board) believes this proposed rulemaking and IRPS is timely considering the growth of these types of loans during the recent economic stresses experienced in the financial industry.

**DATES:** Send your comments to reach us on or before [Insert date 30 days from date of publication in the FEDERAL REGISTER]. We may not consider comments received after the above date in making our decision on the proposed rule.

**ADDRESSES:** You may submit comments by any of the following methods (Please send comments by one method only):

- Federal eRulemaking Portal: [http:// www.regulations.gov](http://www.regulations.gov). Follow the instructions for submitting comments.
- NCUA Web Site: <http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx>. Follow the instructions for submitting comments.
- E-mail: Address to [regcomments@ncua.gov](mailto:regcomments@ncua.gov). Include “[Your name] Comments on Proposed Rule 741/IRPS 12-1, “Loan Workouts” in the e-mail subject line.
- Fax: (703) 518–6319. Use the subject line described above for e-mail.

- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

- Hand Delivery/Courier: Same as mail address.

**PUBLIC INSPECTION:** You can view all public comments on NCUA’s website at <http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx> as submitted, except for those we cannot post for technical reasons. NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in NCUA’s law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to [OGCmail@ncua.gov](mailto:OGCmail@ncua.gov).

**FOR FURTHER INFORMATION CONTACT:** Director of Supervision Matthew J. Biliouris and Chief Accountant Karen Kelbly, Office of Examination and Insurance; at the above address or telephone: (703) 518-6360.

**SUPPLEMENTARY INFORMATION:**

- I. Background
- II. The Rule and IRPS as Proposed
- III. Analysis of Rule Amendment and IRPS
- IV. Regulatory Procedures

## I. Background

Why is NCUA proposing this rule and IRPS?

The economic challenges of the last several years have resulted in an increasing number of distressed borrowers. In order to better serve members experiencing financial difficulties and improve collectability, FICUs have worked with members and offered sensible workout loans, including programs offered through the Obama Administration's "Making Home Affordable Program" (MHA). MHA is an important part of the Obama Administration's comprehensive plan to stabilize the U.S. housing market by helping homeowners get mortgage relief and avoid foreclosure.<sup>1</sup>

NCUA Call Report data illustrates FICU loan modifications have increased 60 percent, or \$5 billion, from March 2010 to September 2011, proving FICUs are working with their members during this stressful economic downturn.<sup>2</sup> FICUs reported \$13.5 billion in outstanding balances of loans that have been modified on the September 2011 Call Report, of which 62.6 percent, or \$8.5 billion, are TDR loans – see Figure 1 below.<sup>3</sup>

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<sup>1</sup> MHA was developed to help homeowners avoid foreclosure, stabilize the country's housing market, and improve the nation's economy. MHA includes such programs as the "Home Affordable Refinance Program" (HARP) and "Home Affordable Modification Program" (HAMP). Programs such as these further enable FICUs to provide workout loans to their members. For additional information regarding programs available through MHA see <http://www.makinghomeaffordable.gov/pages/default.aspx>.

<sup>2</sup> NCUA began collecting data on modified real estate loans with the September 30, 2008 Call Report. Data regarding other types of modified loans was added with the March 31, 2010 Call Report.

<sup>3</sup> "Troubled Debt Restructuring" is as defined in generally accepted accounting principles (GAAP) and means a restructuring in which a credit union, for economic or legal reasons related to a member borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. The restructuring of a loan may include, but is not necessarily limited to: (1) the transfer from the borrower to the credit union of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the

FICUs reported modifying \$4 billion in loans, with \$2.4 billion reported as TDR loans, for the first nine months of 2011. September 2011 data also reported approximately 42,000 delinquent modified loans totaling \$2.2 billion, which equates to a 16.42 percent delinquency rate for these loans.

Figure 1 – Summary of Loan Modification Data

|           |                  | Reported Modified Loan Count | Reported Modified Loan Balance | Percent of Total Loans Outstanding | Reported Delinquent Modified Loan Count <sup>4</sup> | Reported Delinquent Modified Loan Balance | Delinquent Modified Percentage |
|-----------|------------------|------------------------------|--------------------------------|------------------------------------|--|---|--------------------------------|
| 2008      | FCU <sup>5</sup> | 4,855                        | \$702,903,362                  | 0.23%                              | N/A  | \$156,418,754                             | 22.25%                         |
|           | FISCU            | 5,400                        | \$782,308,903                  | 0.30%                              | N/A  | \$164,981,230                             | 21.09%                         |
|           | Totals           | 10,255                       | \$1,485,212,265                | 0.26%                              | N/A  | \$321,399,984                             | 21.64%                         |
| 2009      | FCU              | 15,562                       | \$2,779,601,418                | 0.89%                              | 3,259  | \$619,178,160                             | 22.28%                         |
|           | FISCU            | 19,485                       | \$3,247,090,975                | 1.24%                              | 3,590  | \$679,078,846                             | 20.91%                         |
|           | Totals           | 36,047                       | \$6,026,692,393                | 1.05%                              | 6,849  | \$1,298,257,006                           | 21.54%                         |
| 2010      | FCU              | 189,809                      | \$6,161,299,433                | 2.01%                              | 23,390   | \$1,024,208,423                           | 16.62%                         |
|           | FISCU            | 116,259                      | \$5,561,026,453                | 2.15%                              | 16,330   | \$1,084,561,131                           | 19.50%                         |
|           | Totals           | 306,068                      | \$11,722,325,886               | 2.08%                              | 39,720   | \$2,108,769,554                           | 17.99%                         |
| Sept 2011 | FCU              | 207,067                      | \$6,789,980,370                | 2.20%                              | 21,274   | \$929,089,211                             | 13.68%                         |
|           | FISCU            | 141,235                      | \$6,705,125,149                | 2.59%                              | 20,662   | \$1,287,161,821                           | 19.20%                         |
|           | Totals           | 348,302                      | \$13,495,105,519               | 2.38%                              | 41,936   | \$2,216,251,032                           | 16.42%                         |

loan, (2) a modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or (3) a combination of the above. A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured troubled loan. FASB ASC 310-40, "Receivables, Troubled Debt Restructurings by Creditors."

<sup>4</sup> NCUA began collecting the number of delinquent modified loans with the September 30, 2009 Call Report.

<sup>5</sup> Federal Credit Union (FCU) and Federally-Insured State Credit Union (FISCU).

As specified in the “Interagency Question and Answers for Accounting for Loan and Leases Losses” and distributed through NCUA Accounting Bulletin 06-01 (December 2006), NCUA’s current regulatory reporting policy for TDR loans is:<sup>6</sup>

For regulatory reporting purposes on the Call Report, credit unions should report TDR loans (as defined in GAAP) as delinquent consistent with the original loan contract terms until the borrower/member has demonstrated an ability to make timely and consecutive monthly payments over a six month period consistent with the restructured terms. Likewise, such loans may not be returned to full accrual status until the six month consecutive payment requirement is met.

As previously discussed, data supports FICUs are modifying loans to assist their members, the majority of which are considered TDRs. The increased volume of this activity coupled with the existing reporting requirements has underscored the practical challenges for the industry. The Board is aware that in order to follow the agency’s Call Report instructions for TDRs, most FICUs must maintain separate, manual delinquency computations and nonaccrual schedules. In response to feedback from the industry and in the spirit of reduced regulatory burden, the Board proposes to revise this reporting requirement and allow delinquency on TDR loans to be calculated consistent with loan contract terms, including amendments made to loan terms by a formal restructure.

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<sup>6</sup> Current Call Report instructions reflect this requirement. See <http://www.ncua.gov> for additional information.

The Board also believes there is confusion regarding what NCUA has defined on the Call Report as a “Modified Loan” for purposes of data collection, workout loans as defined in various interagency guidance, and TDRs as defined by GAAP. To address this confusion, the Board proposes to further revise the regulatory reporting requirements by eliminating data collection on “Modified Loans” and targeting data collection efforts to loans meeting the definition of a TDR under GAAP. In addition, it is important to recognize the Financial Accounting Standards Board (FASB) issued on April 5, 2011, Accounting Standards Update No. 20-11 – Receivables (Topic 310) “A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring.”<sup>7</sup> This Standards Update clarified the definition of a TDR, which has the practical effect in the current economic environment to broaden loan workouts that constitute a TDR. Therefore, the Board concludes that focusing regulatory reporting requirements on TDRs will satisfy NCUA’s data collection and offsite supervision needs.

Over the last several years, the Board has reconfirmed its view that prudent and sound loan workouts can be an effective tool to assist financially distressed members. Similarly, the Board understands and recognizes the need to effectively balance appropriate loan workout programs with potential safety and soundness considerations. Safety and soundness concerns related to such programs include the potential to mask deterioration in the quality of the loan portfolio, especially given the tendency for a high degree of relapse into past due status; delay loss recognition; and to ensure appropriate

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<sup>7</sup> This standard is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods.

income recognition.<sup>8</sup> The Board's current policy of requiring delinquency be calculated on the original contract terms for six consecutive payments under the restructured terms was intended to provide the regulatory controls necessary to address the issues described above. With the proposal to modify this regulatory reporting requirement, the Board is clarifying regulatory expectations for the proper control of these lending activities.<sup>9</sup> These include requiring each FICU to have a written loan workout policy and associated monitoring and controls, and formalizing the existing practice of nonaccrual standards for past due loans.

Call Report data further indicates FISCUs engage in comparable volume of this type of activity and experience similar performance trends as FCUs (see Table 1 above). As both FCUs and FISCUs actively engage in loan workout programs it is important for managing risk to the National Credit Union Share Insurance Fund (NCUSIF) that all FICUs adhere to the same minimum standards for such programs. The Board, therefore, proposes to amend Section 741.3 relating to required FICU lending policies in order to specifically address the management of loan workouts and nonaccrual practices.

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<sup>8</sup> See NCUA Letter to Credit Unions (LCU) 07-CU-06 "Working with Residential Mortgage Borrowers" at <http://www.ncua.gov>; FFIEC Press Release dated March 4, 2009, "Making Home Affordable" at <http://www.ncua.gov>; LCU 09-CU-04, "Making Homes Affordable – A Program for Mortgage" at <http://www.ncua.gov>; FFIEC Press Release August 6, 2009 at <http://www.ffiec.gov>; LCU 10-CU-07, "Commercial Real Estate Loan Workouts" at <http://www.ncua.gov>.

<sup>9</sup> At the time of publishing the Interagency ALLL Policy Statement (July 2001), the banking regulators, through the FFIEC, had in place policy requirements related to the loan account management matters, in guidance entitled "Uniform Retail Credit Classification and Account Management Policy." 65 FR 36903 (June 12, 2000). When the Board implemented IRPS 02-3 conforming the ALLL to GAAP and banking regulators' like policies, it did not adopt parallel loan account management guidance for FICUs.



## II. The Rule and IRPS as Proposed

### A. How would the proposal change current practice?

This proposal establishes standards for the management of loan workout arrangements that assist borrowers; revises regulatory reporting requirements related to TDR loans; and reaffirms the existing policy and practice within the credit union industry of placing loans on nonaccrual status when they reach 90 days past due. The following table summarizes these specific changes:

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| <b>Topic</b>   | <b>Current Requirement</b>   | <b>Proposed Requirement</b>   | <b>Current Requirement Reference</b>  |
|--|--|---|---|
| Loan workout policy  | No formal requirement.<br><br>NOTE – NCUA has provided specific guidance on loan modification policies for real estate loans and commercial loan workouts. | All federally insured credit unions must have a written loan workout policy.  | NCUA Letter to Credit Unions (LCU) 09-CU-19, “Evaluating Residential Real Estate Mortgage Loan Modification Program,” (September 2009), <a href="http://www.ncua.gov">http://www.ncua.gov</a><br><br>FFIEC “Uniform Retail Credit Classification and Account Management Policy” 65 FR 36903 (June 12, 2000) LCU 10-CU-07, “Commercial Real Estate Loan Workouts, transmitting Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts”(June 2010), and Enclosure <a href="http://www.ncua.gov">http://www.ncua.gov</a> . |
| TDR Delinquency Reporting                                    | Calculate and report TDR loan delinquency based on original contract terms until the member has made six consecutive payments under modified terms.        | Calculate and report TDR loan delinquency based on restructured contract terms.   | 2006 Interagency Allowance for Loan and Lease Losses (ALLL) Policy Statement and Interagency FAQ on ALLL transmitted by NCUA Accounting Bulletin 06-1 (December 2006), <a href="http://www.ncua.gov">http://www.ncua.gov</a> .  |
| Data Collection of Loan Modification and TDRs                | Data collection involves both modified loans as defined by NCUA and TDRs as defined by GAAP.   | Data collection reduced to TDRs as defined by GAAP.   | NCUA 5300 Call Report.  |
| Loan Nonaccrual Policy (not including Member Business Loans) | No formal requirements except for TDRs. For TDRs, maintain in nonaccrual until receive 6 consecutive payments.   | All federally insured credit unions must cease accruing interest on loans at 90 days or more past due (with some exceptions).   | Nonaccrual policy not currently memorialized in a current policy document but has been consistent credit union practice, and is supported by their existing tracking systems.   |
| Member Business Loan (MBL) Workout Nonaccrual Policy         | No formal requirements except for TDRs. For TDRs, maintain in nonaccrual until receive 6 consecutive payments.   | All federally insured credit unions must maintain member business workout loans in a nonaccrual status until the credit union receives 6 consecutive payments under the modified terms. | LCU 10-CU-07, “Commercial Real Estate Loan Workouts, transmitting Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts” (June 2010) and Enclosure <a href="http://www.ncua.gov">http://www.ncua.gov</a> .   |

The proposed rule requires policies governing loan workout practices and loan nonaccruals. The proposed rule also includes an IRPS as an appendix to establish NCUA’s expectations and requirements regarding compliance. The Board seeks to

ensure loan workout management is subject to written credit union policies and monitoring strategies, thereby limiting inherently ineffective workout strategies that do not improve loan collectability but delay loss recognition and potentially lead to further deterioration in the loan portfolio. The Board invites the public's comment on all aspects of the proposed rule and IRPS (Appendix).

B. Does the proposed rule and IRPS create greater restrictions than the current guidance?

The proposed rule and associated IRPS reduce regulatory burden by eliminating the requirement to maintain a separate, mostly manual process for tracking TDR loans. The proposed rule does, however, introduce compensating controls by requiring FICUs to establish a written loan workout policy and formulate measuring and monitoring controls. It also memorializes a longstanding nonaccrual practice for past due loans.

C. Why is the period for public comment thirty days?

As a matter of policy, NCUA believes that the public should be given at least sixty days to comment on a proposed regulation. See NCUA IRPS 87-2 (as amended by IRPS 03-2). In this case, however, the Board is issuing the proposed rule and IRPS with a thirty-day comment period to address the industry's request that NCUA clarify its expectations and reduce confusion and burden, particularly with regard to the classification and regulatory reporting for TDRs.

D. When will FICUs have to comply with the proposed rule?

With a shortened comment period, the Board will issue a final rule as soon as practicable, but recognizes that FICUs will need time to revise existing lending policies. Furthermore, to implement these new requirements, certain system changes will be required for reporting purposes. As such, the Board intends on issuing the final rule with an effective date of 120 days after it is published in the Federal Register to require the implementation of the written lending policies by such date. As further discussed in the preamble, the Board plans to closely time its adjustments to the Call Report requirements for reporting TDRs, consistent with this rulemaking. The Board anticipates that the Call Report requirements will go into effect no later than the quarter ending December 31, 2012.

The Board requests comment on the proposed effective dates for the policy requirements and the Call Report changes as well as any suggestions to lessen burden or otherwise reduce the necessary implementation time period.

### III. Analysis of Rule Amendment and IRPS

#### Section 741.3, Lending Policies

The Board proposes to amend §741.3(b)(2) to require FICUs to adopt policies that govern loan workout and nonaccrual practices. Section 741.3(b)(2) currently requires all FICUs to maintain written lending policies that address, at a minimum, adequate loan documentation, protection of security interests, determinations of collateral value, and evaluations of a borrower's ability to repay in the event of default. The existence and adequacy of written lending policies are critical factors in evaluating whether a FICU is operating in a safe and sound manner. In light of the increased demand for loan workouts and to ensure appropriate income recognition for loans that are past due by 90 days or more, the Board believes it prudent to require loan account management policies in the rule. The proposed rule establishes minimum standards to be applied consistently throughout the industry and serves as a tool for managing risk to NCUSIF.

To set NCUA's supervisory expectations and assist FICUs in compliance with the proposed change to §741.3, the Board proposes to include an appendix to Part 741. The proposed appendix 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 are to report their data collections related to TDRs on Call Reports. The contents of the appendix are described in detail below.

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

### 1. Written Loan Workout Policy and Monitoring Requirements

The Board recognizes loan workouts can be used to help borrowers overcome temporary financial difficulties, such as loss of job, medical emergency, or change in family circumstances like loss of a family member. The Board further acknowledges that the lack of a sound workout policy can mask the true performance and past due status of the loan portfolio. Accordingly, the proposal 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 should also include aggregate program limits (for total workout portfolio and each type of workout) as a percentage of net worth. The Board proposes to use net worth, rather than unimpaired capital and surplus, as the means for striking this balance. Net worth cushions fluctuations in earnings, supports growth, and provides protection against insolvency. As such, the Board believes establishing limits tied to this measure is appropriate. The Board understands that not

all FICUs are alike and this policy will enable FICUs to tailor their written policies to their own unique circumstances.

Furthermore, the Board believes loan workouts should be adequately controlled and monitored by the board of directors and management, and therefore proposes the decision to re-age, extend, defer, renew, or rewrite a loan, like any other revision to contractual terms, be supported by the FICU's management information systems. Sound management information systems are able to identify and document any loan that is re-aged, extended, deferred, renewed, or rewritten, including the frequency and extent such action has been taken. Appropriate documentation typically shows that 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.

The policy must also 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.<sup>10</sup> The policy must ensure the FICU makes loan workout decisions based on the borrower's renewed willingness and ability to repay the loan. In addition, the policy must establish sound controls to ensure loan workout actions are appropriately structured.

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<sup>10</sup> 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.

In developing a written policy, the FICU board and management may wish to consider similar parameters as those established in the FFIEC's "Uniform Retail Credit Classification and Account Management Policy" (FFIEC Policy).<sup>11</sup> 65 FR 36903 (June 12, 2000). The FFIEC Policy sets forth specific limitations on the number of times a loan can be re-aged (for open-end accounts) or extended, deferred, renewed or rewritten (for closed-end accounts).<sup>12</sup> Additionally, LCU 09-CU-19, "Evaluating Residential Real Estate Mortgage Loan Modification Programs," outlines policy requirements for real estate modifications.<sup>13</sup> Those requirements remain applicable to real estate loan modifications but could be adapted in part by the FICU in its written loan workout policy for other loans.

The Board does not intend for these minimum requirements to be an all inclusive list, rather they provide a basic framework within which to establish a sound loan workout program.

The Board seeks comment on the proposed policies including any additional elements that should be added.

## 2. Regulatory Reporting of Workout Loans Including TDR Past Due Status

<sup>11</sup> The FFIEC was established in March 1979 to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: a Governor of the Board of Governors of the Federal Reserve System designated by the Chairman of the Board, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the Board of the National Credit Union Administration, the Comptroller of the Currency, the Director of the Consumer Financial Protection Bureau, and the Chairman of the State Liaison Committee. The Council's activities are supported by interagency task forces and by an advisory State Liaison Committee, comprised of five representatives of state agencies that supervise financial institutions.

<sup>12</sup> See <http://www.fdic.gov> for additional information.

<sup>13</sup> See <http://www.ncua.gov> for additional information.



The Board recognizes that loan workouts that qualify under GAAP as TDRs require special financial reporting considerations. Confusion has been evident throughout the credit union industry about what constitutes a TDR and how to report the TDR identified.

The proposed policy 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. This proposed revision eliminates the dual, 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. If the proposal is finalized, the Board intends to modify the Call Report instructions accordingly. As previously indicated for purposes of Call Report data, in determining if a loan is a TDR, it is the Board's view that in an economic downturn absent contrary supportable information workout loans are TDRs.

Additionally, the proposed IRPS will institute revised Call Report data collections related to loan workouts eliminating much of the current data collections on the broad category "loan modifications," focusing data collection on TDR loans. The Board will add additional data elements as necessary to effectively monitor and measure TDR activity and corresponding risk to the NCUSIF. This will assist national and field examination and supervision staff both to detect the level of activity and possible overuse of reworking a nonperforming loan multiple times without improving overall collectability, and will ensure income recognition is appropriate.

Accordingly the Board invites public comment on its proposal to modify Call Report instructions to change the “past due” definition, and to revise loan modification data collections to target TDR data elements, as discussed.

### 3. Loan Nonaccrual Policy

Generally, the NCUA has required, and it has become accepted credit union practice, to cease accruing interest on a loan when it becomes 90 days or more past due. The existing approach is referenced in various letters and publications but currently is not memorialized or enforceable through any statute or regulation.<sup>14</sup> The Board reaffirms this longstanding credit union practice by proposing that the rule and appended IRPS require a FICU to adopt written nonaccrual policies that specifically address the discontinuance of interest accrual on loans that are past due by 90 days or more, as well as the requirements for returning such loans (including member business loan workouts) to accrual status.

#### *Nonaccrual Status*

As proposed, the IRPS specifies when FICUs must place loans in nonaccrual status, including the reversal of previously accrued but uncollected interest, set the conditions for restoration of a nonaccrual loan to accrual status, and discuss the criteria under

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<sup>14</sup> The policy was discussed in an obsolete version of the NCUA Accounting Manual for FCUs, last published in June 1995.

GAAP for Cash or Cost Recovery basis of income recognition. The Board is proposing that 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. The policy also addresses the treatment of cash interest payments received and prohibits the reversal of previously accrued, but uncollected, interest applicable to any loan placed in nonaccrual status. The Board believes this uniform policy will promote consistency and appropriate income recognition practices across FICUs of all sizes. The Board further believes this is a longstanding practice and data processing systems already support this nonaccrual policy. Therefore, the Board anticipates no more than minimal, if any, changes to credit union processes would be required.

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

The proposed IRPS sets forth specific parameters for returning a nonaccrual loan to accrual. 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 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.

The Board believes these policies surrounding restoration of loans to accrual status are a necessary supplement to the nonaccrual requirements previously discussed and will ensure appropriate and consistent income recognition in credit unions.

#### *Restoration to Accrual Status on Member Business Loan Workouts*

The Board recognizes there are unique circumstances governing the restoration of accrual for member business loan workouts and has set forth a separate policy in the proposal. This policy is largely derived from the “Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts” that NCUA and the other financial

regulators issued on October 30, 2009.<sup>15</sup> The proposed 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 consecutive payments and would involve payments of 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. An example is included in the IRPS to illustrate the application of the six consecutive month sustained repayment history. The Board has included tables setting forth nonaccrual criteria and restoration to accrual in the IRPS.

#### 4. Glossary

The final section of the IRPS is a glossary of terms used throughout.

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<sup>15</sup> See *Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts* (October 30, 2009) transmitted by Letter to Credit Unions No. 10-CU-07, and available at <http://www.ncua.gov>.

Accordingly, the Board invites public comment on its proposal to require FICUs to adopt loan nonaccrual policies incorporating more specifically the GAAP elements of the Cash and Cost Recovery bases of income recognition in relation to nonperforming loan workouts. Additionally, the Board invites comment on its proposed policy on the restoration of nonaccrual loans to accrual under certain conditions. The Board also seeks comment on its additional parameters for restoring member business loan workouts to accrual status.

To assist commenters in understanding existing agency guidance, the following illustration is provided:

#### Summary of Source Guidance Related to Lending and Loan Modifications

| Source of Supervisory Guidance   | Consumer Lending   | Member Business Lending   |
|--|--|---|
| <b>Existing Recent Supervisory Guidance on Lending and/or Loan Modifications</b> | <p>Letter to Credit Union 11-CU-01, <i>Residential Mortgage Foreclosure Concerns</i>, (January 2011) <a href="http://www.ncua.gov">http://www.ncua.gov</a></p> <p>Letter to Credit Unions 09-CU-19, <i>Evaluating Residential Real Estate Mortgage Loan Modification Programs</i>, (September 2009) <a href="http://www.ncua.gov">http://www.ncua.gov</a></p> <p>Federal Financial Regulatory Agencies Issue Statement In Support of the “<i>Making Home Affordable</i>” Loan Modification Program,” (March 2009) <a href="http://www.ncua.gov">http://www.ncua.gov</a></p> <p><i>Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages</i>, (September 2007) <a href="http://www.ncua.gov">http://www.ncua.gov</a></p> | <p>Letter to Credit Unions 10-CU-07, <i>Commercial Real Estate Loan Workouts</i>, transmitting <i>Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts</i>, (June 2010), and Enclosure <a href="http://www.ncua.gov">http://www.ncua.gov</a></p> <p>Letter to Credit Unions 10-CU-02, <i>Current Risks in Business Lending and Sound Risk Management Practices</i>, (February 2010) <a href="http://www.ncua.gov">http://www.ncua.gov</a></p> |
| <b>Written Policy Requirement on Frequency of Modifications</b>                  | <p>Proposed policy is in this Proposed IRPS 12-1.</p>  | <p>Proposed policy is in this Proposed IRPS 12-1, and</p> <p>Letter to Credit Unions 10-CU-07, <i>Commercial Real Estate Loan Workouts</i>, transmitting</p>  |

|  |   |  |
|--|---|--|
|  |   | <i>Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts, (June 2010) and Enclosure <a href="http://www.ncua.gov">http://www.ncua.gov</a></i> |
| <b>Nonaccrual</b>                          | Proposed policy is in this Proposed IRPS 12-1.  |  |
| <b>Delinquency</b>                         | Change to existing policy in this Proposed IRPS 12-1. For all loans including workout loans, past due status is based on loan contract terms.   |  |
| <b>Allowance for Loan and Lease Losses</b> | IRPS 02-3, <i>Allowance for Loan and Lease Losses Methodologies and Documentation for Federally-Insured Credit Unions (May 2002)</i> , <a href="http://www.ncua.gov">http://www.ncua.gov</a> .<br><br>2006 Interagency ALLL Policy Statement transmitted by Accounting Bulletin 06-1 (December 2006), <a href="http://www.ncua.gov">http://www.ncua.gov</a> . |  |
| <b>Charge-offs</b>                         | Letter to Credit Unions No. 03-CU-01, <i>Loan Charge-off Guidance (January 2003)</i> , and its Enclosure, <a href="http://www.ncua.gov">http://www.ncua.gov</a> .   |  |

#### IV. Regulatory Procedures

##### A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact agency rulemaking may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. This proposed rule tightens loan account management processes that should already be in place in FICUs. While FICUs are required to have policies that address loan management protocols, the proposed rule and IRPS set additional parameters that are consistent with existing best practices and federal banking regulators' policies. NCUA has determined this proposed rule will not have a significant impact on a substantial number of small credit unions so NCUA is not required to conduct a Regulatory Flexibility Analysis.

## B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden. 44 USC 3507(d); 5 CFR part 1320. For purposes of the PRA, a paperwork burden may take the form of either a reporting or a recordkeeping requirement, both referred to as information collections.

The proposed rule contains an information collection in the form of a written policy requirement. Any FICU making loan workout arrangements that assist borrowers must have a written policy to govern this activity. As required by the PRA, NCUA is submitting a copy of this proposed IRPS to the Office of Management and Budget (OMB) for its review and approval. Persons interested in submitting comments with respect to the information collection aspects of the proposed rule should submit them to OMB at the address noted below.

Based on NCUA's experience, FICUs already maintain written loan policies, which often include minimum workout loan requirements. As such, they will only need to modify current policies to include any additional parameters established in the proposed rule. It is therefore NCUA's view that implementing this type of policy will create minimum burden to credit unions. The parameters established within the proposed rule and IRPS are usual and customary operating practices of a prudent financial institution. NCUA estimates it should take a FICU an average of 8 hours to modify current policies to



comply with the parameters set forth in the proposed IRPS. Therefore, the total initial burden imposed to 7,250 FICUs for modifying the policies is approximately 58,000 hours. NCUA further estimates a FICU spends on average 15 minutes per month manually calculating and reporting past due status on each TDR loan. This policy eliminates this requirement. Per the September 30, 2011, Call Report, FICUs have 150,453 TDR loans outstanding. Eliminating this reporting requirement therefore results in an annual savings of 451,359 hours. Thus, on net, this policy results in a substantial hours (393,359 annually) reduction of regulatory burden. NCUA is specifically interested in receiving comments regarding estimates of reduced burden relating to the proposed changes on regulatory reporting of TDR loans.

NCUA considers comments by the public on this proposed collection of information in:

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the NCUA, including whether the information will have a practical use;
- Evaluating the accuracy of the NCUA's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are required to respond, including through the use of appropriate automated, electronic,

mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

The PRA requires OMB to make a decision concerning the collection of information contained in the proposed rule and IRPS between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This coincides with the 30-day public comment period on the proposed regulation.

Comments on the proposed information collection requirements should be sent to:

Office of Information and Regulatory Affairs, OMB, New Executive Office Building, 725 17th Street, NW, Washington, DC 20503; Attention: NCUA Desk Officer, with a copy to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

### C. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This proposed rule applies to all FICUs but does not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of

power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

#### D. Assessment of Federal Regulations and Policies on Families

NCUA has determined that this proposed rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

#### E. Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We request your comments on whether the proposed rule is understandable and minimally intrusive if implemented as proposed.

List of Subjects

12 CFR part 741

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on January 26, 2012.

Mary F. Rupp

Secretary of the Board

For the reasons discussed above, NCUA proposes to amend 12 CFR part 741 as follows:

#### PART 741 - REQUIREMENTS FOR INSURANCE

The authority citation for part 741 continues to read:

Authority: 12 U.S.C. 1757, 1766(a), 1781-1790 and 1790d; 31 U.S.C. 3717.

In §741.3, revise paragraph (b)(2) to read as follows:

#### §741.3 Criteria

(b) Financial condition and policies. \* \* \*

(2) The existence of written lending policies, including adequate documentation of secured loans and the protection of security interests by recording, bond, insurance or other adequate means, adequate determination of the financial capacity of borrowers and co-makers for repayment of the loan, adequate determination of value of security on loans to ascertain that said security is adequate to repay the loan in the event of default, loan workout arrangements, and nonaccrual standards that include the discontinuance of interest accrual on loans past due by 90 days or more and

requirements for returning such loans, including member business loans, to accrual status.

Part 741 is amended by adding Appendix C to read as follows:

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

This Interpretive Ruling and Policy Statement (IRPS) establishes requirements for the management of loan *workout*<sup>1</sup> arrangements, loan *nonaccruals*, and regulatory reporting of *troubled debt restructured loans* (herein after referred to as TDR or TDRs).

This IRPS applies to all federally insured credit unions.

Under this IRPS, TDR loans are as defined in *generally accepted accounting principles* (GAAP) and the Board does not intend through this policy to change the Financial Accounting Standards Board's (FASB) definition of TDR in any way. In addition to existing agency policy, this IRPS sets NCUA's supervisory expectations governing loan workout policies and practices and loan accruals.

Written Loan Workout Policy and Monitoring Requirements<sup>2</sup>

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<sup>1</sup> Terms defined in the Glossary will be *italicized* on their first use in the body of this guidance.

For purposes of this policy statement, types of workout loans to borrowers in financial difficulties include re-agings, extensions, deferrals, renewals, or rewrites. See the Glossary entry on “workouts” for further descriptions of each term. Borrower retention programs or *new loans* are not encompassed within this policy nor considered by the Board to be workout loans.

Loan workouts can be used to help borrowers overcome temporary financial difficulties, such as loss of job, medical emergency, or change in family circumstances like loss of a family member. Loan workout arrangements should consider and balance the best interests of both the borrower and the credit union.

The lack of a sound written policy on workouts can mask the true performance and *past due* status of the loan portfolio. Accordingly, the credit union board and management must 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, must be in line with the credit union’s broader risk mitigation strategies, and must include aggregate program limits (for total workout portfolio and each type of workout) as a percentage of net worth. The policy must define eligibility requirements (i.e. under what conditions the credit union will consider a loan workout), including

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<sup>2</sup> For additional guidance on member business lending extension, deferral, renewal, and rewrite policies, see *Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts* (October 30, 2009) transmitted by Letter to Credit Unions No. 10-CU-07, and available at <http://www.ncua.gov>.

establishing limits on the number of times an individual loan may be modified.<sup>3</sup> The policy must also ensure credit unions make loan workout decisions based on the borrower's renewed willingness and ability to repay the loan. In addition, the policy must establish sound controls to ensure loan workout actions are appropriately structured.<sup>4</sup> In no event should the credit union authorize additional advances to finance unpaid interest and fees. For loan workouts granted, the credit union must document the determination that the borrower is willing and able to repay the loan.

Management must ensure that comprehensive and effective risk management and internal controls are established and maintained so that loan workouts can be adequately controlled and monitored by the credit union's board of directors and management, to provide for timely recognition of losses,<sup>5</sup> and to permit review by examiners. To be effective, management information systems need to track the principal reductions and *charge-off* history of loans in workout programs by type of program. Any decision to re-age, extend, defer, renew, or rewrite a loan, like any other revision to contractual terms, needs to be supported by the credit union's management

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<sup>3</sup> 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.

<sup>4</sup> In developing a written policy, the credit union board and management may wish to consider similar parameters as those established in the FFIEC's "Uniform Retail Credit Classification and Account Management Policy" (FFIEC Policy). 65 FR 36903 (June 12, 2000). The FFIEC Policy sets forth specific limitations on the number of times a loan can be re-aged (for open-end accounts) or extended, deferred, renewed or rewritten (for closed-end accounts). Additionally, NCUA Letter to Credit Unions (LCU) 09-CU-19, "Evaluating Residential Real Estate Mortgage Loan Modification Programs," outlines policy requirements for real estate modifications. Those requirements remain applicable to real estate loan modifications but could be adapted in part by the credit union in their written loan workout policy for other loans.

<sup>5</sup> Refer to NCUA guidance on charge-offs set forth in LCU 03-CU-01, "Loan Charge-off Guidance," dated January 2003. Examiners will require that a reasonable written charge-off policy is in place and that it is consistently applied. Additionally, credit unions need to adjust historical loss factors when calculating ALLL needs for pooled loans to account for any loans with protracted charge-off timeframes (e.g., 12 months or greater).

information systems. Sound management information systems are able to identify and document any loan that is re-aged, extended, deferred, renewed, or rewritten, including the frequency and extent such action has been taken. Documentation normally shows that the credit union's personnel communicated with the borrower, the borrower agreed to pay the loan in full under any new terms, and the borrower has the ability to repay the loan under any new terms.

#### Regulatory Reporting of Workout Loans Including TDR Past Due Status

The *past due* status of all loans will be calculated consistent with loan contract terms, including amendments made to loan terms through a formal restructure. Credit unions will report delinquency on the Call Report consistent with this policy.<sup>6</sup>

#### Loan Nonaccrual Policy

Credit unions must ensure appropriate income recognition by placing loans in nonaccrual when conditions as specified below exist, reversing previously accrued but uncollected interest, complying with the criteria under GAAP for Cash or Cost Recovery basis of income recognition, and following the specifications below regarding restoration

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<sup>6</sup> Subsequent Call Reports and accompanying instructions will reflect this policy, including focusing data collection on loans meeting the definition of TDR under GAAP. Credit unions should also refer to the recently revised standard from the FASB, Accounting Standards Update No. 2011-02 (April 2011) to the FASB Accounting Standards Codification entitled, Receivables (Topic 310), "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring." This clarified the definition of a TDR, which has the practical effect in the current economic environment to broaden loan workouts that constitute a TDR. This standard is effective for annual periods ending on or after December 15, 2012.



of a nonaccrual loan to accrual status. This policy on loan accrual is consistent with longstanding credit union industry practice as implemented by the NCUA over the last several decades. The balance of the policy relates to member business loan workouts and is similar to the FFIEC policies adopted by the federal banking agencies<sup>7</sup> as set forth in the FFIEC Call Report for banking institutions and its instructions.<sup>8</sup>

### Nonaccrual Status

Credit unions may not accrue interest<sup>9</sup> 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*.<sup>10</sup> Additionally, loans will be placed in nonaccrual status if maintained on a *Cash basis* (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. For purposes of applying the “well secured” and “in process of collection” test for nonaccrual status listed above, the date on which a loan reaches nonaccrual status is determined by its contractual terms.

While a loan is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in the loan (i.e., after charge-off of identified losses, if any) is deemed to be

<sup>7</sup> The federal banking agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

<sup>8</sup> FFIEC Report of Condition and Income Forms and User Guides, Updated September 2011, <http://www.fdic.gov>.

<sup>9</sup> Nonaccrual of interest also includes the amortization of deferred net loan fees or costs, or the accretion of discount. Nonaccrual of interest on loans past due 90 days or more is a longstanding agency policy and credit union practice.

<sup>10</sup> A purchased credit impaired loan asset need not be placed in nonaccrual status as long as the criteria for accrual of income under the interest method in GAAP is met. Also, the accrual of interest on workout loans is covered in a separate section of this IRPS later in the policy statement.

fully collectable. The reversal of previously accrued, but uncollected, interest applicable to any loan placed in nonaccrual status must be handled in accordance with GAAP.<sup>11</sup>

Where assets are collectable over an extended period of time and, because of the terms of the transactions or other conditions, there is no reasonable basis for estimating the degree of collectability - when such circumstances exist, and as long as they exist – consistent with GAAP the *Cost Recovery Method* of accounting must be used.<sup>12</sup>

Use of the Cash or Cost Recovery basis for these loans and the statement on reversing previous accrued interest is the practical implementation of relevant accounting principles.

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

A nonaccrual loan may be restored 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 bases, and the credit union is plausibly assured of repayment of the remaining contractual principal and interest within a reasonable period;

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<sup>11</sup> Acceptable accounting treatment includes a reversal of all previously accrued, but uncollected, interest applicable to loans placed in a nonaccrual status against appropriate income and balance sheet accounts. For example, one acceptable method of accounting for such uncollected interest on a loan placed in nonaccrual status is: (1) to reverse all of the unpaid interest by crediting the "accrued interest receivable" account on the balance sheet, (2) to reverse the uncollected interest that has been accrued during the calendar year-to-date by debiting the appropriate "interest and fee income on loans" account on the income statement, and (3) to reverse any uncollected interest that had been accrued during previous calendar years by debiting the "allowance for loan and lease losses" account on the balance sheet. The use of this method presumes that credit union management's additions to the allowance through charges to the "provision for loan and lease losses" on the income statement have been based on an evaluation of the collectability of the loan and lease portfolios and the "accrued interest receivable" account.

<sup>12</sup> When a purchased impaired loan or debt security that is accounted for in accordance with ASC Subtopic 310-30, "Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality," has been placed on nonaccrual status, the cost recovery method should be used, when appropriate.

- When it otherwise becomes both *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 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.

#### Restoration to Accrual Status on Member Business Loan Workouts<sup>13</sup>

A formally restructured member business loan workout need not be maintained in nonaccrual status, provided the restructuring and any charge-off taken on the loan are supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the restructured loan must remain in nonaccrual status. 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 consecutive payments and would involve payments of cash or cash equivalents. In returning the

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<sup>13</sup> This policy is derived from the "Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts" NCUA and the other financial regulators issued on October 30, 2009.

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 credit union from the responsibility to promptly charge off all identified losses.

For example, if the original contractually due monthly payment was \$1,500, and the borrower's payment was lowered to \$1,000 through formal member business loan restructure, then based on the following schedule of repayment performance (in the first row) the "*sustained historical repayment performance for a reasonable time prior to the restructuring*" would encompass five of the pre-workout consecutive payments that were at least \$1,000; so, in total, the six consecutive repayment burden would be met by the first month post workout. In the second row, only one of the pre-workout payments would count toward the six consecutive repayment requirement, so the loan would remain on nonaccrual for at least five post-workout consecutive payments consistent with restructured terms.

**TABLE 1 – Six Consecutive Periods Sustained Repayment Performance<sup>14</sup>**

| Pre-Workout          |                      |                      |                      |                      | Post Workout         |                      |                      |
|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
|                      |                      |                      |                      |                      | Month 1              | Month 2              | Month 3              |
| <sup>1</sup> \$1,500 | <sup>2</sup> \$1,200 | <sup>3</sup> \$1,200 | <sup>4</sup> \$1,000 | <sup>5</sup> \$1,000 | <sup>6</sup> \$1,000 | \$1,000              | \$1,000              |
| \$1,500              | \$1,200              | \$900                | \$875                | <sup>1</sup> \$1,000 | <sup>2</sup> \$1,000 | <sup>3</sup> \$1,000 | <sup>4</sup> \$1,000 |

After a formal restructure of a member business loan, if the restructured loan has been returned to accrual status, the loan otherwise remains subject to the nonaccrual standards of this policy.

The following tables summarize nonaccrual and restoration to accrual requirements previously discussed:

**TABLE 2 – Nonaccrual Criteria**

| Action                                      | Condition Identified   | Additional Consideration   |
|---|--|--|
| Nonaccrual on All Loans                     | 90 days or more past due unless loan is both well secured and in the process of collection; or<br><br>If the loan must be maintained on the Cash or Cost Recovery basis because there is a deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected | See Glossary descriptors for “well secured” and “in the process of collection.”<br><br>Consult GAAP for Cash Basis and Cost Recovery income recognition guidance. See also Glossary Descriptors. |
| Nonaccrual on Member Business Loan Workouts | Continue on nonaccrual at workout point and until restore to accrual criteria are met  | See Table 3 -- Restore to Accrual  |

<sup>14</sup> Number prior to monthly payment amounts indicate payments received towards the six consecutive payment requirement as explained in the example above.

**TABLE 3 – Restore to Accrual**

| Action  | Condition Identified   | Additional Consideration   |
|---|--|--|
| Restore to Accrual on Loans (not including Member Business Loan Workouts) | <p>When the loan is past due 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.</p> <p>When it otherwise becomes both “well secured” and “in the process of collection”; or</p> <p>The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of income under the interest method.</p> | <p>See Glossary descriptors for “well secured” and “in the process of collection.”</p> <p>Interest payments received while the loan was in nonaccrual status and applied to reduce the recorded investment in the loan must not be reversed and income 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.</p> |
| Restore Accrual on Member Business Loan Workouts                          | <p>Formal restructure with a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms</p>  | <p>The evaluation must include consideration of the borrower's sustained historical repayment performance for a minimum of six consecutive payments. In returning the loan to accrual status, sustained historical repayment performance for a reasonable time prior to the restructuring may be taken into account.</p>   |

Glossary<sup>15</sup>

“Cash Basis” method of income recognition is set forth in GAAP and means while a loan is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in the loan (i.e., after charge-off of identified losses, if any) is deemed to be fully collectible.<sup>16</sup>

<sup>15</sup> Terms defined in the Glossary will be *italicized* on their first use in the body of this guidance.

<sup>16</sup> Acceptable accounting practices include: (1) allocating contractual interest payments among interest income, reduction of the recorded investment in the asset, and recovery of prior charge-offs. If this method is used, the

*“Charge-off”* means a direct reduction (credit) to the carrying amount of a loan carried at amortized cost resulting from uncollectability with a corresponding reduction (debit) of the ALLL. Recoveries of loans previously charged off should be recorded when received.

*“Cost Recovery”* method of income recognition means equal amounts of revenue and expense are recognized as collections are made until all costs have been recovered, postponing any recognition of profit until that time.<sup>17</sup>

*“Generally accepted accounting principles (GAAP)”* means official pronouncements of the FASB as memorialized in the FASB Accounting Standards Codification® as the source of authoritative principles and standards recognized to be applied in the preparation of financial statements by federally-insured credit unions in the United States with assets of \$10 million or more.

*“In the process of collection”* means collection of the loan is proceeding in due course either: (1) through legal action, including judgment enforcement procedures, or (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future, i.e., generally within the next 90 days.

*“Member Business Loan”* is defined consistent with Section 723.1 of NCUA’s Member Business Loan Rule, 12 CFR §723.1.

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amount of income that is recognized would be equal to that which would have been accrued on the loan's remaining recorded investment at the contractual rate; and, (2) accounting for the contractual interest in its entirety either as income, reduction of the recorded investment in the asset, or recovery of prior charge-offs, depending on the condition of the asset, consistent with its accounting policies for other financial reporting purposes.

<sup>17</sup> FASB Accounting Standards Codification (ASC) 605-10-25-4, “Revenue Recognition, Cost Recovery.”

*“New Loan”* means the terms of the revised loan are at least as favorable to the credit union (i.e., terms are market-based, and profit driven) as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the credit union, and the revisions to the original debt are more than minor.

*“Past Due”* means a loan is determined to be delinquent in relation to its contractual repayment terms including formal restructures, and must consider the time value of money. Credit unions may use the following method to recognize partial payments on “consumer credit,” i.e., credit extended to individuals for household, family, and other personal expenditures, including credit cards, and loans to individuals secured by their personal residence, including home equity and home improvement loans. A payment equivalent to 90 percent or more of the contractual payment may be considered a full payment in computing past due status.

*“Recorded Investment in a Loan”* means the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

*“Troubled Debt Restructuring”* is as defined in GAAP and means a restructuring in which a credit union, for economic or legal reasons related to a member borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.<sup>18</sup> The restructuring of a loan may include, but is not necessarily limited to: (1) the transfer from the borrower to the credit union of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of

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<sup>18</sup> FASB ASC 310-40, “Troubled Debt Restructuring by Creditors.”



the loan, (2) a modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or (3) a combination of the above. A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured troubled loan.

*“Well secured”* means the loan is collateralized by: (1) a perfected security interest in, or pledges of, real or personal property, including securities with an estimable value, less cost to sell, sufficient to recover the recorded investment in the loan, as well as a reasonable return on that amount, or (2) by the guarantee of a financially responsible party.

*“Workout Loan”* means a loan to a borrower in financial difficulty that has been formally restructured so as to be reasonably assured of repayment (of principal and interest) and of performance according to its restructured terms. A workout loan typically involves a *re-aging, extension, deferral, renewal, or rewrite* of a loan.<sup>19</sup> For purposes of this policy

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<sup>19</sup> *“Re-Age”* means returning a past due account to current status without collecting the total amount of principal, interest, and fees that are contractually due.

*“Extension”* means extending monthly payments on a closed-end loan and rolling back the maturity by the number of months extended. The account is shown current upon granting the extension. If extension fees are assessed, they should be collected at the time of the extension and not added to the balance of the loan.

*“Deferral”* means deferring a contractually due payment on a closed-end loan without affecting the other terms, including maturity, of the loan. The account is shown current upon granting the deferral.

*“Renewal”* means underwriting a matured, closed-end loan generally at its outstanding principal amount and on similar terms.

*“Rewrite”* means significantly changing the terms of an existing loan, including payment amounts, interest rates, amortization schedules, or its final maturity.

statement, workouts do not include loans made to market rates and terms such as refinances, borrower retention actions, or new loans.<sup>20</sup>

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<sup>20</sup> There may be instances where a workout loan is not a TDR even though the borrower is experiencing financial hardship. For example, a workout loan would not be a TDR if the fair value of cash or other assets accepted by a credit union from a borrower in full satisfaction of its receivable is at least equal to the credit union's recorded investment in the loan, e.g., due to charge-offs.