BYBEL RUTLEDGE LLP

LEGAL ALERT

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Loan Modifications: Payment Deferrals, TDRs and the CARES Act

Federal and state financial regulatory agencies[1] on April 7, 2020, released the Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised). The revised statement encourages financial institutions to work constructively with borrowers impacted by the Coronavirus (COVID-19) and clarifies the relationship between an earlier interagency statement issued by the agencies[2] and related relief provided by Section 4013 of the Coronavirus Aid, Relief and Economic Security (CARES) Act. The revised statement expresses the agencies' understanding that the unique and evolving circumstances deriving from COVID-19 pose temporary disruptions in the lending relationship that affect lenders, borrowers, businesses and the economy.

One of the purposes of the CARES Act is to encourage the implementation of an assistance policy that would protect borrowers from potential negative credit reporting resulting from a loan accommodation made by their lenders. The CARES Act provides financial institutions the ability temporarily to suspend certain requirements of U. S. GAAP governing troubled debt restructurings (TDRs)[3] for a limited time to account for the adverse effects of COVID-19.

The Interagency Statements: Safety and Soundness

The principal message of the regulatory agencies in issuing the revised statement is that they view loan modification programs as positive responses by lenders that mitigate adverse effects on borrowers caused by COVID-19. The revised interagency statement encourages financial institutions to work with borrowers who are unable to meet their contractual payment obligations because of the effects of COVID-19.

The agencies view loan modification initiatives favorably, consistent with their longstanding practice of encouraging financial institutions to assist their borrowers in times of natural disaster and other extreme events. Accordingly, the agencies have stated that they will not criticize institutions for working cooperatively with their customers in a safe and sound manner. Prudent loan modification programs are perceived as leading ultimately to improved loan performance and reduced credit risk

[1] The regulatory agencies include 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, the Conference of State Bank Supervisors, the American Council of State Savings Supervisors and the National Association of State Credit Union Supervisors.

[2] The earlier interagency statement was titled Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus and dated March 22, 2020.

[3] "TDR" is an accounting categorization defined in U. S. GAAP and further described in ASC Subtopic 310-40, Receivables. Essentially, a debt restructuring constitutes a TDR if a creditor, for economic or legal reasons related to a debtor's financial difficulties, grants a concession that the creditor would not otherwise consider.

Accounting and Reporting Loan Accommodations: FASB Accounting Standards Codification Topic 310

Not all payment deferrals are TDRs.

The CARES Act permits a lender to account for an eligible loan modification either under Section 4013 or in accordance with ASC Subtopic 310-40 (Receivables-Troubled Debt Restructurings by Creditors). ASC Subtopic 310-40 may become applicable if a loan modification is not eligible under Section 4013.[4]

Loan modifications not eligible under Section 4013 of the CARES Act do not automatically result in treatment as TDRs. ASC Subtopic 310-40 provides that a loan restructuring constitutes a TDR if a lender, for reasons related to a debtor's financial difficulties, grants a concession to the distressed debtor that the lender would not otherwise consider. The agencies have worked closely with the staff of the Financial Accounting Standards Board (FASB) to achieve consensus that short-term modifications (for example, up to six months) made on a good-faith basis in response to COVID-19 for borrowers who were previously current in payment should not be classified as TDRs. Borrowers are considered current if they are less than 30 days past due on their required payments when a modification becomes effective.

Generally, financial institutions may presume that borrowers are not experiencing financial difficulty at the time of a loan modification if:

- the modification was made because of a national emergency,
- the borrower was previously current in payment, and
- the modification is short in term.

A lender should maintain a record of the justifications supporting a loan modification, including the borrower's recovery plan, the necessary period of payment deferral, sources of repayment, proposed additional advances on existing loans and any changes in the value of the collateral as supported by appraisal.

Section 4013 of the CARES Act

The CARES Act, which was signed into law on March 27, 2020 (H.R. 748), permits a financial institution to make an election under section 4013 of the Act during the term of the "applicable period."[5] The institution may elect to:

> suspend the requirements of U. S. GAAP for a loan modification necessitated by COVID-19 that would otherwise be classified as a TDR, and
>
> suspend a determination that a loan modified because of the effects of the pandemic constitutes a TDR.

The "applicable period" means the period beginning on March 1, 2020, and ending on the earlier of (1) December 31, 2020, or (2) the date that is sixty days after the date on which the national emergency concerning the COVID-19 outbreak terminates.

If a financial institution elects to suspend the requirements of U. S. GAAP, the suspension is applicable for the term of the loan modification, but solely with respect to a modification comprising a forbearance arrangement, an interest rate modification, a repayment plan and any other similar arrangement that defers payment of principal or interest. A suspension can only apply to an adverse impact on a borrower's credit that relates to the COVID-19 pandemic.

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[4] For example, a loan modified after the "applicable period" as defined in Section 4013(a)(1) of the CARES Act would not be eligible for treatment Section 4013.

[5] While the election must be made during the "applicable period," the suspension of the requirements of U. S. GAAP is applicable for the term of the loan modification.

A suspension of the applicability of U. S. GAAP is only available under Section 4013 for a loan that was not more than 30 days past due as of December 31, 2019.

Subsection (d) of Section 4013 of the CARES Act further provides that (1) financial institutions should continue to maintain records of the volume of loans to which suspensions of GAAP under Section 4013 apply, and (2) appropriate Federal banking agencies may collect data about such loans for supervisory purposes..

Past Due Reporting, Nonaccrual Status, and Charge-offs

Financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due so long as the loans are not otherwise reportable as past due. A loan's payment date is governed by the governing loan documents.

Each financial institution should refer to the applicable regulatory reporting instructions and its internal accounting policies to determine if loans to stressed borrowers should be reported as nonaccrual assets in regulatory reports. During the short-term deferral caused by COVID-19, these loans should generally not be reported as nonaccrual.

Need More Information?

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