

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 741

[NCUA 2020-0114]

RIN: 3133-AF30

Capitalization of Interest in Connection with Loan Workouts and Modifications

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board (Board) is amending its regulations to remove the prohibition on the capitalization of interest in connection with loan workouts and modifications. The final rule also establishes documentation requirements to help ensure that the addition of unpaid interest to the principal balance of a mortgage loan does not hinder the borrower's ability to become current on the loan. The Board has also taken the opportunity afforded by the rulemaking to make several technical changes to the regulations to improve their clarity and update certain references. The final rule follows publication of the December 4, 2020, proposed rule and takes into consideration the public comments on the proposed rule. After careful consideration, the Board has decided to adopt the proposed rule without change.

DATES: *Effective Date:* [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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I. Background: The Board’s December 4, 2020, Proposed Rule

At its November 19, 2020, meeting, the Board proposed amending the NCUA’s regulations to remove the prohibition on the capitalization of interest in connection with loan workouts and modifications. The proposed rule was subsequently published in the *Federal Register* on December 4, 2020.¹ The prohibition is codified in Appendix B to Part 741 (hereinafter referred to as “Appendix B”) of the NCUA’s regulations.

As explained in the preamble to the December 4, 2020, proposed rule, the NCUA established the prohibition on authorizing additional advances to finance unpaid interest in a

¹ 85 FR 78269 (Dec. 4, 2020) (<https://www.govinfo.gov/content/pkg/FR-2020-12-04/pdf/2020-25988.pdf>).

May 3, 2012, final rule.² The May 2012 final rule established loan workout and monitoring requirements applicable to all federally insured credit unions (FICUs). Among other amendments, the final rule required that FICUs have written policies addressing loan workouts and nonaccrual practices. Under that final rule, such policies were required to prohibit a FICU from authorizing additional advances to a borrower to finance unpaid interest (capitalization of interest) and credit union fees and commissions. However, the final rule permitted FICUs to make such advances to cover third-party fees, such as force-placed insurance and property taxes.

The Board was prompted to reconsider these prohibitions because of the challenges and economic disruption caused by the COVID-19 pandemic. For borrowers experiencing financial hardship, a prudently underwritten and appropriately managed loan modification, consistent with safe and sound lending practices, is generally in the long-term best interest of both the borrower and the FICU. Such modifications may allow a borrower to remain in their home or a commercial borrower to maintain operations and can help FICUs minimize the costs of default and foreclosures. Thus, the prohibition in the May 2012 final rule on the capitalization of interest might be overly burdensome and, in some cases, possibly hamper a FICU's good-faith efforts to engage in loan workouts with borrowers facing financial difficulty.

Other considerations, such as parity with the treatment of interest capitalization by banks, also factored in the Board's determination. Banks are not subject to the same prohibition on capitalizing interest (the banking agencies have not adopted an absolute standard equivalent to the rule that the Board codified in 2012). The banking agencies have addressed capitalization of

² 77 FR 31993 (May 31, 2012) (<https://www.govinfo.gov/content/pkg/FR-2012-05-31/pdf/2012-13214.pdf>).

interest through guidance, letters, and Call Report instructions, none of which strictly prohibit the capitalization of interest when modifying loans. Further, the government-sponsored enterprises (GSEs)—Fannie Mae and Freddie Mac—have had a long-standing policy supporting the ability of servicers to capitalize interest and fees as part of a prudent modification program.

Accordingly, the Board issued the December 4, 2020, proposed rule to make capitalization of interest a permissible option indefinitely. The proposed rule applies to workouts of all types of member loans, including commercial and business loans. In proposing the change, the Board underscored that Appendix B currently requires several safety and soundness and consumer protection-oriented measures that would also apply to capitalizing interest. The Board also proposed to add several consumer protection and safety and soundness requirements to Appendix B for FICUs when they modify loans with an interest capitalization component.

The proposed rule also makes several technical changes to Appendix B to improve its clarity and update certain references. Interested readers should refer to the preamble of the December 4, 2020, proposed rule for additional background and information on the proposed regulatory changes.

II. Legal Authority

The Board issues this final rule pursuant to its authority under the Federal Credit Union (FCU) Act.³ Under the FCU Act, the NCUA is the chartering and supervisory authority for

³ 12 U.S.C. 1751 *et al.*

federal credit unions (FCUs) and the Federal supervisory authority for FICUs.⁴ The FCU Act grants the NCUA a broad mandate to issue regulations that govern both FCUs and FICUs. Section 120 of the FCU Act is a general grant of regulatory authority and authorizes the Board to prescribe rules and regulations for the administration of the FCU Act.⁵ Section 209 of the FCU Act is a plenary grant of regulatory authority to the NCUA to issue rules and regulations necessary or appropriate to carry out its role as share insurer for all FICUs.⁶ Accordingly, the FCU Act grants the Board broad rulemaking authority to ensure that the credit union industry and the National Credit Union Share Insurance Fund remain safe and sound.

III. Discussion of Public Comments Received on the December 4, 2020, Proposed Rule

A. The Comments, Generally

The proposed rule provided for a 60-day public comment period, which closed on February 2, 2021. The NCUA received 26 comments in response to the proposed rule. These came from FICUs, individuals, and credit union leagues and trade associations. In general, the commenters expressed support for lifting the prohibition on interest capitalization as a helpful tool to assist financially distressed borrowers. The main reasons given by commenters for supporting the proposed rule were parity with banks, which are not prohibited from capitalizing interest; parity for FICU members whose loans are held in portfolio by the originating FICU and who, unlike members whose loans are sold on the secondary market, cannot currently take advantage of interest capitalization; and flexibility for distressed borrowers for whom interest capitalization may be the only realistic solution for avoiding foreclosure.

⁴ 12 U.S.C. 1752–1775.

⁵ 12 U.S.C. 1766(a).

⁶ 12 U.S.C. 1789(a)(11).

While noting the Board's interest in receiving public comment on all aspects of the interest capitalization issue, the preamble to the proposed rule also provided six questions requesting input on specific issues related to the proposed rule. This section of the preamble summarizes the issues raised by the public commenters and provides the Board's responses to these issues. This comment summary is organized in two sections. The first addresses the comments received in response to the questions posed in the preamble. The second section summarizes the other issues raised by the commenters. As previously noted, and discussed more fully in the responses below, after careful review of the comments, the Board has elected to adopt the proposed regulatory amendments without change. However, the Board is clarifying below its supervisory position with regard to FICUs that may already have begun offering interest capitalization prior to the finalization of this rule.

B. Comments on Specific Provisions

Responses to NCUA Questions 1 to 4. The NCUA asked FICUs to lay out their experience or level of use with interest capitalization before the agency prohibited the practice in 2012. Of those that answered the question, one FICU stated that it did not allow the use of this mortgage modification tool. Others stated that it was beneficial, including one who said it was frequently used, particularly during the last financial crisis. One FICU stated that its program enjoyed an 85 percent success rate from 2010 to 2012 and included approximately 170 workouts representing about \$22 million in mortgage loans that were saved from foreclosure.

The NCUA also asked how likely FICUs would be to use interest capitalization if the prohibition is lifted. All FICUs that answered the question stated that they would use the tool to varying degrees largely dependent on its suitability for individual borrowers.

The NCUA asked what risks might arise either to the FICU or the borrower in a mortgage modification that includes capitalization of interest. Of those that answered the question, one commenter stated that the risks would include a lack of understanding on the member's part of what interest capitalization means for their loan and there could be risk to the FICU if interest is capitalized on loans that already have high loan-to-value ratios. This commenter noted, however, that such risks could be effectively mitigated by the FICU providing clear communication to its members and reviewing its member's ability to repay the modified loan. Some stated that the consumer protection guardrails in the proposed rule would help mitigate any consumer protection risks. Others noted that the risk of not permitting interest capitalization needed to be weighed against any potential risk in permitting the practice. Some commenters noted that they evaluate each member's situation individually and did not anticipate any risks to the FICU or the member.

The NCUA asked how the limitations imposed by the GSEs on the use of interest capitalization would impact a credit union's use of this mortgage modification tool. Those that answered this question stated that the impact would be minimal. One FICU stated that they already underwrite to Fannie Mae guidelines and are aware of the limitations. One commenter stated that loans that feature interest capitalization would not be loans that it would sell on the secondary market. Another stated that its recent sales to the GSEs were all newly originated and

that a loan requesting forbearance between origination date and sale date is expected to occur so infrequently that it would be of no concern.

NCUA Response. The NCUA appreciates the thoughtful comments submitted in response to the first four questions posed in the preamble to the December 4, 2020, proposed rule. The comments indicate that interest capitalization was used prior to the 2012 change in policy, and that it will likely again be used following the issuance of this final rule. Accordingly, the Board continues to believe that the capitalization of interest, when used prudently, can be a helpful loan modification tool in the best interests of members and FICUs. In response to the commenters concerned the change may raise risks for consumers, the Board reiterates that the consumer protection measures that currently apply to FICU loan workout policies also apply to loan workouts involving the capitalization of interest. In addition, as provided in the proposed rule, the Board is adding several consumer protection requirements that will apply to loan workouts involving the capitalization of interest.

Comment: Consumer Protection Guardrails. NCUA question 5 asked commenters to provide their feedback on the consumer protection guardrails and documentation requirements in the proposed rule. The proposed rule states that capitalization of interest is not an appropriate solution in all cases and, as Appendix B currently provides, a FICU should consider and balance the best interests of the FICU and the borrower. The Board proposed adding several consumer protection and safety and soundness requirements to the Appendix for FICUs that capitalize interest in connection with loan workouts. At a minimum, if a FICU's loan modification policy permits capitalization of unpaid interest, under the proposed rule, the policy would have to

require documentation that reflects a borrower's ability to repay, a borrower's source(s) of repayment, and when appropriate, compliance with the FICU's valuation policies at the time the modification is approved.

Of the commenters that referenced the documentation requirements, 17 stated that they support them. Some of these commenters, however, asked for clarification or suggested changes to certain aspects of the requirements. For example, one of the commenters suggested additional consumer guardrails to prohibit changes in loan terms such as interest rates or punitive fees established in the existing loan contract. Another commenter asked for clarification as to whether the proposed consumer protections would apply to all loan types, including business and commercial, or just consumer loans. Another commented that NCUA should strive for balance so that administrative burdens do not outweigh member benefits and noted that temporary income impairment may prevent a member from providing the documentary proof that examiners traditionally expect. Finally, one of these commenters added that NCUA examiners should refrain from adding documentation requirements beyond those in the proposed rule and, absent a safety and soundness issue, should also defer to the judgment of the FICU and its understanding of a borrower's ability to repay the loan.

Four commenters stated that existing consumer protection measures are sufficient to protect and inform members, including two whose specific comments are set forth below. One commenter stated that the requirement to document a borrower's ability to repay would be problematic with COVID-related loans due to the enormous volume of members requesting COVID-related assistance. For example, if the FICU is capitalizing interest it would be

increasing the current loan amount to avoid delays and unnecessary paperwork. Furthermore, if the new loan amount does not exceed 110 percent of the original loan amount then the FICU does not need to verify income or request a new appraisal. In these situations, a certification from the borrower that his/her income has not decreased from the time the loan was originally approved should suffice. Therefore, the NCUA should waive the “ability-to-repay” documentation requirements in these instances.

The second commenter stated that the revisions required of a FICU’s modification policy are so burdensome that they will deter many FICUs from offering interest capitalization because the requirements effectively require FICUs to complete a full underwriting of a modified loan multiple times. The commenter stated that the NCUA’s existing rule already requires credit unions to make loan workout decisions based on a borrower’s renewed willingness and ability to repay the loan and if a loan workout is granted then the credit union must document the determination that the borrower is willing and able to repay the loan. This existing requirement thus fulfils the ability to repay and documentation requirements while recognizing the need for flexibility.

The commenter stated that the existing rule also enables FICUs to respond to large-scale, short-term financial challenges arising, for example, from natural disasters such as hurricanes, temporary gaps in employment, or the current pandemic which may make it difficult to access documentation, even though the FICU reasonably determines that the borrower’s mid- to long-term income prospects remain intact.

Finally, the commenter stated that the way the proposed rule is drafted implies that these additional documentation requirements would apply to *all* modification types if the credit union merely permits interest capitalization.⁷

NCUA Response. The Board appreciates the support expressed by the large majority of commenters for the proposed consumer protection guardrails. The final rule adopts these consumer protection measures without change.

Appendix B applies to consumer and commercial loans. The rule requires that loan modification policies must provide for “[c]ompliance with all applicable consumer protection laws and regulations.” The term “applicable” indicates that FICUs must comply with the laws and regulations that apply to a particular transaction. While some of those, such as the Equal Credit Opportunity Act, might apply to a commercial loan, most will not.

As noted, one of the comments suggested additional consumer guardrails to prohibit changes to interest rates or fees. The Board designed the proposed rule to provide FICUs greater flexibility when restructuring an existing loan. However, the proposed rule requires that, when doing so, a FICU must consider whether the loan modification is well-designed and provides a favorable outcome for borrowers. While a fair consideration of a borrower’s circumstances

⁷ The proposed rule states in the regulatory text: “Modifications of loans that result in capitalization of unpaid interest are appropriate only when the borrower has the ability to repay the debt in accordance with the modification. At a minimum, if a FICU’s loan modification policy permits capitalization of unpaid interest, the policy must require each of the following...” (*Supra* note 1, at 78272).

would generally not support an increase to interest rates or fees, the Board believes the language of the proposed rule provides the desired protections and declines to change it at this time.

In response to the commenters who raised concerns that compliance with the new requirements might be burdensome, the Board notes that the consumer protection guardrails added by this rule apply solely to loan modifications that involve the capitalization of interest. FICUs will therefore not be required to comply with the additional documentation requirements for other types of loan modifications. In addition, several of the guardrails reflect current best practices and requirements that should not impose any additional significant burden on credit unions. For example, credit unions are already required to comply with all applicable consumer protections laws and regulations. The guardrails reiterate the need for compliance to emphasize the importance of these legal consumer protections. Likewise, FICUs are already assumed to undertake the necessary due diligence to ensure a borrower's ability to repay. For example, Appendix B currently requires that a FICU's loan modification policy "must also ensure credit unions make loan workout decisions based on the borrower's renewed willingness and ability to repay the loan."⁸ The Board also notes that the rule does not prescribe a specific method for making this determination, thereby providing credit unions with a large degree of flexibility in meeting the requirement. The rule requires only that FICUs maintain documentation reflecting how the determination was made.

⁸ See 12 CFR part 741, Appendix B, section captioned "Written Loan Workout Policy and Monitoring Requirements."

Comment: Prohibition on Advancing Credit Union Fees and Commissions. Seventeen commenters responded to question 6 regarding whether NCUA should lift the current prohibition on the capitalization of credit union fees and commissions.

The commenters in support of maintaining the prohibition stated that they did not deem it necessary to charge such fees or feel that it was appropriate to charge internal fees to members who are struggling. They noted that continuing to prohibit the practice is an important consumer protection. One of the commenters stated that in the event the NCUA did decide to authorize the capitalization of credit union fees and commissions, appropriate limitations should be put in place, without which the potential for predatory behavior and risk to the member-borrower may be heightened.

Two commenters in support of removing the prohibition stated that FICUs should have the ability to charge reasonable modification fees so long as those fees are disclosed. One stated that FICUs have an incentive to not overburden the member with excessive workout-related fees to help the member repay the loan. Another commenter stated that if the NCUA chose not to allow all FICU fees to be capitalized, it should consider allowing the capitalization of fees up to a certain level. Another stated that for consumer protection purposes any fees charged for a modification involving interest capitalization should not be commissionable and that fees should be limited to actual costs incurred.

One FCU commenter stated that its mortgage modifications are handled by a third-party service provider which charges a fee for each modification. If the fee cannot be capitalized and

the borrower cannot afford to pay it as a direct charge, the FCU's only alternatives are to deny the modification or absorb the cost. This commenter was the only one to provide some data regarding the actual cost of modification fees. Prior to 2012, when interest capitalization was permitted, the cost to this FCU for the modification of 170 mortgage loans would have been approximately \$42,500. If the cost to the FCU of managing the program and operating its loan system were included, the cost more than doubled. The FCU further noted that the fees are the reimbursement of costs and not a revenue generation opportunity.

NCUA Response. Having reviewed the comments, the Board is not persuaded that FICUs should be permitted to capitalize credit union fees and commissions at this time. Most commenters advocating for the change did not include any discussion of how borrowers would be protected from excessive fees or supply any data on the actual cost to FICUs of providing loan workouts with interest capitalization. The final rule continues to permit FICUs to make advances covering third-party fees, such as force-placed insurance or property taxes. The Board, however, continues to believe that the current restrictions on fee reimbursement have provided a level of protection for borrowers in distress. The Board agrees with the comment that it would be contrary to the purposes of the credit union system to capitalize internally generated fees and commissions in a time of economic stress. Accordingly, credit union fees and commissions must be paid directly by the borrower at the time of the modification and not added to the loan balance.

C. Other Issues Raised by Commenters

Comment: Federal Preemption of State Consumer Protection Laws. Two commenters raised state preemption issues. Both commenters asked the NCUA to clarify that the proposed rule's requirement that all FICUs follow applicable state consumer protection laws does not override its regulation preempting state law on issues pertaining to "terms of repayment" (12 CFR 701.21(b)(1)(ii)(B)). Both commenters noted that some states prohibit the charging of interest on interest which if not preempted will dampen the effectiveness of NCUA's proposed rule.

NCUA Response: As an initial matter, the NCUA notes that the part 701 regulations, including §701.21, generally apply solely to FCUs. Federally insured, state-chartered credit unions (FISCUs) must follow any requirements established by their State regarding the terms of repayment.⁹ With respect to FCUs, this final rule does not in any way amend the regulation regarding the relationship between State law and the NCUA's regulations on loans made to members and lines of credit (12 CFR 701.21). The Board is not inclined to provide a blanket preemption of any or all State laws that may relate to capitalization of interest. FCUs may need to evaluate the application of relevant state laws on a case-by-case basis and may contact the NCUA for its opinion in the event a particular State law raises a preemption issue.

Comment: Retroactive Applicability. Two commenters asked that the NCUA apply the rule retroactively. One stated that NCUA should make January 1, 2020, the effective date to fully capture the economic disruption caused by the pandemic. The other commenter stated that in the interests of fairness if a credit union has already been capitalizing interest on loans without

⁹ As provided in §701.21(a), certain provisions of § 701.21 apply to FISCUs as specified in § 741.23; however, the part 741 provision does not make §701.21(b)(1)(ii)(B) applicable to FISCUs.

receiving an examination finding or Document of Resolution (DOR),¹⁰ then examiners should not take corrective action for these practices once the rule is finalized.

NCUA Response. The Board has not revised the rule in response to these comments. The Board notes that, as a legal matter, agencies may not generally adopt retroactive rules without explicit congressional authorization.¹¹ Accordingly, this final rule will apply prospectively upon issuance. The Board, however, is cognizant of the extraordinary nature of the COVID-19 pandemic, and the resulting stresses that have been placed on FICUs and their members. In their June 2020 interagency examiner guidance, the NCUA and the other banking agencies noted that loan modifications are “positive actions that can mitigate adverse effects on borrowers due to the pandemic.”¹² The interagency guidance specifies that “[e]xaminers will not criticize institutions for working with borrowers as part of a risk mitigation strategy intended to improve existing loans, even if the restructured loans have or develop weaknesses that ultimately result in adverse credit classification.”¹³ The NCUA will take into account the interagency examiner guidance in assessing any loan modification actions taken by credit unions, including interest capitalization, prior to the effective date of this final rule.

Comment: Troubled Debt Restructuring. One commenter stated that the NCUA should emphasize, either in the regulation or in supervisory guidance, the importance of a FICU update

¹⁰See generally the NCUA Examiner’s Guide, for more information regarding the agency’s examination process, including examination findings and DORs. The Guide is available at: https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/Home.htm%3FTocPath%3D_____1

¹¹ *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988).

¹² Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions (June 2020), page 6, available at <https://www.ncua.gov/files/press-releases-news/examiner-guidance-covid19-effect.pdf>.

¹³ *Id.*

to its troubled debt restructuring (TDR) policy because a TDR policy that harmonizes interest capitalization and other accounting tools is essential if NCUA's proposed rule is to achieve its full, intended effect.

NCUA Response. The Board appreciates this comment and agrees that FICUs should update their TDR policies as necessary to maintain consistency with applicable requirements. TDRs are a concept found in generally accepted accounting principles (GAAP),¹⁴ which FICUs are generally required to follow pursuant to section 202 of the FCU Act.¹⁵ The NCUA and the other banking agencies most recently issued guidance regarding TDRs on April 7, 2020. The April 7, 2020, interagency statement is designed to assist financial institutions that are working with borrowers affected by COVID-19.¹⁶ The NCUA is not revising any TDR requirements through this rulemaking.

IV. This Final Rule

A. Capitalization of Interest

The Board is amending Appendix B to remove the prohibition on the capitalization of interest in connection with loan workouts and modifications. As noted, the change applies to workouts of all types of member loans, including commercial and business loans. The NCUA also notes that—consistent with the scope of Appendix B—the regulatory amendments made by this final rule apply only to loan modifications involving the capitalization of interest. The final

¹⁴ See Federal Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 310-40, *Receivables – Troubled Debt Restructurings by Creditors*, available at <https://asc.fasb.org/subtopic&trid=2196892>

¹⁵ See section 202(b)(6)(C)(i) of the Federal Credit Union Act (12 U.S.C. 1782(b)(6)(C)(i)).

¹⁶ Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised) (April 7, 2020), available at: <https://www.ncua.gov/files/press-releases-news/interagency-statement-tdr-policy-revised.pdf>

rule does not address the capitalization of interest that may occur in other contexts. The Board notes that banks frequently include interest capitalization as one of several components in a loan restructuring to mutually benefit the lender and the borrower. The Board expects that FICUs will follow suit, and provide borrowers with the option to capitalize interest along with other loan modification options, such as the lowering of loan payments or the interest rate, extending the maturity date, partial principal or interest forgiveness and other modifications.

The final rule adds a definition of capitalized interest to the Glossary of Appendix B. For the purposes of this rulemaking, capitalization of interest constitutes the addition of accrued but unpaid interest to the principal balance of a loan.

The final rule continues to provide that a FICU may not, under any event, authorize additional advances to finance credit union fees and commissions. FICUs will be permitted to continue to make advances to cover third party fees to protect loan collateral, such as force-placed insurance or property taxes. The Board believes that maintaining the prohibition on the capitalization of credit union fees is an important consumer protection feature of the rule for member borrowers.

The Board underscores that it is maintaining several requirements that apply to all loan workout policies in Appendix B. For example, the Appendix establishes the expectation that loan workouts will consider and balance the best interests of the FICU and the borrower, including consumer financial protection measures. Ensuring the best interest of the borrower prohibits predatory lending practices such as including loan terms that result in negative

amortization. In addition, a FICU's policy must establish limits on the number of modifications allowed for an individual loan. Further, the policy must ensure that a FICU make loan workout decisions based on a borrower's renewed willingness and ability to repay the loan.

If a FICU restructures a loan more frequently 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. The current Appendix also sets forth several supervisory expectations relating to multiple restructurings, stating that examiners will request validation documentation regarding collectability if a FICU engages in multiple restructurings of a loan. The current Appendix also requires that a FICU maintain sufficient documentation to demonstrate that the FICU's personnel communicated the new terms with the borrower, that the borrower agreed to pay the loan in full under the new terms and, most importantly, the borrower has the ability to repay the loan under the new terms.

These requirements and expectations, which currently apply to FICUs' loan workout policies, will apply equally if a FICU adopts a practice of capitalizing interest in connection with loan workouts. In addition, in light of the potential for interest capitalization to have a detrimental effect on borrowers if executed inappropriately, and to mask the true financial status of a loan and a credit union's financial statements, the Board is adding requirements to the Appendix to apply to FICUs that engage in this practice.

Modifications of loans that result in capitalization of unpaid interest are appropriate only when the borrower has the ability to repay the debt in accordance with the modification. At a

minimum, if a FICU's loan modification policy permits capitalization of unpaid interest, the policy must require each of the following:

1. Compliance with all applicable consumer protection laws and regulations, including, but not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, the Truth In Lending Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, and the prohibitions against the use of unfair, deceptive or abusive acts or practices contained in the Consumer Financial Protection Act of 2010. (The Board notes that FICUs are also expected to comply with applicable State consumer protection laws that, in some instances, may be more stringent than Federal law, prohibiting, for example, the charging of interest on interest, subject to any case-by-case Federal preemption determinations that may be appropriate.)

2. Documentation that reflects a borrower's ability to repay, a borrower's source(s) of repayment, and when appropriate, compliance with the FICU's valuation policies at the time the modification is approved.

3. Providing borrowers with documentation that is accurate, clear, and conspicuous and consistent with Federal and state consumer protection laws.

4. Appropriate reporting of loan status for modified loans in accordance with applicable law and accounting practices. The FICU shall not report a modified loan as past due if the loan was current prior to modification and the borrower is complying with the terms of the modification.

5. Prudent policies and procedures to help borrowers resume affordable and sustainable repayments that are appropriately structured, while at the same time minimizing losses to the credit union. The prudent policies and procedures must consider:

i. Whether the loan modifications are well-designed, consistently applied, and provide a favorable outcome for borrowers.

ii. The available options for borrowers to repay any missed payments at the end of their modifications to avoid delinquencies or other adverse consequences.

6. Appropriate safety and soundness safeguards to prevent the following:

i. Masking deteriorations in loan portfolio quality and understating charge-off levels;

ii. Delaying loss recognition resulting in an understated allowance for loan and lease losses account or inaccurate loan valuations;

iii. Overstating net income and net worth (regulatory capital) levels; and

iv. Circumventing internal controls.

B. Technical Updates to Appendix B

The Board also took this opportunity to propose several technical changes to Appendix B to improve its clarity and update certain references. No commenters opposed these changes, and the Board is adopting them as proposed.

For example, the final rule updates references to the NCUA's or other guidance in the Appendix, such as guidance or standards issued by other federal banking agencies or the Financial Accounting Standards Board (FASB). These changes are intended to provide current information, and are not substantive policy changes.

In May 2014, FASB issued an accounting standard update for revenue recognition (ASU 2014-09) which replaced the cost recovery method of income recognition in ASC 605-10-25-4 with transition guidance found in ASC 606—Revenue from Contracts with Customers. The (2012) Appendix made reference to the cost recovery method of income recognition with citation in the Glossary. As this has been superseded by ASC 606, the Board has eliminated this reference in the Appendix and emphasizes that accrual of interest income ceases on a financial asset when full payment of principal and interest in cash is not expected.

In addition, to conform to the terminology that the Board adopted in 2016 in amending part 723,¹⁷ the final rule updates references to member business loans to also refer to commercial loans. These changes are not intended to create new requirements or standards.

The final rule also makes terminology in the Appendix consistent with its purpose. The Appendix sets forth requirements for FICU policies relating to loan workouts, TDRs, and nonaccrual status. In several instances, the current Appendix uses the word “should” when referring to necessary elements of a FICU’s policies or refers to the Appendix as “guidance” or an interpretive ruling and policy statement. To make the purpose and effect of the Appendix clearer, the final rule uses mandatory language where appropriate and eliminates references to the Appendix as “guidance.”

¹⁷ 81 FR 13530 (Mar. 14, 2016) (<https://www.govinfo.gov/content/pkg/FR-2016-03-14/pdf/2016-03955.pdf>).

Finally, the Board clarified several statements of the Appendix to make it more consistent with plain language principles.

None of these changes were substantive and were outlined for commenters in a redlined copy of the Appendix that the agency made available in the rulemaking docket.

V. Regulatory Procedures

A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities.¹⁸ For purposes of this analysis, the NCUA considers small credit unions to be those having under \$100 million in assets.¹⁹ The final rule allows FICUs to capitalize unpaid interest when working with borrowers. The final rule is not expected to increase the cost burden for FICUs. Accordingly, the NCUA certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 et seq.) requires that the Office of Management and Budget (OMB) approve all collections of information by a Federal agency from the public before they can be implemented. Respondents are not required to respond to any collection of information unless it displays a valid OMB control number. In

¹⁸ 5 U.S.C. 603(a).

¹⁹ 80 FR 57512 (Sept. 24, 2015) (<https://www.govinfo.gov/content/pkg/FR-2015-09-24/pdf/2015-24165.pdf>).

accordance with the PRA, the information collection requirements included in this final rule have been submitted to OMB for approval under control number 3133-0092.

C. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rulemaking will not have a substantial direct effect on the states, on the connection between the National Government and the states, or on the distribution of power and responsibilities among the various levels of government. The NCUA has determined that this final 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

The NCUA has determined that this final rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999.²⁰

E. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA)²¹ generally provides for congressional review of agency rules. A reporting requirement is triggered in instances where the NCUA issues a final rule as defined by section 551 of the Administrative

²⁰ Pub. L. 105-277, 112 Stat. 2681 (1998).

²¹ 5 U.S.C. 551.

Procedure Act. An agency rule, in addition to being subject to congressional oversight, may also be subject to a delayed effective date if the rule is a “major rule.” The NCUA does not believe this rule is a “major rule” within the meaning of the relevant sections of SBREFA. As required by SBREFA, the NCUA will submit this final rule to OMB for it to determine if the final rule is a “major rule” for purposes of SBREFA. The NCUA also will file appropriate reports with Congress and the Government Accountability Office so this rule may be reviewed.

List of Subjects in 12 CFR Part 741

Credit, Credit unions, Share insurance.

By the National Credit Union Administration Board on **XXXXXX**, 2021.

Melane Conyers-Ausbrooks

Secretary of the Board

1 For the reasons discussed in the preamble, the Board amends 12 CFR part 741 as follows:

2
3 **PART 741—REQUIREMENTS FOR INSURANCE**

4
5 1. The authority citation for part 741 continues to read as follows:

6
7 **Authority:** 12 U.S.C. 1757, 1766(a), 1781-1790, and 1790d; 31 U.S.C. 3717.

8
9 2. Appendix B to Part 741 is revised and republished to read as follows:

10 ***Appendix B to Part 741—Loan Workouts, Nonaccrual Policy, and Regulatory Reporting of***
11 ***Troubled Debt Restructured Loans***

12 This Appendix establishes requirements for the management of loan *workout*²²
13 arrangements, loan nonaccrual, and regulatory reporting of *troubled debt restructured*
14 *loans* (herein after referred to as TDR or TDRs). This Appendix applies to all federally insured
15 credit unions.

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

²² Terms defined in the Glossary will be italicized on their first use in the body of this Appendix.

1 WRITTEN LOAN WORKOUT POLICY AND MONITORING REQUIREMENTS²³

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

6 A credit union can use loan workouts to help borrowers overcome temporary financial
7 difficulties such as loss of job, medical emergency, or change in family circumstances such as
8 the loss of a family member. Loan workout arrangements must consider and balance the best
9 interests of both the borrower and the credit union.

10 The lack of a sound written policy on workouts can mask the true performance and *past due*
11 status of the loan portfolio. Accordingly, the credit union board and management must adopt
12 and adhere to an explicit written policy and standards that control the use of loan workouts, and
13 establish controls to ensure the policy is consistently applied. The loan workout policy and
14 practices should be commensurate with a credit union's size and complexity, and must conform
15 with a credit union's broader risk mitigation strategies. The policy must define eligibility
16 requirements (that is, under what conditions the credit union will consider a loan workout),
17 including establishing limits on the number of times an individual loan may be modified.²⁴ The
18 policy must also ensure credit unions make loan workout decisions based on a borrower's

²³ For additional guidance on commercial and 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>

²⁴ 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.

1 renewed willingness and ability to repay the loan. If a credit union restructures a loan more
2 frequently than once a year or twice in five years, examiners will have higher expectations for
3 the documentation of the borrower’s renewed willingness and ability to repay the loan. The
4 NCUA is concerned about restructuring activity that pushes existing losses into future reporting
5 periods without improving a loan’s collectability. One way a credit union can provide
6 convincing evidence that multiple restructurings improve collectability is to validate completed
7 multiple restructurings that substantiate the claim. Examiners will ask for such validation
8 documentation if a credit union engages in multiple restructurings of a loan.

9 In addition, the policy must establish sound controls to ensure loan workout actions are
10 appropriately structured.²⁵ The policy must explicitly prohibit the authorization of additional
11 advances to finance credit union fees and commissions. The credit union may, however, make
12 advances to cover third-party fees, such as force-placed insurance or property taxes. For loan
13 workouts granted, a credit union must document the determination that the borrower is willing
14 and able to repay the loan.

15 Modifications of loans that result in capitalization of unpaid interest are appropriate only
16 when a borrower has the ability to repay the debt. At a minimum, if a FICU’s loan modification
17 policy permits capitalization of unpaid interest, the policy must require:

²⁵ 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) (<https://www.govinfo.gov/content/pkg/FR-2000-06-12/pdf/00-14704.pdf>). 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). NCUA Letter to Credit Unions (LCU) 09-CU-19, “Evaluating Residential Real Estate Mortgage Loan Modification Programs,” also outlines policy best practices for real estate modifications (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/evaluating-residential-real-estate-mortgage-loan-modification-programs>). Those best practices remain applicable to real estate loan modifications (with the exception to the capitalization of credit union fees) but could be adapted in part by the credit union in their written loan workout policy for other loans.

- 1 1. Compliance with all applicable federal and state consumer protection laws and
2 regulations, including, but not limited to, the Equal Credit Opportunity Act, the Fair
3 Housing Act, the Truth In Lending Act, the Real Estate Settlement Procedures Act,
4 the Fair Credit Reporting Act, and the prohibitions against the use of unfair, deceptive
5 or abusive acts or practices in the Consumer Financial Protection Act of 2010.
- 6 2. Documentation that reflects a borrower's ability to repay, a borrower's source(s) of
7 repayment, and when appropriate, compliance with the FICU's valuation policies at
8 the time the modification is approved.
- 9 3. Providing borrowers with written disclosures that are accurate, clear and conspicuous
10 and that are consistent with Federal and state consumer protection laws.
- 11 4. Appropriate reporting of loan status for modified loans in accordance with applicable
12 law and accounting practices. The FICU shall not report a modified loan as past due
13 if the loan was current prior to modification and the borrower is complying with the
14 terms of the modification.
- 15 5. Prudent policies and procedures to help borrowers resume affordable and sustainable
16 repayments that are appropriately structured, while at the same time minimizing
17 losses to the credit union. The prudent policies and procedures must consider
 - 18 i. Whether the loan modifications are well-designed, consistently applied, and
19 provide a favorable outcome for borrowers.
 - 20 ii. The available options for borrowers to repay any missed payments at the end
21 of their modifications to avoid delinquencies or other adverse consequences.
- 22 6. Appropriate safety and soundness safeguards to prevent the following:

- 1 i. Masking deteriorations in loan portfolio quality and understating charge-off
2 levels²⁶;
3
4 ii. Delaying loss recognition resulting in an understated allowance for loan and lease
5 losses account or inaccurate loan valuations;
6
7 iii. Overstating net income and net worth (regulatory capital) levels; and
8
9 iv. Circumventing internal controls.
10

11 The credit union’s risk management framework must include thresholds, based on aggregate
12 volume of loan workout activity, which trigger enhanced reporting to the board of directors.
13 This reporting will enable the credit union’s board of directors to evaluate the effectiveness of
14 the credit union’s loan workout program, understand any implications to the organization’s
15 financial condition, and make any compensating adjustments to the overall business strategy.
16 This information will also be available to examiners upon request.

17 To be effective, management information systems need to track the principal reductions and
18 *charge-off* history of loans in workout programs by type of program. Any decision to re-age,
19 extend, defer, renew, or rewrite a loan, like any other revision to contractual terms, must be
20 supported by the credit union’s management information systems. Sound management
21 information systems identify and document any loan that is re-aged, extended, deferred,
22 renewed, or rewritten, including the frequency and extent of such action. Documentation

²⁶ Refer to NCUA guidance on charge-offs set forth in LCU 03-CU-01, “Loan Charge-off Guidance,” dated January 2003 (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/loan-charge-guidance>). 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 (for example, 12 months or more). See discussions on the latter point in the 2006 Interagency ALLL Policy Statement transmitted by Accounting Bulletin 06-1 (December 2006) (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/interagency-advisory-addressing-alll-key-concepts-and-requirements>). Upon implementation of ASC 326—Financial Instruments—Credit Losses, credit unions will use the guidance in Interagency Policy Statement on Allowances for Credit Losses (May 2020) (<https://www.ncua.gov/files/press-releases-news/policy-statement-allowances-credit-losses.pdf>).

1 normally shows that credit union personnel communicated with the borrower, the borrower
2 agreed to pay the loan in full under any new terms, and the borrower has the ability to repay the
3 loan under any new terms.

4 REGULATORY REPORTING OF WORKOUT LOANS INCLUDING TDR PAST DUE STATUS

5 Credit unions will calculate the past due status of all loans consistent with loan contract
6 terms, including amendments made to loan terms through a formal restructure. Credit unions
7 will report delinquency on the Call Report consistent with this policy.²⁷

8 LOAN NONACCRUAL POLICY

9 Credit unions must recognize interest income appropriately. Credit unions must place loans
10 in nonaccrual status when doubt exists as to full collection of principal and interest or the loan
11 has been in default for a period of 90 days or more. Upon placing a loan in nonaccrual, a credit
12 union must reverse or charge-off previously accrued but uncollected interest. A nonaccrual loan
13 may be returned to accrual status when a credit union expects repayment of the remaining
14 contractual principal and interest or it is well secured and in process of collection.²⁸ This policy
15 on loan accrual is consistent with longstanding credit union industry practice as implemented by
16 the NCUA over the last several decades. The balance of the policy relates to *commercial* and

²⁷ Subsequent Call Reports and accompanying instructions will reflect this policy, including focusing data collection on loans meeting the definition of TDR under GAAP. In reporting TDRs on regulatory reports, the data collections will include all TDRs that meet the GAAP criteria for TDR reporting, without the application of materiality threshold exclusions based on scoping or reporting policy elections of credit union preparers or their auditors. Credit unions should also refer to ASC Subtopic 310-40 when determining if a restructuring of a debt constitutes a TDR.

²⁸ Placing a loan in nonaccrual status does not change the loan agreement or the obligations between the borrower and the credit union. Only the parties can effect a restructuring of the original loan terms or otherwise settle the debt.

1 *member business loan* workouts and is similar to the policies adopted by the federal banking
2 agencies²⁹ as set forth in the FFIEC Call Report for banking institutions and its instructions.³⁰

3 ***Nonaccrual Status***

4 Credit unions may not accrue interest³¹ on any loan where principal or interest has been in
5 default for a period of 90 days or more unless the loan is both “*well secured*” and “*in the process*
6 *of collection.*”³² For purposes of applying the “well secured” and “in process of collection” test
7 for nonaccrual status listed above, the date on which a loan reaches nonaccrual status is
8 determined by its contractual terms.

9 While a loan is in nonaccrual status, a credit union may treat some or all of the cash
10 payments received as interest income on a cash basis provided no doubt exists about the
11 collectability of the remaining *recorded investment in the loan*. A credit union must handle the
12 reversal of previously accrued, but uncollected, interest applicable to any loan placed in
13 nonaccrual status in accordance with GAAP.³³

²⁹ 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.

³⁰ FFIEC Report of Condition and Income Forms, Instructions and Supplemental Instructions, <https://www.ffiec.gov/forms041.htm>.

³¹ 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.

³² 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 later section of this Appendix.

³³ 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,

1 RESTORATION TO ACCRUAL STATUS FOR ALL LOANS EXCEPT COMMERCIAL AND MEMBER
2 BUSINESS LOAN WORKOUTS

3 A nonaccrual loan may be restored to accrual status when:

- 4 • Its past due status is less than 90 days and the credit union expects repayment of the
5 remaining contractual principal and interest within a reasonable period;
- 6 • It otherwise becomes both *well secured* and *in the process of collection*; or
- 7 • The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual
8 of interest income under the accretable yield method. See ASC 310-30.

9 In restoring all loans to accrual status, if the credit union applied any interest payments
10 received while the loan was in nonaccrual status to reduce the recorded investment in the
11 loan, the credit union must not reverse the application of these payments to the loan's
12 recorded investment (and must not credit interest income). Likewise, a credit union cannot
13 restore the accrued but uncollected interest reversed or charged-off at the point the loan was
14 placed on nonaccrual status to accrual; it can only be recognized as income if collected in
15 cash or cash equivalents from the member.

(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.

1 RESTORATION TO ACCRUAL STATUS ON COMMERCIAL AND MEMBER BUSINESS LOAN
2 WORKOUTS³⁴

3 A formally restructured commercial or member business loan workout need not be
4 maintained in nonaccrual status, provided the restructuring and any charge-off taken on the loan
5 are supported by a current, well-documented credit evaluation of the borrower's financial
6 condition and prospects for repayment under the revised terms. Otherwise, the restructured loan
7 must remain in nonaccrual status.

8 The credit union's evaluation must include consideration of the borrower's sustained
9 historical repayment performance for a reasonable period prior to the date on which the loan is
10 returned to accrual status. A sustained period of repayment performance is a minimum of six
11 consecutive payments, and includes timely payments under the restructured loan's terms of
12 principal and interest in cash or cash equivalents. In returning the commercial or member
13 business workout loan to accrual status, a credit union may consider sustained historical
14 repayment performance for a reasonable time prior to the restructuring. Such a restructuring
15 must improve the collectability of the loan in accordance with a reasonable repayment schedule
16 and does not relieve the credit union from the responsibility to promptly charge off all identified
17 losses.

18 The following graph provides an example of a schedule of repayment performance to
19 demonstrate a determination of six consecutive payments. If the original loan terms required a
20 monthly payment of \$1,500, and the credit union lowered the borrower's payment to \$1,000

³⁴ This policy is derived from the "Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts" the NCUA and the other financial regulators issued on October 30, 2009.

1 through formal commercial or member business loan restructure, then based on the first row of
 2 the graph, the “*sustained historical repayment performance for a reasonable time prior to the*
 3 *restructuring*” would encompass five of the pre-workout consecutive payments that were at least
 4 \$1,000 (months 1 through 5). In total, the six consecutive repayment burden would be met by
 5 the first month post workout (month 6).

6 In the second row, only one of the pre-workout payments would count toward the six
 7 consecutive repayment requirement (month 5), because it is the first month in which the
 8 borrower made a payment of at least \$1,000 after failing to pay at least that amount. Therefore,
 9 the loan would remain on nonaccrual for at least five post-workout consecutive payments
 10 (months 6 through 10) provided the borrower continues to make payments consistent with the
 11 restructured terms.

Pre-workout					Post-workout				
Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10
\$1,500	\$1,200	\$1,200	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
1,500	1,200	900	875	1,000	1,000	1,000	1,000	1,000	1,000

12 After a formal restructure of a commercial or member business loan, if the restructured loan
 13 has been returned to accrual status, the loan otherwise remains subject to the nonaccrual
 14 standards of this policy. If any interest payments received while the commercial or member
 15 business loan was in nonaccrual status were applied to reduce the recorded investment in the
 16 loan the application of these payments to the loan’s recorded investment must not be reversed
 17 (and interest income must not be credited). Likewise, accrued but uncollected interest reversed

1 or charged-off at the point the commercial or member business workout loan was placed on
 2 nonaccrual status cannot be restored to accrual; it can only be recognized as income if collected
 3 in cash or cash equivalents from the member.

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

6 **TABLE 1—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 The loan is maintained on the Cash 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 definitions for “well secured” and “in the process of collection.”
Nonaccrual on Commercial or Member Business Loan Workouts	Continue on nonaccrual at workout point and until restore to accrual criteria are met	See Table 2—Restore to Accrual.

7 **TABLE 2—RESTORE TO ACCRUAL**

Action	Condition identified	Additional consideration
<p>Restore to Accrual on All Loans except Commercial or Member Business Loan Workouts</p>	<p>When a loan is less than 90 days past due and the credit union expects repayment of the remaining contractual principal and interest within a reasonable period, or</p> <p>When it otherwise becomes both “well secured” and “in the process of collection”;</p> <p>or</p> <p>The asset is a purchased impaired loan and it meets the criteria under GAAP (see ASC 310-30) for accrual of interest income under the accretable yield method</p>	<p>See Glossary definitions 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>
<p>Restore to Accrual on Commercial or</p>	<p>Formal restructure with a current, well documented credit evaluation of the</p>	<p>The evaluation must include consideration of the borrower’s sustained historical repayment performance for a minimum of six timely</p>

Action	Condition identified	Additional consideration
Member Business Loan Workouts	borrower's financial condition and prospects for repayment under the revised terms	consecutive payments comprised of principal and interest. In returning a loan to accrual status, a credit union may take into account sustained historical repayment performance for a reasonable time prior to the restructured terms. Interest payments received while the commercial or member business loan was in nonaccrual status and applied to reduce the recorded investment in the loan must not be reversed and income credited. Accrued but uncollected interest reversed or charged-off at the point the commercial or member business loan was placed on nonaccrual status cannot be restored to accrual.

1

2

1 GLOSSARY³⁵

2 “*Capitalization of Interest*” constitutes the addition of accrued but unpaid interest to the
3 principal balance of a loan.

4 “*Cash Basis*” method of income recognition is set forth in GAAP and means while a loan is
5 in nonaccrual status, some or all of the cash interest payments received may be treated as interest
6 income on a cash basis provided no doubt exists about the collectability of the remaining
7 recorded investment in the loan.³⁶

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

11 “*Commercial Loan*” is defined consistent with Section 723.2 of the NCUA’s MEMBER
12 BUSINESS LOANS; COMMERCIAL LENDING Rule, 12 CFR 723.2.

13 “*Generally accepted accounting principles (GAAP)*” means official pronouncements of the
14 FASB as memorialized in the FASB Accounting Standards Codification[®] as the source of
15 authoritative principles and standards recognized to be applied in the preparation of financial

³⁵ Terms defined in the Glossary will be italicized on their first use in the body of this guidance.

³⁶ 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 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.

1 statements by federally insured credit unions in the United States with assets of \$10 million or
2 more.

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

8 “*Member Business Loan*” is defined consistent with Section 723.8 of the NCUA’s
9 MEMBER BUSINESS LOANS; COMMERCIAL LENDING Rule, 12 CFR 723.8.

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

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

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

4 “*Troubled Debt Restructuring*” is as defined in GAAP and means a restructuring in which a
5 credit union, for economic or legal reasons related to a member borrower’s financial difficulties,
6 grants a concession to the borrower that it would not otherwise consider.³⁷ The restructuring of a
7 loan may include, but is not necessarily limited to:

- 8 (1) The transfer from the borrower to the credit union of real estate, receivables from
9 third parties, other assets, or an equity interest in the borrower in full or partial
10 satisfaction of the loan,
- 11 (2) a modification of the loan terms, such as a reduction of the stated interest rate,
12 principal, or accrued interest or an extension of the maturity date at a stated interest
13 rate lower than the current market rate for new debt with similar risk, or
14 (3) a combination of the above.

15 A loan extended or renewed at a stated interest rate equal to the current market interest rate
16 for new debt with similar risk is not to be reported as a restructured troubled loan.

17 “*Well secured*” means the loan is collateralized by: (1) A perfected security interest in, or
18 pledges of, real or personal property, including securities with an estimable value, less cost to

³⁷ FASB ASC 310-40, “Troubled Debt Restructuring by Creditors.”

1 sell, sufficient to recover the recorded investment in the loan, as well as a reasonable return on
2 that amount, or (2) by the guarantee of a financially responsible party.

3 “*Workout Loan*” means a loan to a borrower in financial difficulty that has been formally
4 restructured so as to be reasonably assured of repayment (of principal and interest) and of
5 performance according to its restructured terms. A workout loan typically involves a *re-aging*,
6 *extension, deferral, renewal, or rewrite* of a loan.³⁸ For purposes of this policy statement,
7 workouts do not include loans made to market rates and terms such as refinances, borrower
8 retention actions, or new loans.³⁹

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

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

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

³⁸ “*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.

³⁹ 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.

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

3