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Client Alert: Federal Financial Institution Regulators Encourage Financial Institutions to Work with Borrowers

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We are updating our Client Alert from March 26, 2020,[1] in light of the issuance, on April 7, 2020, by the primary federal financial institution regulators[2] (the "**Regulators**") of a revised Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by Coronavirus (Revised) (the "**Revised Interagency Statement**").[3] The Revised Interagency Statement has been issued to address certain changes in the Regulators' approach to loan modifications as a result of the Coronavirus Aid, Relief, and Economic Security Act (the "**CARES Act**")[4] signed into law by President Trump on March 27, 2020, and supersedes the Regulators' prior Interagency Statement of March 22, 2020, on the same subject matter (the "**Prior Interagency Statement**").[5]

Under U.S. GAAP (generally accepted accounting principles), a debt restructuring is classified as a troubled debt restructuring ("**TDR**") if the lender grants a concession to a borrower, on legal or economic bases because of the borrower's financial difficulties, if it would not otherwise consider such a concession.[6]

Pursuant to the CARES Act, regulated financial institutions may account for qualifying loan modifications under either (i) Section 4013 of the CARES Act (a "**Section 4013 Loan**") or (ii) in accordance with FASB (Financial Accounting Standards Board) Accounting Standards Codification® (ASC) Subtopic 310-40[7] ("**ASC Subtopic 310-40**") dealing with TDRs.

In order to qualify as a Section 4013 Loan, a loan modification must be:

- Related to Coronavirus Disease 2019 ("**COVID-19**");
- Executed on a loan that was not more than thirty (30) days past due as of December 31, 2019; and
- Executed between March 31, 2020 and first to occur of (i) 60 days after the date of termination of the National Emergency[8] or (ii) December 31, 2020.

So long as a loan modification qualifies as a Section 4013 Loan, the provisions of ASC Subtopic 310-40,

which might otherwise require the loan to be classified as a TDR, will not be applicable during the term of the loan modification, and financial institutions will not be required to report Section 4013 Loans as TDRs in their regulatory reporting, although they will be required to maintain records as to the volume of Section 4013 Loans and such data may be collected for supervisory purposes. Further, certain concessions, such as interest rate concessions, payment deferrals, or loan extensions, will not require that a financial institution determine impairment, as would be necessary if the loan was a TDR.

To the extent that a loan is not eligible for treatment as a Section 4013 Loan, or for some reason the financial institution does not elect to apply Section 4013 of the CARES Act to a loan, other rules would apply. It should be noted that a loan modification does not automatically result in classification of the loan as a TDR. The Regulators have reiterated that they view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19 and they will not criticize financial institutions that "work prudently" with borrowers unable to make their regular payments as a result of the effects of COVID-19.[9] The Regulators have consulted with staff of FASB, which has confirmed short-term[10] loan modifications, including payment deferrals, fee waivers, extensions of repayment, or other insignificant delays in payment[11] made in response to COVID-19 will not be considered as TDRs provided that the modification is made in good faith and the borrower is "current." "Current" borrowers are those that are less than 30 days past due on their required payments at the time the modification is put in place.[12] Financial institutions are not required to perform any other TDR analysis provided that a borrower is current. Note that the Interagency Statement indicates that federal or state government mandated modification or deferral programs, such as New York Governor Andrew Cuomo's Executive Order No. 202.9, issued March 21, 2020 (in essence mandating that all institutions regulated by New York's Department of Financial Services grant 90-day forbearances for COVID-19-impacted borrowers (including persons and businesses), and requiring all such institutions to grant requests to suspend mortgage payments for a specified period), would not be within the TDR provisions of ASC 310-40.

Additionally, Regulators have indicated in the Interagency Statement that regulated financial institutions will not be required to report as "past due" a loan with deferred payments granted as a result of the effects of COVID-19, unless such loan is otherwise reportable as past due. The Regulators' reasoning is that payment dates of loans are governed by the loan documents evidencing such loans and if the financial institution has agreed to deferral of a payment, this would result in the payment not being contractually past due. Further, loans that are modified on a short-term basis as discussed in the Interagency Statement would not be required to be reported as nonaccrual assets for regulatory reporting purposes. However, if additional information indicates that a loan will not be repaid, such loans are subject to the charge-off guidance in the instructions for Consolidated Reports of Condition and Income (commonly referred to as a Call Report) or, as to federally-insured credit unions, NCUA[13] Letter to Credit Unions No. 03-CU-01, relating to loan charge off.

Additionally, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency have indicated that working with borrowers of one-to-four family residential mortgages, where the loans are prudently underwritten, not 90 days or more past due, and not classified as nonaccrual loans, will not result in the loans being deemed restructured or modified for the respective risk-based capital rules of such Regulators.

The Regulators have also indicated that, in order to provide liquidity, loans which have been restructured (either Section 4013 Loans or as otherwise described above) under the Revised Interagency Statement will, as a general matter, continue to be eligible as collateral at the Federal Reserve Board's discount window.

The Regulators have also indicated that because of the unique nature of the National Emergency and its impact on both borrowers and financial institutions, they will take into account an institution's good-faith

efforts "demonstrably designed to support consumers, comply with consumer protection laws," and that they do not expect to take consumer compliance public enforcement actions against a regulated institution, if the circumstances relate to the National Emergency, the institution has made good-faith efforts to support borrowers and comply with applicable consumer protection requirements, and has responded to any needed corrective actions as identified by the Regulators.

The information in this Client Alert is current as of April 8, 2020 and is a supplement to our initial Client Alert of March 19, 2020 (*Commercial Loan Documentation: Effects of COVID-19*).[14] We are committed to keeping our clients informed of important issues that affect them, including as a result of the COVID-19 pandemic.

Shumaker's Financial Services practice group has extensive experience in representing both financial institutions and commercial borrowers in a variety of transactions and structures, in all areas of commercial lending. Please contact us if you have questions regarding this Client Alert or if we can be of assistance in reviewing loan documentation and advising of potential courses of action.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource Center at shumaker.com. We have also established a 24/7 Legal & Legislative Helpline at 1.800.427.1493 monitored by Shumaker lawyers around the clock.

1 See, *Client Alert: Federal Financial Institution Regulators Encourage Financial Institutions to Work with Borrowers; Fed Adjustment to Supervisory Report*, March 26, 2020, https://www.shumaker.com/latest-thinking/publications/2020/03/client-alert-federal-financial-institution-regulators-encourage-financial-institutions-to-work-with-borrowers-fed-adjustment-to-supervisory-approach.

2 The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the Conference of State Bank Supervisors.

3 See, Joint Press Release of Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the Conference of State Bank Supervisors, April 7, 2020, 3:00 p.m., EDT, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200407a.htm.

4 50 U.S.C. 1601 et seq.

5 The Prior Interagency Statement has been removed from the various Regulators' websites.

6 TDRs are an accounting categorization codified within Accounting Standards Codification (ASC) Subtopic 310-40, Receivables—Troubled Debt Restructurings by Creditors (ASC 310-40).

7 A copy of ASC Suptopic 310-40, Receivables—Troubled Debt Restructurings by Creditors, can be found at https://asc.fasb.org/imageRoot/90/52428090.pdf.

8 See, Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak, issued by President Donald J. Trump on March 13, 2020.

9 See, Joint Press Release of Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the Conference of State Bank Supervisors, March 9, 2020, 4:30 p.m., EDT, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200309a.htm.

10 The Interagency Statement uses six (6) months as an example.

11 ASC 310-40 considers the following factors as whether a delay in payment is insignificant: (i) the amount of the delayed/restructured payment is insignificant in relation to the unpaid principal or collateral value of the debt resulting in an insignificant shortfall in the contractual payment due from the borrower and (ii) whether the delay as a result of the restructured payment is insignificant based on payment frequency under, original contractual maturity of, or original expected duration of the debt.

12 Note, *supra*, the different treatment for Section 4013 Loans, which are required to be current as of December 31, 2019, as opposed to the date of the modification.

13 National Credit Union Association.

14 https://www.shumaker.com/latest-thinking/publications/2020/03/client-alert-commercial-loan-documentation-effects-of-covid-19

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