

**CHAPTER 13-03-28**  
**LOAN WORKOUTS, LOAN MODIFICATIONS, AND NONACCRUAL POLICY**

Section

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**13-03-28-01. Definitions.**

1. "Cash basis" method of income recognition is set forth in generally accepted accounting principles and means 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, after charge-off of identified losses, if any, is deemed to be fully collectible.
2. "Charge-off" means a direct reduction (credit) to the carrying amount of a loan carried at amortized cost resulting from uncollectability with a corresponding reduction (debit) of the allowance for loan and lease loss account. Recoveries of loans previously charged off should be recorded when received.
3. "Cost recovery" method of income recognition means equal amounts of revenue and expense are recognized as collections are made until all costs have been recovered, postponing any recognition of profit until that time.
4. "Credit grading system" means a formal process that identifies and assigns a relative credit score to each commercial loan as set forth under chapter 13-03-06.
5. "Deferral" means deferring a contractually due payment on a closed-end loan without affecting the other terms, including maturity, of the loan. The account is shown current upon granting the deferral.
6. "Extension" means extending monthly payments on a closed-end loan and rolling back the maturity by the number of months extended. The account is shown current upon granting the extension. If extension fees are assessed, they should be collected at the time of the extension and not added to the balance of the loan.
7. "In the process of collection" means collection of the loan is proceeding in due course either:
  - a. Through legal action, including judgment enforcement procedures; or
  - b. In appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future, generally within the next ninety days.
8. "Loan classifications" means all loans meeting the definition of substandard, doubtful, or loss in accordance with accepted industry and regulatory guidance and as assigned during examinations.
9. "New loan" means the terms of the revised loan are at least as favorable to the credit union, having terms are market-based, and profit driven, as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the credit union, and the revisions to the original debt are more than minor.
10. "Past due" means a loan is determined to be delinquent in relation to its contractual repayment terms including formal restructures, and must consider the time value of money.

Credit unions may use the following method to recognize partial payments on "consumer credit," which includes credit extended to individuals for household, family, and other personal expenditures, including credit cards, and loans to individuals secured by their personal residence, including home equity and home improvement loans. A payment equivalent to ninety percent or more of the contractual payment may be considered a full payment in computing past due status.

11. "Re-age" means returning a past due account to current status without collecting the total amount of principal, interest, and fees that are contractually due.
12. "Recorded investment in a loan" means the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.
13. "Renewal" means underwriting a matured, closed-end loan generally at its outstanding principal amount and on similar terms.
14. "Rewrite" means significantly changing the terms of an existing loan, including payment amounts, interest rates, amortization schedules, or its final maturity.
15. "Total reserves" means, for the purpose of this section, net worth as defined in chapter 13-03-06 plus the allowance for loan and lease loss account.
16. "Troubled debt restructure" loans are as defined in generally accepted accounting principles.
17. "Well secured" means the loan is collateralized by:
  - a. A perfected security interest in, or pledges of, real or personal property, including securities with an estimable value, less cost to sell, sufficient to recover the recorded investment in the loan, as well as a reasonable return on that amount; or
  - b. By the guarantee of a financially responsible party who has demonstrated support of the credit by making loan payments or injecting cash or otherwise improving the financial position of the business to allow it to make loan payments.
18. "Workout loans" include types of workout loans to borrowers in financial difficulties include re-agings, extensions, deferrals, renewals, or rewrites. Borrower retention programs, new loans unless used to restructure or pay existing loans, skip-a-pay programs or like loans are not encompassed within this definition.

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**General Authority:** NDCC 6-01-04

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### **13-03-28-02. Loan workout policy and monitoring requirements.**

1. The board and management shall 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 consistently applied. These policies must:
  - a. Be commensurate with the size and complexity of the credit union;
  - b. Define eligibility requirements, under what conditions the credit union will consider a loan workout, including establishing limits on the number of times an individual loan may be modified;
  - c. Ensure credit union makes loan workout decisions based on the borrower's renewed willingness and ability to repay the loan;

- d. Establish sound controls to ensure loan workout actions are appropriately structured;
  - e. Prohibit additional advances to finance unpaid interest or credit union fees. This is also known as capitalizing interest, and must be prohibited by policy. Advances to cover third party fees such as appraisals or property taxes are permissible;
  - f. Require documentation that demonstrates the borrower is willing and able to repay the loan; and
  - g. Require workout loans to be accurately classified; for commercial loans be risk rated with the credit union's credit grading system; be consistent with accepted industry and regulatory guidance, including federal financial institutions examination council's uniform retail classification and account management policy; and accurately identify loans for impairment testing consistent with generally accepted accounting principles.
2. Loan policy must require documented workout arrangements that consider and balance the best interests of both the borrower and the credit union.
  3. Management and the board of directors shall implement comprehensive and effective risk management and internal controls. This must include:
    - a. Thresholds based on aggregate volume of loan workout activity which trigger enhanced reporting to the board of directors;
    - b. Monitoring of total loan classifications in relation to the credit union's total reserves;
    - c. A written charge-off policy that it is consistently applied and consistent with industry standards; and
    - d. A process capable of identifying, documenting, and aggregating any loan that is re-aged, extended, deferred, renewed, or rewritten, including the frequency and extent such action has been taken, and aggregate these loans by loan type.

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**13-03-28-03. Past due status workout loans including troubled debt restructure past due status.**

1. The past due status of all loans must be calculated consistent with loan contract terms, including amendments made to loan terms through a formal restructure. Credit unions shall report delinquency on the call report consistent with this policy.
2. Troubled debt restructure status must be determined and reported without the application of materiality threshold exclusions.

**History:** Effective January 1, 2019.

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**13-03-28-04. Loan nonaccrual policy and procedures.**

1. Policy or procedure must prohibit the accrual of interest or fees on any loan upon which principal or interest has been in default for a period of ninety days or more.
2. Policy or procedure must require loans to be placed in nonaccrual status if maintained on a cash or cost recovery basis under generally accepted accounting principles because of

deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected.

3. Policy or procedure must allow nonaccrual noncommercial loan to be restored to accrual status when:
  - a. Its past due status is less than ninety days, generally accepted accounting principles 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;
  - b. When it otherwise becomes both well secured and in the process of collection; or
  - c. The asset is a purchased impaired loan and it meets the criteria under generally accepted accounting principles for accrual of income under the interest method specified therein.
4. Policy or procedure must allow nonaccrual commercial loans to be restored to accrual status provided the following conditions are satisfied:
  - a. The restructuring and any chargeoff taken on the loan are supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms.
  - b. Repayment performance is demonstrated and would involve timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents. In returning the member business workout loan to accrual status, sustained historical repayment performance for a reasonable time prior to the restructuring may be taken into account. Such a restructuring must improve the collectability of the loan in accordance with a reasonable repayment schedule and does not relieve the credit union from the responsibility to promptly charge off all identified losses.
5. After a formal restructure of a member business loan, if the restructured loan has been returned to accrual status, the loan otherwise remains subject to the nonaccrual standards of this rule. If any interest payments received while the member business loan was in nonaccrual status were applied to reduce the recorded investment in the loan the application of these payments to the loan's recorded investment must not be reversed and interest income must not be credited. Likewise, accrued but uncollected interest reversed or charged off at the point the member business workout loan was placed on nonaccrual status cannot be restored to accrual; it can only be recognized as income if collected in cash or cash equivalents from the member.

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