Federal Financial Institutions Examination Council

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Joint Statement on Additional Loan Accommodations Related to COVID-19

Introduction

The Federal Financial Institutions Examination Council on behalf of its members (collectively referred to as FFIEC members)[1] is issuing this joint statement to provide prudent risk management and consumer protection principles for financial institutions to consider while working with borrowers as loans near the end of initial loan accommodation periods[2] applicable during the Coronavirus Disease 2019 (COVID event).[3] These principles are consistent with Interagency Guidelines Establishing Standards for Safety and Soundness[4] and are generally applicable to both commercial and retail loan accommodations.[5] The principles in this joint statement are intended to be tailored to a financial institution's size, complexity, and loan portfolio risk profile, as well as the industry and business focus of its customers or members.

[1] The FFIEC is composed of the following: a member of the Board of Governors of the Federal Reserve System (FRB), appointed by the Chairman of the FRB; the Chairman of the Federal Deposit Insurance Corporation (FDIC); the Chairman of the National Credit Union Administration (NCUA); the Comptroller of the Currency (OCC); the Director of the Bureau of Consumer Financial Protection; and, the Chairman of the State Liaison Committee.

[2] For purposes of this joint statement, an accommodation includes any agreement to defer one or more payments, make a partial payment, forbear any delinquent amounts, modify a loan or contract or provide other assistance or relief to a borrower who is experiencing a financial challenge. Loans include revolving and open-end credit products. "Additional accommodation options" refer to the options a financial institution may provide to the borrower after the initial accommodation, which may include an additional accommodation, an agreement to repay any amounts deferred as a result of the initial accommodation, or an agreement to change the terms of the loan agreement to improve the long-term sustainability and affordability of the loan.

[3] See Proclamation 9994, "Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak," 85 FR 15337 (March 18, 2020).

[4] 12 CFR 30, appendix A (OCC); 12 CFR 208, appendix D-1 (Board); 12 CFR 364, appendix A (FDIC). Credit unions are subject to safety and soundness requirements under the Federal Credit Union Act and the NCUA's regulations. See 12 USC 1786(b), (e); 12 CFR 741.3; and 12 CFR 723 (NCUA).

[5] Financial institutions must comply with applicable laws and regulations in considering borrowers' requests, including section 4022 of the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (Mar. 27, 2020).

Background

The COVID event has had a significant adverse impact on consumers, businesses, financial institutions, and the economy.[6] To address such impacts, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)[7] provides several forms of relief to businesses and borrowers, and some states and localities have provided similar credit accommodations. Also, many financial institutions have voluntarily offered other credit accommodations to their borrowers.

The FFIEC members have encouraged financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the COVID event.[8] Specifically, the FFIEC members have stated that they view loan accommodations as positive actions, which can mitigate adverse effects on borrowers caused by the COVID event.

While some borrowers will be able to resume contractual payments at the end of an accommodation, others may be unable to meet their obligations due to continuing financial challenges. The FFIEC members recognize that some financial institutions may face difficulties in assessing credit risk due to limited access to borrower financial data, COVID event-induced covenant breaches, and difficulty in analyzing the impact of COVID event-related government assistance programs.

The FFIEC members encourage financial institutions to consider prudent accommodation options that are based on an understanding of the credit risk of the borrower; are consistent with applicable laws and regulations; and, that can ease cash flow pressures on affected borrowers, improve their capacity to service debt, and facilitate a financial institution's ability to collect on its loans. Such arrangements may mitigate the long-term impact of a financial challenge on borrowers by avoiding delinquencies or other adverse consequences. Imprudent practices can adversely affect borrowers and expose financial institutions to increases in credit, compliance, operational, and other risks as well as present risks to a financial institution's capital.

Risk Management and Consumer Protection Principles

The following principles provide prudent practices for financial institutions to work with borrowers in a safe and sound manner as loans near the end of accommodation periods.

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[6] Refer to footnote 3.

[7] Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (March 27, 2020).

[8] See "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)" (April 7, 2020).

Prudent Risk Management Practices

Prudent risk management practices include identifying, measuring, and monitoring the credit risks of loans that receive accommodations. Effectively managed institutions understand provisions of loan agreements and accurately monitor the terms[9] of accommodations (such as payment changes, interest rate changes, and modified amortization terms). Monitoring and assessing loan accommodations on an ongoing basis typically enables financial institutions to recognize any deterioration, including potential loss exposure, in a timely manner.

Sound credit risk management includes applying appropriate loan risk ratings or grades and making appropriate accrual status decisions on loans affected by the COVID event. Generally, following an accommodation, a financial institution reassesses risk ratings for each loan based on a borrower's current debt level, current financial condition, repayment ability, and collateral.[10] A reasonable accommodation may not necessarily result in an adverse risk rating solely because of a decline in the value of underlying collateral, provided that the borrower has the ability to perform according to the modified terms.

Effective management information systems and reporting helps to ensure that management understands the scope of loans that received an accommodation, the types of initial and any additional accommodations provided, when the accommodation periods end, and the credit risk of potential higher-risk segments[11] of the portfolio(s). In executing an accommodation, financial institutions are encouraged to take prudent steps to provide clear, accurate, and timely information to borrowers and guarantors regarding the accommodation. This includes information on how to contact the lender or servicer to discuss options that might best fit an individual borrower's specific needs.

Well-Structured and Sustainable Accommodations

For a borrower that continues to experience financial challenges after an initial accommodation, it may be prudent for the financial institution to consider additional accommodation options to mitigate losses for the borrower and the financial institution. Well-designed and consistently applied accommodation options accompanied by prudent risk management practices can minimize losses to the financial institution, while helping its borrowers resume structured, affordable, and sustainable repayment of amounts contractually due over a reasonable period of time. The effectiveness of accommodations improves when they are based on a comprehensive review of how the hardship has affected the financial condition and current and future performance of the borrower.

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[9] The Federal Credit Union Act includes provisions addressing loan maturities applicable to loans made by credit unions. See 12 USC 1575(5); 12 CFR 701.21(e)-(g).

[10] Refer to footnote 5.

[11] Segments may include product types, post-relief payment characteristics (such as balloon payments, payment changes, and maturity extension), or borrower characteristics (such as unemployed or underemployed borrowers, credit score bands, industry, businesses in full or partial operation, or credit risk rating) where performance may vary.

When a financial institution considers whether to offer additional accommodation options to a borrower, it is generally appropriate for the financial institution to assess each loan based upon the fundamental risk characteristics affecting the collectability of that particular credit. For both commercial and retail loans, this typically includes evaluating the borrower's financial condition and repayment capacity and assessing whether current conditions have affected collateral values or the strength of guarantees, if applicable. For a commercial loan, this would also include the financial institution evaluating both actual and projected cash flows of a borrower's business. The COVID event may have a long-term adverse impact on a borrower's future earnings and therefore management may need to rely more heavily on projected financial information for both commercial and retail borrowers in making underwriting decisions as supporting documentation may be limited, and cash flow projections may be uncertain.

Consumer Protection

Financial institutions are encouraged to provide consumers with available options for repaying any missed payments at the end of their accommodation to avoid delinquencies or other adverse consequences. Financial institutions are also encouraged, where appropriate, to provide consumers with options for making prudent changes to the terms of the credit product to support sustainable and affordable payments for the long term.[12]

Effective approaches to risk management generally include the following:

- Providing additional accommodation options to borrowers that are affordable and sustainable;
- Providing clear, conspicuous, and accurate communications and disclosures to inform the borrowers of the available options;
- Providing such communications and disclosures in a timely manner, before the end of the accommodation period to allow adequate time for the borrower and financial institution to consider next steps, which may include payment deferral, loan modification, or loan extension, among other options;[13]
- Basing eligibility and payment terms on consistent analyses of borrowers' (and, if applicable, guarantors') financial condition and reasonable capacity to repay;
- Ensuring policies and procedures reflect accommodation options offered by the financial institution and promote consistency with applicable laws and regulations, including fair lending laws;[14]

[12] For Community Reinvestment Act (CRA) treatment of certain activities in response to the COVID event, see the "Joint Statement on CRA Consideration for Activities in Response to COVID-19" (March 19, 2020); and "CRA Consideration for Activities in Response to the Coronavirus, Frequently Asked Questions" (May 27, 2020).

[13] For certain mortgage products, there are regulatory requirements governing the timing of communications. For example, see Regulation X, 12 CFR 1024.41.

[14] Applicable laws include, but are not limited to, the Equal Credit Opportunity Act (ECOA), the Fair Credit Reporting Act (FCRA), the Fair Debt Collection Practices Act (FDCPA), the Fair Housing Act, prohibitions against unfair or deceptive acts or practices (UDAP) (such as section 5 of the Federal Trade Commission Act), the Real Estate Settlement Procedures Act (RESPA), the Servicemembers Civil Relief Act (SCRA), the Truth in Lending Act (TILA), and the regulations issued pursuant to those laws.

- Providing appropriate training to employees and other persons responsible for compliance and operational procedures related to any additional accommodation options, including customer service personnel;
- Ensuring that risk monitoring, audit, and consumer complaint systems are adequate to evaluate compliance with applicable laws, regulations, policies, and procedures; and
- Providing complete and accurate information to borrowers and subsequent servicers during loan transfers and ensuring post-transfer servicing is consistent with the agreement with the borrower and the borrower's status at the time of transfer.[15]

Accounting and Regulatory Reporting

Financial institutions must follow applicable accounting and regulatory reporting requirements for all loan modifications, as the term "modification" is used in U.S. generally accepted accounting principles (GAAP) and regulatory reporting instructions,[16] including additional modifications made to borrowers who may continue to experience financial hardship at the end of the initial accommodation period. This includes maintenance of appropriate allowances for loan and lease losses (ALLL) or allowances for credit losses (ACL), as applicable. Financial institutions may refer to regulatory reporting instructions,[17] section 4013 of the CARES Act, "Temporary Relief from Troubled Debt Restructurings" (section 4013), and the "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)" (Interagency Statement).[18]

Appropriate ALLL or ACL methodologies, as applicable, consider all relevant and available information when assessing the collectability of cash flows, including changes in borrower financial condition, collateral values, lending practices, and economic conditions as a result of the COVID event. Borrowers facing identified financial difficulties as they near the end of the accommodation periods generally pose greater credit risk. According to GAAP, loans are to be segmented into a separate portfolio when they share similar risk characteristics for the purposes of estimating credit losses, unless they are evaluated on an individual basis.[19]

A financial institution may have difficulty accurately determining the collectability of certain loans affected by the COVID event and may need more time to determine the effect of the COVID event on some borrowers' long-term ability to repay and to assess the value of underlying collateral. In accordance with GAAP and regulatory reporting instructions,

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[15] See, e.g., Regulation X, 12 CFR 1024.38(b)(4) (requiring certain mortgage servicers to maintain certain policies and procedures to facilitate the transfer of information during mortgage servicing transfers). The CFPB recently issued guidance on handling of information and documents during mortgage servicing transfers: Bulletin 2020-02 – Compliance Bulletin and Compliance Guidance: Handling of Documents and Information During Mortgage Servicing Transfers, 85 FR 25281 (May 1, 2020).

[16] Refer to www.ffiec.gov for Federal Financial Institution Examination Council regulatory reporting instructions. Credit Unions can refer to the 5300 Call Report Instruction.

[17] Id.

[18] Refer to footnote 8.

[19] Refer to ASC 310-10-35 or ASC 326-20-30-2, as applicable.

management should consider the effect of the COVID event in its ALLL or ACL estimation processes, as applicable, and whether the resulting changes in estimated credit losses are in accordance with GAAP and regulatory reporting requirements as additional information becomes available.

Section 4013 provides financial institutions the option to temporarily suspend certain requirements under GAAP related to troubled debt restructurings (TDR) for a limited period of time to account for the effects of the COVID event.[20] The Interagency Statement addresses accounting and regulatory reporting considerations for loan modifications, including those accounted for under section 4013.

- If a financial institution elects to account for a loan modification under section 4013, an additional loan modification could also be eligible under section 4013. To be eligible, each loan modification must be (1) related to the COVID event; (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.

- If a financial institution does not elect to account for a loan modification under section 4013 or a loan modification is not eligible under section 4013, additional modifications should be viewed cumulatively in determining whether the additional modification is a TDR. Financial institutions can refer to the Interagency Statement for additional information when making the determination. For example, if the cumulative modifications for a loan are all COVID event related, in total represent short-term modifications (e.g., six months or less combined), and the borrower is contractually current (i.e., less than 30 days past due on all contractual payments) at the time of the subsequent modification, management may continue to presume the borrower is not experiencing financial difficulties at the time of the modification for purposes of determining TDR status, and the subsequent modification of loan terms would not be considered a TDR.

- For all other subsequent loan modifications, a financial institution can appropriately evaluate the subsequent modifications by referring to applicable regulatory reporting instructions and internal accounting policies to determine whether such modifications are accounted for as TDRs under ASC Subtopic 310-40, "Receivables-Troubled Debt Restructurings by Creditors."[21]

A loan's payment date is governed by the due date stipulated in the loan agreement. The past due status reported in regulatory reports should therefore be determined in accordance with the revised contractual terms of a loan. With regards to accrual status, a financial institution should continue to refer to the applicable regulatory reporting instructions, as well as internal accounting

[20] Financial institutions accounting for eligible loans under section 4013 are not required to (1) apply ASC Subtopic 310-40, "Receivables–Troubled Debt Restructurings by Creditors," to the section 4013 loans for the term of the loan modification and (2) report section 4013 loans as TDRs in regulatory reports.

[21] For additional information, see "Interagency Supervisory Guidance Addressing Certain Issues Related to Troubled Debt Restructurings" (October 24, 2013).

policies, to determine whether a modified loan should be reported as a nonaccrual asset in regulatory reports.

Internal Control Systems

Prudent risk management practices at the end of initial accommodation periods and for additional accommodations include quality assurance, credit risk review, operational risk management, compliance risk management, and internal audit functions that are commensurate with the size, complexity, and risk of the financial institution's activities. These internal control functions typically include appropriate targeted testing of the process for managing each stage of the accommodation. Even when a financial institution outsources all or a portion of these functions, the financial institution remains responsible for ensuring that the service provider acts consistently with applicable laws, regulations, and the financial institution's policies and procedures.[22] Prudent testing by internal control functions typically confirm the following:

- Accommodation terms are extended with appropriate approval;
- Additional accommodation options offered to borrowers are presented and processed in a fair and consistent manner and comply with applicable laws and regulations, including fair lending laws;
- Servicing systems accurately consolidate balances, calculate required payments, and process billing statements for the full range of potential repayment terms that exist once the accommodation periods end;
- Staff, including problem loan and collections personnel are qualified and can efficiently handle expected workloads;
- Borrower and guarantor communications, and legal documentation, are clear, accurate, and timely, and in accordance with contractual terms, policy guidelines, and federal and state laws and regulatory requirements; and
- Risk rating assessments are timely and appropriately supported.

[22] See Federal Reserve Letters SR 13-19/CA 13-21 "Guidance on Managing Outsourcing Risk" (December 5, 2013); OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance"; OCC Bulletin 2020-10, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29"; Supervisory Letter No. 07-01, Evaluating Third Party Relationships (NCUA); Guidance For Managing Third-Party Risk, FDIC FIL-44-2008 (June 6, 2008).