
Joint Statement

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

For immediate release

**Revised Interagency Guidance on
Returning Certain Nonaccrual Loans to Accrual Status**

June 10, 1993

Introduction

On March 10, 1993, the four federal banking agencies issued an Interagency Policy Statement on Credit Availability. That policy statement outlined a program of interagency initiatives to reduce impediments to the availability of credit to businesses and individuals.

As part of that program, the agencies are making two revisions to existing policies for returning certain nonaccrual loans to accrual status. The revised policies should remove impediments to working with borrowers who are experiencing temporary difficulties in a manner that maximizes recovery on their loans, while at the same time improving disclosures in this area.

The first change conforms the banking and thrift agencies' policies on troubled debt restructurings (TDRs) that involve multiple notes (sometimes referred to as "A"/"B" note structures). The second change would permit institutions to return past due loans to accrual status, provided the institution expects to collect all contractual principal and interest due and the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms.

The revised policies are effective immediately. Thus, institutions may elect to adopt such changes for purposes of the June 30, 1993, Consolidated Reports of Condition and Income (Call Report) and Thrift Financial Report (TFR). Revised Call Report and TFR instructions will be distributed as of September 30, 1993.

TDR Multiple Note Structure

The agencies are conforming their reporting requirements for TDR structures involving multiple notes. The basic example is a troubled loan that is restructured into two notes where the first or "A" note represents the portion of the original loan principal amount which is expected to be fully collected along with contractual interest. The second part of the restructured loan, or "B" note, represents the portion of the original loan that has been charged off.

Such TDRs generally may take any of three forms. (1) In certain TDRs, the "B" note may be a contingent receivable that is payable only if certain conditions are met (e.g., sufficient cash flow from the property). (2) For other TDRs, the "B" note may be contingently forgiven (e.g., note "B" is forgiven if note "A" is paid in full). (3) In other instances, an institution would have granted a concession (e.g., rate reduction) to the troubled borrower but the "B" note would remain a contractual obligation of the borrower. Because the "B" note is not reflected as an asset on the institution's books and is unlikely to be collected, the agencies have concluded that for reporting purposes the "B" note could be viewed as a contingent receivable.

Institutions may return the "A" note to accrual status provided the following conditions are met:

- (1) The restructuring qualifies as a TDR as defined by FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructuring," (SFAS 15) and there is economic substance to the restructuring. (Under SFAS 15, a restructuring of debt is considered a TDR if "the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.")
- (2) The portion of the original loan represented by the "B" note has been charged off. The charge-off must be supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. The charge-off must be recorded before or at the time of the restructuring.
- (3) The "A" note is reasonably assured of repayment and of performance in accordance with the modified terms.
- (4) In general, the borrower must have demonstrated sustained repayment performance (either immediately before or after the restructuring) in accordance with the modified terms for a reasonable period prior to the date on which the "A" note is returned to accrual status. A sustained period of payment performance generally would be a minimum of six months and involve payments in the form of cash or cash equivalents.

Under existing reporting requirements, the "A" note would be disclosed as a TDR. In accordance with these requirements, if the "A" note yields a market rate of interest and performs in accordance with the restructured terms, such disclosures could be eliminated in the year following the restructuring. To be considered a market rate of interest, the interest rate on the "A" note at the time of the restructuring must be equal to or greater than the rate that the institution is willing to accept for a new receivable with comparable risk.

Nonaccrual Loans That Have Demonstrated Sustained Contractual Performance

Certain borrowers have resumed paying the full amount of scheduled contractual interest and principal payments on loans that are past due and in nonaccrual status. Although prior arrearages may not have been eliminated by payments from the borrowers, some borrowers have demonstrated sustained performance over a period of time in accordance with the contractual terms. Under existing regulatory standards, institutions cannot return these loans to accrual status unless they expect to collect all contractual principal and interest and the loans are brought fully current (or unless the loan becomes well secured and in the process of collection).

Such loans may henceforth be returned to accrual status, even though the loans have not been brought fully current, provided two criteria are met: (1) all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period, and (2) there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms involving payments of cash or cash equivalents. Consistent with existing guidance, when the regulatory reporting criteria for restoration to accrual status are met, previous charge-offs taken would not have to be fully recovered before such loans are returned to accrual status.

Loans that meet the above criteria would continue to be disclosed as past due (e.g., 90 days past due and still accruing for Call Report and TFR purposes), as appropriate, until they have been brought fully current.

Additional Guidance

The Financial Accounting Standards Board (FASB) recently issued Statement No. 114, "Accounting by Creditors for Impairment of a Loan," which establishes a new approach for recognizing impairment on problem loans and for recognizing income on such loans. In addition, the standard establishes new disclosure requirements for impaired loans for financial reporting purposes. In light of the significance of those changes, the agencies are reevaluating regulatory disclosure and nonaccrual requirements that will apply when the statement becomes effective, and expect to issue revised policies at a later date.