

Insights

Interagency Statement on Loan Modifications and Reporting for Financial Institutions

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INTRODUCTION

On April 7, 2020, the Board of Governors of the Federal Reserve System (“FRB”), the Federal Deposit Insurance Corporation (“FDIC”), the National Credit Union Administration (“NCUA”), the Office of the Comptroller of the Currency (“OCC”), and the Consumer Financial Protection Bureau (“CFPB”) (collectively, “the Agencies”) issued a revised interagency statement (the “Statement”) to provide information to financial institutions working with individuals and businesses affected by the Coronavirus Disease 2019 (“COVID-19”). The Statement supplements certain provisions in the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), signed into law on March 27, 2020. Specifically, the Statement provides additional guidance related to Section 4013 of the CARES Act, which provides financial institutions with relief from Troubled Debt Restructurings (“TDRs” or “TDR”). More generally, the Statement also encourages financial institutions to work with borrowers to modify loans in a manner that ensures safety and soundness while also complying with applicable consumer protection laws.

ANALYSIS

1. Accounting and Reporting Framework

As provided for under section 4013 of the CARES Act, a financial institution is provided the flexibility to modify eligible loans in response to COVID-19 without having to categorize the modification as a TDR in accordance with ASC Subtopic 310-40. The Statement provides further guidance on modifications eligible for the Section 4013 election, and those modifications that are not.

- Accounting for Loan Modifications Under Section 4013.

To be an eligible loan under Section 4013, a loan modification must be (1) related to COVID-19; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (A) 60 days after the date of termination of the National Emergency or (B) December 31, 2020 (applicable period). See <https://www.kriegdevault.com/insights/the-cares-act-provides-some-flexibility-lenders> for more information on the eligibility of certain loan modifications under the CARES Act.

The Statement provides clarification on reporting requirements under ASC Subtopic 310-40 that are typically required of TDRs. Specifically, if the loan modification is eligible for the Section 4013 election, the financial institution does not have to report the loans as TDRs in regulatory reports, or provide details of the impairment associated with certain loan concessions that would otherwise have been required for TDRs (e.g., interest rates concessions, payment deferrals, or loan extensions). The Agencies may want to collect data on Section 4013 loans for supervisory purposes, so financial institutions should still maintain records of the loan modifications, even if they don't need to be reported.

- Accounting for Loan Modifications Not Under Section 4013

The Statement also provides guidance for loan modifications that are ineligible for the Section 4013 election, or situations in which a financial institution decides not to elect Section 4013.

The Statement reminds us that loan modifications do not automatically result in TDRs. The Agencies have confirmed with staff of the Financial Accounting Standards Board ("FASB") that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any loan modification are not considered TDRs. Specifically, if (1) the modification is in response to the National Emergency, (2) the borrower was current on payments at the time the modification program was implemented, and (3) the modification is short term (e.g., 6 months), financial institutions may presume that borrowers are not experiencing financial difficulties for determining TDR status, and need not delve further into the TDR analysis. This guidance will be especially prevalent in the months following the National Emergency while different facets of the economy feel the impact of COVID-19 and borrowers are getting back on their feet.

2. Additional Considerations

In addition to the accounting and reporting framework described above, the Statement includes additional guidance regarding: (1) credit risk, (2) regulatory capital, (3) past due reporting, and (4) nonaccrual status and charge-offs. The Statement also provides additional information regarding the FRB's discount window and the applicability of consumer protection laws during the loan modification process. Guidelines regarding each are explained in greater detail below.

- Credit Risk. During examinations, each agency will exercise judgment when reviewing COVID-19 related loan modifications, and will not automatically provide an adverse risk rating for such modifications. Regardless of whether modifications result in loans that are considered TDRs, section 4013 loans, or are adversely classified, agency examiners will not criticize prudent efforts to modify the terms on existing loans to affected customers, however lenders must be prudent to ensure all modifications are consistent with safe and sound banking practices.
- Regulatory Capital. The Statement includes specific guidance from the FRB, FDIC, and OCC stating that if an institution is working with borrowers of one-to-four family residential mortgages underwritten by responsible loans not ninety days or more past due, then such loans will not be considered to be "modified" or "restructured" under the applicable risk-based capital rules.
- Past Due Payment Reporting. Under the guidance, so long as a loan is not otherwise considered past due, the Agencies will not require financial institutions to designate loan deferrals related to COVID-19 as past due during the deferral period.
- Nonaccrual and Charge-offs. Applicable reporting instructions and internal accounting policies remain the primary guidance when financial institutions consider whether loans to borrowers are reportable as nonaccrual assets. Nevertheless, if the financial institution enters a short term arrangement regarding the loan then it should be reported as nonaccrual. Should it become apparent that a modified loan will not be repaid, financial institutions should refer to applicable charge-off guidance.



- Discount Window. Loans modified under the guidance provided by the Agencies will generally be accepted as collateral at the FRB discount window.
- Consumer Protection. The Statement provides that lenders will remain subject to consumer protection laws while working to accommodate the needs of borrowers. While exercising their regulatory authority, the Agencies will consider the extraordinary circumstances impacting lenders and the good-faith effort to support customers while complying with applicable consumer protection laws. Accordingly, the Agencies are unlikely to initiate public enforcement actions against financial institutions so long as the institution's actions were related to COVID-19 and made in good faith to comply with consumer protection laws.

CONCLUSION

The Krieg DeVault Financial Services Team is closely monitoring the regulatory response to the COVID-19 pandemic and is able to assist your institution with navigating the myriad of issues this unprecedented crisis presents. As further updates occur, this Alert will be updated.