THE CURCHIN GROUP, LLC

Credit Union Navigator

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Loan Workout and Nonaccrual Policies Under the Microscope

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After careful consideration of the many comments received on its February 2012 Notice of Proposed Rulemaking related to loan workout policies, nonaccrual policies, and regulatory reporting of troubled debt restructured (TDR) loans, the National Credit Union Administration's (NCUA) final rule was published in the Federal Register in May 2012. The Final Rule was effective July 2, 2012, with the compliance date for adoption of written loan workout policies and nonaccrual practices being extended to October 1, 2012. An extension to December 31, 2012 was given to collect nonaccrual status data. Please note all references to "credit unions" below are to federally insured credit unions (FICU).

The final rule amends Section 741.3, Lending Policies, and includes an Appendix to Part 741 (Appendix C) that "thoroughly addresses the loan workout account management and reporting standards FICUs must implement in order to comply with the rule." Call reporting of TDR data collected is also explained in the Appendix.

With the compliance deadlines now past, is your credit union ready to have its loan workout and nonaccrual policies put under the microscope during the next NCUA exam? These policies are sure to be one of NCUA's focus areas for compliance in 2013. Let's take a look at the requirements of the final rule to make sure that your policies are ready for the scrutiny they will soon undergo.

Many institutions have previously documented policies to address loan modification and TDR programs they have been using to assist members experiencing financial pressures and struggling to meet financial commitments. A thorough review and modification of these existing policies should be completed to ensure that any additional requirements of the final rule are added to the policies and any outdated parameters are removed.

Institutions that have not previously formalized their policies and procedures in this area, but have been following informal policies to assist members with temporary financial difficulties and to reduce the likelihood of loss to the credit union have a bit more work to do in documenting these policies.

Minimum Requirements of Written Loan Workout Policy and Monitoring Requirements

General

- Management and the credit union Board of Directors must adopt and adhere to an explicit written policy and standards that control the use of loan workouts;
- The policy must establish controls to ensure that the policy is consistently applied;
- The policy and practices should be commensurate with the credit union's size and complexity, and must be in line with the credit union's broader risk mitigation strategies.

Specific

The policy must:

- Define eligibility requirements including establishing limits on the number of times an individual loan may be modified. Keep in mind that programs commonly used as a member benefit and applied only to accounts in good standing such as skip-a-pay programs are not intended to count toward these limits.
- Ensure the credit union 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

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In Memoriam:
Remembering Alan Schneider

The Curchin Group is deeply saddened to bid farewell to one of its own, Alan Schneider, who passed away at the age of 81 this past November. In 1972, Alan joined George Curchin in founding Curchin and Schneider CPAs which would later become known as The Curchin Group. Alan served as a Partner of the firm for over 15 years focusing in small business and tax and also providing business consulting services. He retired in 1989, but later returned in a Senior Advisor role, providing guidance to Curchin's younger CPAs. "Alan will be remembered by the Curchin Group for the genuine care and concern he expressed for his clients and for people in general," shared Partner, Dave Ferullo. "He made himself available to his clients 24/7 and was always there to help them."

upcoming events at The Curchin Group

✦ Save the Date! Join the Curchin Group for our upcoming Mid Year Economic Update for New Jersey

Please join us on June 4, 2013 for a Mid Year Economic Update for New Jersey. Keynote Speaker, Joseph J. Seneca, PhD, Professor at Rutgers University's Edward J. Bloustein School of Planning and Public Policy, will be providing interest rate predictions for 2013 and beyond as well as an outlook on consumer spending. Additional information on the event will be made available in spring 2013.

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advances to cover third-party fees, but not to finance any commissions the credit union may receive from the third party.

- Require the decision to re-age, extend, defer, renew or rewrite a loan, like any other revision to contractual terms; be supported by the management information systems to assist the board of directors and management in controlling and monitoring loan workouts. The board of directors should be able to evaluate the overall effectiveness of the loan workout program and its impact on the institution's financial condition and determine any compensating adjustments to the organization's overall business strategy.
- Management information systems should be 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. Tracking of principal reductions and charge-off history of loans in workout programs by type of program should be maintained. Documentation should show that credit union personnel communicated with the borrower who agreed to pay the loan in full and the borrower has the ability to repay the loan under the new terms.

In addition, keep in mind that there will be higher regulatory expectations for documentation of the borrower's renewed willingness and ability to repay loans that have been restructured more often than once in a year or twice in five years. NCUA will likely require credit unions to produce evidence that collectability of these loans has been improved through permitting multiple restructurings.

The final rule suggests credit unions consider parameters included in the FFIEC's "Uniform Retail Credit Classification and Account Management Policy" and LCU 09-CU-19, "Evaluating Residential Real Estate Mortgage Loan Modification Programs" when developing loan workout policies.

Regulatory Reporting of Workout Loans Including TDR Past Due Accounts

Past due status of all loans should be calculated consistent with loan contract terms, including amendments made to loan terms through a formal restructure.

Institutes a nonaccrual policy on TDR loans apart from past due status.

Eliminates the current, dual, and often manual delinquency tracking burden on credit unions managing and reporting on TDR loans.

Loan Nonaccrual Policy

Under the final rule FICUs must 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 to accrual status. This includes member business loan workouts.

Credit unions 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" as defined in the rule's glossary. The date on which a loan reaches nonaccrual status is determined by its contractual terms when applying these two factors.

In addition, loans 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, will be placed in nonaccrual status.

Restoration to Accrual Status for All Loans except Member Business Loan (MBL) Workouts

Nonaccrual loans may be restored to accrual status when:

- Past due status is less than 90 days; GAAP does not require 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;
- Loan becomes both well secured and in the process of collection; or
- The asset is a purchased impaired loan and meets the GAAP criteria for accrual of income under the interest method.

Restoration to Accrual Status for Member Business Loan Workouts

Restructuring and charge-offs taken on member business loan workouts supported by current, well documented credit evaluation of the borrower's financial condition and ability to repay under the revised terms do not require maintaining the loan on nonaccrual status. The evaluation must consider the borrower's sustained historical repayment performance for a reasonable period, defined as a minimum of six consecutive, timely payments of principal and interest in cash or cash equivalents, prior to returning the loan to accrual status. The sustained historical repayment performance for a reasonable time prior to the restructuring may also be taken into account for MBL workouts.

Be sure to have your up-to-date written policies ready to go for your next regulatory exam. Complete policies and procedures in these areas will assist your credit union with its overall risk management and monitoring of overall asset quality.