In the attached notice and request for comment, the Federal Financial Institutions Examination Council (FFIEC) requests comment on its planned revisions to the Uniform Retail Credit Classification Policy. This policy statement was originally issued in 1980 and is still in effect.

The FFIEC requests comment on a series of questions concerning retail credit, including a classification policy for open-end and closed-end credit, residential and home equity loans, loans affected by bankruptcy, fraudulent activity and/or death of a borrower, re-aging of accounts, and partial payments.

The notice and request for comments highlights several areas where no definitive interagency policy currently exists. This raises a question as to what standards thrifts should use to classify their retail credits. Until a revised policy is issued, thrifts should use their own prudent classification policies, following OTS' classification guidelines and definitions in Thrift Activities Handbook Section 260.

Thrifts also should use the following guidance:

**Loans Where a Loss is Likely:** Institutions should classify such loans in conformance with OTS policy and record the loss in accordance with generally accepted accounting principles. For example, with respect to loans where the borrower is deceased or files for bankruptcy protection, thrifts should determine the likelihood of repayment, based on the facts of the case and the institution's historical experience with collecting similar loans, and classify the loans accordingly.

**Re-aging of Delinquent Loans:** While OTS expects institutions to follow their own prudent policies, generally, past due loans should only be re-aged when the borrower has demonstrated a renewed willingness and ability to repay the loan.

**Partial Payments:** OTS for several years has allowed institutions to count any amounts remitted toward past due payments in the calculation of a loan's total delinquency, even if the payment was less than 90 percent. Until the revised interagency policy is issued, thrift institutions may continue to give borrowers pro-rata credit for partial payments that are less than 90 percent, consistent with the example used in the request for comment.

The notice and request for comment was published in the September 12, 1997, edition of the Federal Register, Vol. 62, No. 177, pp. 48089-48092. Comments should be sent to Joe M. Cleaver, Executive Secretary, FFIEC, 2100 Pennsylvania Avenue N.W., Suite 200, Washington D.C. 20037. Comments are requested by November 12, 1997.

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FEDERAL FINANCIAL INSTITUTIONS
EXAMINATION COUNCIL

Uniform Retail Credit Classification
Policy

AGENCY: Federal Financial Institutions
Examination Council.

ACTION: Notice and request for comment.

SUMMARY: The Board of Governors of the
Federal Reserve System (FRB), the
Federal Deposit Insurance Corporation
(FDIC), the Office of the Comptroller of
the Currency (OCC), and the Office of
Thrift Supervision (OTS) (collectively
referred to as the agencies), under the
auspices of the Federal Financial
Institutions Examination Council
(FFIEC), are requesting comment on
changes to the 1980 Uniform Policy for
Classification of Consumer Installment
Credit Based on Delinquency Status
(1980 policy). The 1980 policy is used
by the agencies for classifying retail
credit loans of financial institutions on
a uniform basis.

The FFIEC is currently reviewing the
1980 policy to determine where
revisions may be necessary to more
accurately reflect the changing nature of
risk in today's retail credit environment.
The preliminary results of this review
indicate that revisions should include: a
charge-off policy for open-end and
closed-end credit; a classification policy
for loans affected by bankruptcy,
fraudulent activity, and/or death of a
borrower; a prudent re-aging policy for
past due accounts; and a classification
policy for delinquent residential
mortgage and home equity loans.

Before developing a revised policy
statement for public comment, the
FFIEC is first soliciting comments on:
areas in the existing policy statement
that may need to be revised; specific
recommendations for changing the
policy statement; data that would help
quantify the financial or business
impact on financial institutions if the
existing policy was revised; and an
estimate of the time frames necessary for
an institution to successfully implement the revisions. After reviewing the input received, the FFIEC will issue a revised policy statement for public comment that establishes clear guidance for the industry; based on an informed and reasonable analysis of all available data; and satisfies the principles of sound and effective supervision.

DATES: Comments must be received by November 12, 1997.

ADDRESSES: Comments should be sent to Joe M. Cleaver, Executive Secretary, Federal Financial Institutions Examination Council, 2100 Pennsylvania Avenue NW, Suite 200, Washington, DC 20037 or by facsimile transmission to (202) 634-6555.

FOR FURTHER INFORMATION CONTACT:


OCC: Cathy Young, National Bank Examiner, Credit Risk Division, (202) 874-4474; Ron Shimabukuro, Senior Attorney, Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency (202) 874-5090, 250 E Street SW, Washington, DC 20219.

OTS: William J. Magrini, Senior Project Manager, (202) 606-5744, Supervision Policy; Vern McKinley, Attorney, (202) 606-6241, Regulations and Legislation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street NW, Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

Background Information

On June 30, 1980, the FRB, FDIC, and OCC adopted the FFIEC uniform policy for classification of open-end and closed-end credit. The OTS adopted the policy in 1987. The policy was issued to establish uniform guidelines for the classification of installment credit based on delinquency status. While the 1980 policy recognized the statistical validity of measuring losses predicated on past due status, the 1980 policy also permitted exceptions to the classification policy in situations where significant amounts were involved or when a loan was well secured and in the process of collection.

A fundamental objective of the 1980 policy is the timely recognition of losses as required by generally accepted accounting principles (GAAP). While the 1980 policy provides general guidance for a large segment of the retail credit portfolio, it does not provide supervisory guidance on loan charge-offs related to consumer bankruptcy, fraudulent activities, and accounts of decedents. Furthermore, no guidance is provided on the classification of delinquent residential mortgages and home equity loans. In light of the questionable asset quality of many of these accounts and the inconsistent way in which financial institutions report and charge-off these accounts, the FFIEC believes that additional supervisory guidance is necessary.

Request for Comments in the Following Areas

(1) Charge-off Policy for Open-End and Closed-End Credit

The agencies recognize the inconsistency between the level of risk associated with open-end and closed-end credit and the policy for charging-off delinquent accounts. Under the 1980 policy, open-end credit, which is generally unsecured, should be charged-off when an account is 180 days delinquent. Conversely, closed-end credit, which is normally secured by some type of collateral, is subject to a more stringent policy of 120 days delinquent before a loan is charged off. Over the years this inconsistency has become more apparent as the market for open-end credit evolved.

In 1980, open-end credit generally consisted of credit card accounts with small credit limits that limited the exposure an institution had to an individual borrower. In today's environment, open-end credit generally includes accounts with much larger lines of credit and higher risk levels. The change in the nature of these accounts, combined with the variety of charge-off practices examiners recently encountered, raised the concern of the agencies. To address this concern, the FFIEC is seeking public comment on whether a charge-off policy that is more consistent with the risk associated with open-end and closed-end accounts should be adopted and if so, what that policy should be. Specifically, the FFIEC requests comment on:

(1a) Should a uniform time frame be used to charge-off both open-end and closed-end accounts?

(1b) If so, what should that time frame be?

(1c) If a uniform time frame for both types of credit is not considered appropriate, what time frames are reasonable for charging off open-end credit and closed-end credit? Please explain.

(1d) If there was a change in the time frames for charging-off delinquent accounts, what is a reasonable time frame to allow institutions to comply with such a change?

(1e) Should the current regulatory practice be continued of classifying open-end and closed-end credit Substandard when the account is 90 days or more delinquent? If not, what alternative would you suggest? Please explain the benefits of a suggested alternative.

(1f) Should a standard for the Doubtful classification be adopted and, if so, what should the standard and why?

(1g) Currently, no requirement exists to place retail credit loans on nonaccrual status. Should guidance for placing loans on a nonaccrual status be adopted and, if so, at how many days delinquent should open-end credit and closed-end credit be placed on a nonaccrual status?

(1h) An alternative to a requirement that accounts be charged-off after a designated delinquency is the creation of an allocated or specific reserve. Should the FFIEC require an allocated or specific reserve, and if so, when should it be established? Please discuss the advantages and disadvantages of such a proposal.

(2) Bankruptcy, Fraud, and Deceased Accounts

No FFIEC guidance exists for bankruptcy, fraud, and deceased accounts. The FFIEC believes guidance on these accounts is needed to ensure recognition of loss among regulated institutions is timely and consistent. Comment is requested on the need to provide such guidance and on the following more specific issues.

(2a) Should there be separate guidance for determining when an account should be charged-off for Chapter 7 bankruptcies and Chapter 13 bankruptcies? If so, what should that guidance be?

(2b) What event in the bankruptcy process should trigger loss recognition: the filing date, the date of notification to the creditor by the bankruptcy court that a borrower has filed for bankruptcy, the date that the bankruptcy trustee
meets with the creditors, or some other date? Please explain why one date is better than another.

(2)(c) How much time is needed by an institution to process the charge-off after any one of the bankruptcy events identified in question 2(e)?

(2)(d) As an alternative to an immediate charge off, would it be beneficial to set up a specific reserve account at the time of the filing and charge the loss to that reserve account at the bankruptcy discharge date? Please explain the pros and cons of this alternative.

(2)(e) Subsequent to notification, how much time is needed by an institution to charge-off losses due to loan fraud?

(2)(f) Subsequent to notification, how much time is needed by an institution to charge-off losses on loans to deceased borrowers?

(3) Partial Payments

The 1980 policy includes a provision that 90 percent of a contractual payment will be considered a full payment. However, if less than 90 percent is received, no recognition of any partial payment is given. The FFIEC is considering eliminating this policy provision and giving credit for any partial payments received. If such a change is adopted, a loan will be considered one month delinquent when the sum of the missed portions of the payments equals one full payment. A series of partial payments could result in accumulating delinquencies. For example, if a regular installment payment is $300 and the borrower makes payments of only $150 per month for a six-month period, the loan would be $900, or three full months delinquent.

(3)(a) Should borrowers receive credit for partial payments in determining delinquency using the method described? If so, would such a change require significant computer programming changes? Are there other reasonable alternatives?

(3)(b) If partial payments are allowed, how should the payment be applied?

(3)(b)(1) Pro rata, equally to principle and interest.

(3)(b)(2) First to principle, any remaining to interest.

(3)(b)(3) Other.

No guidance currently exists on fixed payment programs. Fixed payment accounts are accounts for which a payment plan (less than contractual) has been established as a result of credit counseling, bankruptcy proceedings, or direct negotiations.

(3)(c) Should the FFIEC adopt policy guidance on fixed payment programs? What standards should be used?

(4) Re-Aging, Extension, Renewal, or Deferral Policy

Re-aging is the practice of bringing a delinquent account current after the borrower has demonstrated renewed willingness and ability to repay the loan by making some, but not all, past due payments. A permissive re-aging policy on credit card accounts or an extension, renewal, or deferral policy on other types of retail credit can distort the true performance and delinquency status of individual accounts and the entire portfolio. Re-aging, extension, renewal, or deferral of delinquent loans is an acceptable practice when it is based on recent, satisfactory performance and other positive credit factors of the borrower and when it is structured in accordance with prudent internal policies. Institutions that re-age, extend, renew, or defer accounts should establish a reasonable policy and ensure that it is followed by adopting appropriate operating standards. While no FFIEC guidance currently addresses this issue, it is an area where uniform guidance is appropriate to protect against distortions in the performance of the consumer loan portfolio. The following standards are under consideration:

(4)(a) The borrower shows a renewed willingness and ability to repay the loan. Is this standard appropriate?

(4)(b) The borrower makes a certain number of contractual payments or the equivalent amount. How many payments are appropriate?

(4)(c) The loan can only be re-aged, extended, renewed, or deferred once within a specified time. What time frame is appropriate? Should there be a limit on the number of re-agings over the life of an account? If so, what should that limit be?

(4)(d) The account must be in existence for a certain period of time before it can be re-aged, extended, renewed, or deferred. What time period is appropriate?

(4)(e) The loan balance should not exceed the predelinquency credit limits (last limit approved by bank). Is this standard appropriate?

(4)(f) Other. What other standards should be considered?

(5) Residential and Home Equity Loans

No FFIEC uniform classification policy exists for residential and home equity loans. Since most of these loans are underwritten using uniform credit criteria, the FFIEC supports reviewing and classifying these portfolios on an aggregate basis. The FFIEC is considering the substandard classification based on delinquency status.

As the delinquency progresses, payment becomes dependent on the sale of the real estate collateral. For collateral dependent loans, GAAP requires that any loan amount in excess of the collateral’s fair value less cost to sell should be charged off, or that a valuation allowance be established for that excess amount. The FFIEC is considering requiring that an evaluation of the residential collateral be made within a prescribed delinquency time frame to determine fair value.

(5)(a) Should residential and home equity loans be classified substandard at a certain delinquency (similar to the time period used in open-end and closed-end credit)? If so, what should that delinquency be?

(5)(b) Should the FFIEC require a collateral evaluation at a certain delinquency? If so, what should that delinquency time frame be?

(6) Need for Additional Retail Credit Guidance

The FFIEC notes that classification policies are just one component of prudent loan portfolio management. Classification policies, by themselves, do not address potential problems or weaknesses that may exist in the origination and underwriting of such loans.

(6)(a) What type of additional supervisory guidance is needed or would be beneficial to address this or other aspects of retail credit portfolio management?

(6)(b) Should there be additional supervisory guidance on the loan loss reserve for retail credit?

(7) Industry Experience and Impact

The FFIEC welcomes comments on any other issues that it should consider in updating this policy. Additionally, the FFIEC would benefit from receiving financial institutions’ data on their charge off and recovery experience rates for charged-off open-end credit, closed-end credit, loans in bankruptcy, fraudulent loans, or loans of deceased persons. The FFIEC is also interested in understanding the financial and business practice impact that these policy changes may have. Revisions to the 1980 policy may result in changes to the Call Report, which may require banks to make reporting system changes. If an institution’s recommendations vary from current business practice, please provide an estimate of the programming costs or other costs that would be incurred to change the practice and report accurately. Some institutions have securitized and sold their loans, but such loans are still under institution
management. Please comment on how the FFIEC should treat such loans.


Joe M. Cleaver,
Executive Secretary. Federal Financial Institutions Examination Council.

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