BANKING ISSUANCES

Comptroller of the Currency
Administrator of National Banks

Type: Banking Bulletin | Subject: Loan Refinancing

TO: Chief Executive Officers of All National Banks and Federal Branches and Agencies, Deputy Comptrollers (Districts), District Administrators, District Counsels, Regional Bank Directors, Department and Division Heads, and All Examining Personnel

Purpose

The purpose of this banking bulletin is to clarify the OCC's policy on refinancing and renegotiating loans where market interest rates have declined, including loans secured by real estate collateral that has declined in value.

Background

Declining interest rates make refinancing appealing to many borrowers whose present contractual interest rate is higher than market interest rates. Strong borrowers in normal market conditions generally have the opportunity to refinance their debts either with their existing bank or elsewhere in the market.

In some parts of the country, the value of the collateral pledged on many loans, particularly real estate loans, may have declined. The OCC has heard that some banks are reluctant to refinance or renegotiate loans where collateral value has declined. Some contacts even indicated a belief that the agency has a policy that would prohibit or discourage a national bank from working with such borrowers, even if the borrower's ability to repay the loan is demonstrated. In other cases, restructuring the loan actually would improve the prospects for repayment and the continued viability of the borrower.

Policy

The decision to refinance or renegotiate loans is a business decision that rests with the lending bank. The OCC has long encouraged banks to work constructively with borrowers. The OCC will not criticize a bank solely for refinancing or renegotiating a loan at current market rates, even when the collateral has declined in value. Refinanced and renegotiated loans will be evaluated based on the borrower's creditworthiness and repayment capacity. A refinancing by itself is not a reason for criticism of the credit.

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Refinancings and renegotiated loans are a normal part of the business of banking. Refinancings or renegotiated loans may benefit both parties by improving borrowers' ability to repay their loans. Borrowers get the opportunity to lower their interest rates, adjust amortization schedules, change collateral, or gain additional funds. Although bankers may give up some income, terms can be adjusted to improve prospects for repayment, improve collateral position, and/or obtain guarantees. Additionally, the bank is able to maintain business relationships that can generate additional income in the future.

There are many decisions and considerations a bank must make when refinancing or renegotiating, including:

- The bank should determine whether or not an appraisal is needed when refinancing a real estate loan. Refinancing does not automatically trigger the need for a new appraisal. Refinancing a loan simply to provide the borrower a lower interest rate may not constitute a real estate related financial transaction requiring an appraisal. Management should review the real estate appraisal regulation and OCC policies that have been issued in this area for guidance.

- The bank also must determine if the refinancing would be classified as a troubled debt restructuring (TDR). Guidelines for determining if the transaction should be accounted for as a TDR are outlined in Banking Circular 195, "Accounting for Restructured Loans and Sales of Foreclosed Properties." As discussed in the issuance, lowering an interest rate does not always trigger a TDR classification.

Summary

OCC policy is to encourage banks to work with their borrowers. It will often be in the bank's, and the borrower's, long-term interest to refinance or renegotiate a loan where market interest rates have fallen. Every lending situation is unique. Bank management should consult previous OCC policy issuances to determine ways to constructively and prudently work with borrowers.

Responsible Office

Questions concerning this issuance or any of the policies discussed in it may be addressed to the local supervisory office or the Office of the Chief National Bank Examiner in Washington at (202) 874-5170

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