

# Maintain Written Policies on Loan Workouts and Nonaccrual Practices

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The National Credit Union Administration (NCUA) has amended its regulations to require federally insured credit unions (FICUs) to maintain written policies on the management of workout arrangements and nonaccrual policies for loans. The new rule takes effect on July 2, 2012. The compliance date for maintaining written policies on loan workouts and nonaccrual practices is October 1, 2012. The compliance date for collecting nonaccrual status data is December 31, 2012.

The NCUA stated that it issued the new rule to effectively balance appropriate loan workout programs with certain safety and soundness considerations. A summary of the rule is set forth below.

## 1. Written Loan Workout Policy and Monitoring Requirements

The rule requires a FICU's 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 applied consistently. The rule does not set forth "bright line" regulatory requirements or place defined parameters on FICU policies. Rather, the loan workout policy 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. Among other things, the policy must:

1. Define workout eligibility requirements, including limits on the number of times an individual loan may be modified;
2. Ensure the FICU makes loan workout decisions based on the borrower's renewed willingness and ability to repay the loan;
3. Establish sound controls to ensure loan workout actions are appropriately structured, including a prohibition on any authorizations of additional advances to finance unpaid interest and credit union fees (the policy may allow a FICU to make advances to cover third-party fees, such as forced place insurance or property taxes, however, the FICU cannot finance any related commissions it may receive from the third party).

The rule also requires that loan workout decisions be supported by the FICU's management information system. This system should be able to identify any loan that is subject to a workout. Appropriate documentation should show that the FICU's personnel communicated with the borrower, the borrower agreed to pay in full under any new terms and that the borrower has the ability to repay the loan under any new terms. NCUA emphasizes these are minimum requirements that merely provide a framework for establishing a sound workout program.

Additionally, the rule states that if a FICU restructures a loan more often than once a year or twice in five years, examiners will have higher expectations for documentation of the borrower's renewed willingness and ability to repay the loan. One way a FICU can provide convincing evidence that multiple restructurings improve collectability is to perform validations of completed multiple restructurings that substantiate the claim.

## 2. Reporting of Workout Loans

The rule mandates that the past due status of all loans should be calculated consistent with the loan contract terms, including amendments made to loan terms through formal restructures. Credit unions will be required to report delinquencies on the Call Report consistent with this policy. (Subsequent Call Reports and accompanying instructions will reflect this policy.)

## 3. Nonaccrual Policy and Status

The rule requires FICUs to adopt written policies that formalize the longstanding NCUA requirement and industry practice to cease accruing interest on a loan when it becomes 90 days or more past due. However, a FICU may still accrue interest on a loan in default for 90 days or more if the loan is both "well secured" and "in the process of collection." An example is a loan that is performing at a level agreed to by the FICU and debtor and has a reasonably demonstrated likelihood of full recovery of the balance.

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 is deemed fully collectible.

## 4. Restoration to Accrual Status for Loans Other Than Member Business Loan Workouts

The rule states that a nonaccrual loan may be restored to accrual status when:

1. It's 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;
2. When it otherwise becomes both "well secured" and "in the process of the collection;" or
3. The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of income under the interest method specified therein.

## 5. Restoration to Accrual Status for Member Business Loan Workouts

The rule requires a 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 timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents.

If you have any questions regarding the new rule, please contact Joseph D. Simon at 516-357-3710 or via email at [jsimon@cullenanddykman.com](mailto:jsimon@cullenanddykman.com).

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