

Problem Loans



New England Directors College
2011

Session Objectives

- Discuss the following:
 - Nonaccrual loan characteristics
 - Troubled debt restructures
 - Maintenance of an appropriate Allowance for Loan and Lease Losses

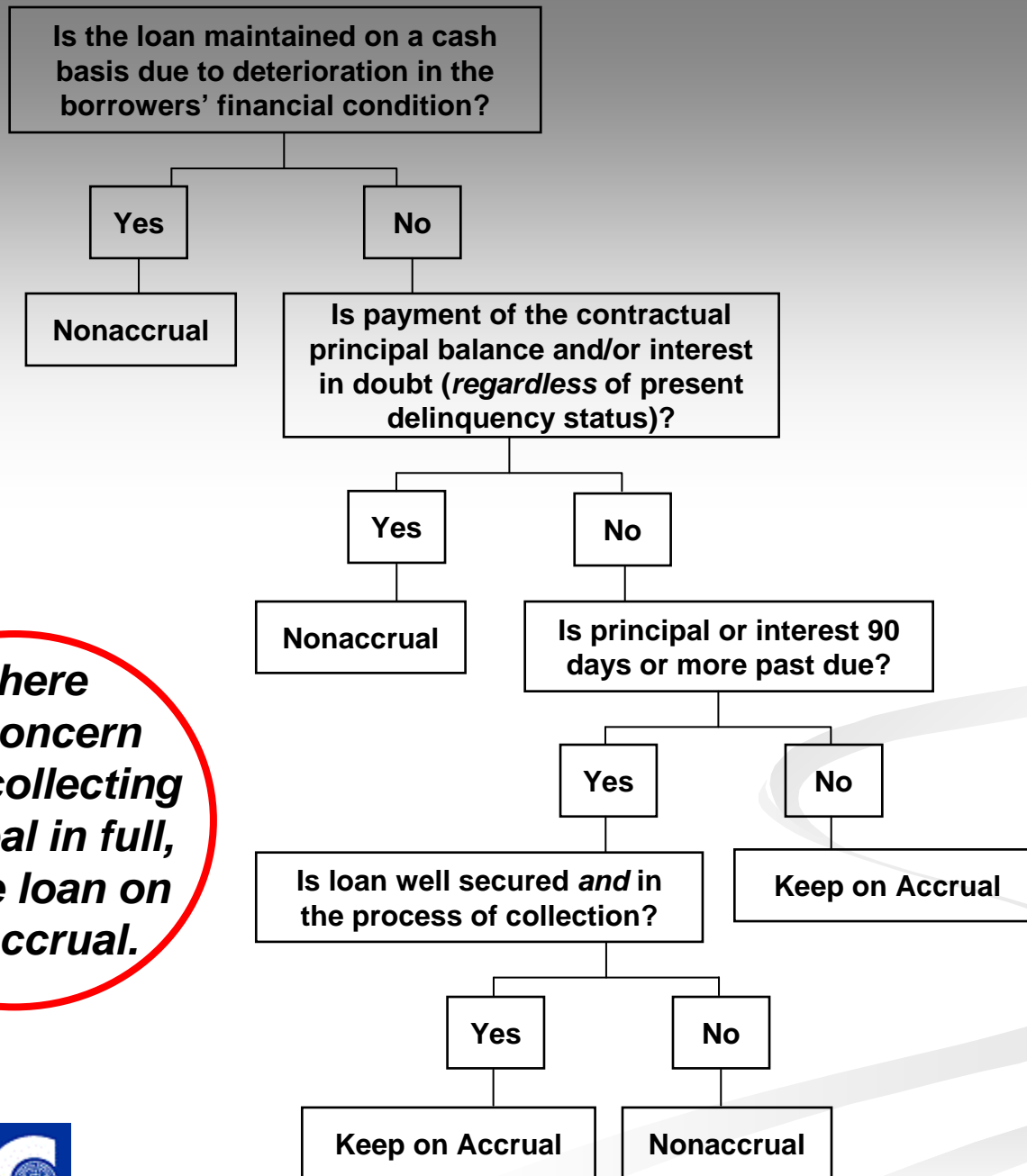


Nonaccrual Loans

- General Rule
 - Loan is on cash basis due to deterioration in borrower's financial condition;
 - Payment in full of principal or interest is not expected; or
 - In default for 90 days or more unless well secured and in process of collection
- Exceptions
 - Consumer & Residential Loans



Non-accrual Decision Tree



If there is a concern about collecting principal in full, put the loan on Nonaccrual.



Nonaccrual Loans

- How should payments on NA loans be handled?
 - Reverse previously accrued and uncollected interest payments
 - Cash payments should generally be applied to principal balance



Nonaccrual Loans

- When can payments be recognized in income?
 - On a cash basis when the recorded investment is deemed fully collectable
 - Must support collectability with well documented credit evaluation and prospects for repayment



Nonaccrual Loans

- When can a nonaccrual loan return to accrual status?
 - No principal or interest remains unpaid
 - AND
 - Remaining P+I payments are expected
- OR
- Loan becomes well secured and in the process of collection



Nonaccrual Loans

- Do restructured loans need to be reported as nonaccrual? No, if...
 - Loan has been formally restructured so as to reasonably assure repayment and performance; and
 - Restructuring and any charge-offs are supported by a current, well-documented credit evaluation



Nonaccrual Loans

- How are bifurcated notes handled?
 - The “A” note (representing the portion that is expected to be fully recovered) may be returned to accrual status if...
 - Meets the aforementioned criteria for returning loans to accrual status
 - Qualifies as a TDR
 - “B” note has been charged off; and
 - “A” note reasonably assured of repayment



Troubled Debt Restructures

- What is a troubled debt restructure?
 - Borrower is experiencing financial difficulties; and
 - Bank grants a concession
- What constitutes a concession?
 - Transfer of assets in partial satisfaction of debt; and/or
 - Modification of loan terms



Loan Modification vs. TDR

- A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not a TDR.
- TDR if:
 - Debtor experiencing financial difficulties; and
 - For economic or legal reasons, a creditor grants a concession to a debtor that it would not otherwise consider.



Income Producing Property – Office Building

<i>\$15 million</i>	Origination	Scenario 1	Scenario 2	Scenario 3
<i>DSC Ratio</i>	1.35x	1.12x	1.12x – 1.05x	1.12x
<i>LTV Ratio</i>	75%	“as stabilized” 104%	Mgt estimate 94%	“as stabilized” 94%
<i>Market Interest?</i>	Market	Market	Market	Below Market
<i>Terms</i>	20-year Am	17-year am	17-year am	1-year I/O
<i>FS, IS, AV</i>	Current	Current	Not Requested	Current
<i>Trends</i>		Stable, LT Leases	Declining DSC & Leases, No PD	ST Leases Some PD Pmt
<i>NA or TDR</i>				



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Troubled Debt Restructures

- Are charge-offs necessary?
 - A credit analysis should be performed to determine collectability and estimated credit loss.
 - If a portion is deemed uncollectible, then a charge-off should be promptly recorded.
 - Ongoing periodic evaluation is expected.



Troubled Debt Restructures

- How are TDR's reported?
 - Restructured loans, in compliance with their modified terms, must be reported on the Call Report unless yielding a market rate.
- How do the regulators view TDR's?
 - Not necessarily a bad thing
 - Shows the bank is willing to work with their customers



Regulatory Guidance

- **October 2009 Policy Statement on Prudent Commercial Real Estate Loan Workouts - FIL-61-2009**
- **Call Report Glossary: Trouble Debt Restructure and Nonaccrual**



Division of Risk Management Supervision

Nature & Purpose Of Allowance for Loan and Lease Losses

Definitions:

- Valuation reserve against total loans to cover estimated losses in the current loan portfolio
- FAS 114 Component (Individual Loan Impairment)
+ FAS 5 Component (Collective Loan Impairment)
= ALLL Level

*Note that management should also estimate credit losses for off-balance sheet credit exposures, although this should be carried as a liability and not part of the ALLL.



Board Responsibilities

- Maintain ALLL at sufficient level to absorb estimated loan losses
- Evaluate ALLL at least quarterly and make provisions, if necessary, to maintain adequacy
- Maintain effective loan review/credit grading systems
- Ensure prompt charge-off of loans deemed uncollectible
- Ensure ALLL analysis is comprehensive, adequately documented, and follows GAAP/regulatory guidance



ALL Policy Elements

- Frequency and timing of determination
- Items to be considered when evaluating appropriateness
- Description of factors or allocations with support for their use
- Specific responsibilities
- Internal Controls
- Independent review



Factors to Consider in Estimation of Credit Losses

- Changes in lending policies and procedures including:
 - Underwriting standards
 - Collection activities
 - Charge-off procedures
 - Recovery practices
- Changes in economic conditions, business conditions, and industry segments
- Changes in nature and volume of loan portfolio



Factors to Consider in Estimation of Credit Losses

- Changes in experience, ability, and depth of lending management
- Changes in volume and severity of past due, nonaccrual, and adversely-rated loans
- Changes in the quality of loan review systems
- Changes in the value of underlying collateral
- Existence and effect of any concentrations of credit
- Impact of other external factors, such as competition, legal, and regulatory requirements.



Environmental Factors

Consumer Loss Environmental Factor Change

EXAMPLE:

- The underwriting standards for Other Consumer Loans were liberalized at the end of 2004 in response to competition. As a result, past dues are increasing. Management estimates that incurred losses increased 25 basis points from historic levels.



Environmental Factor Example

	Consumer
Historical Loss Rates over XX Years	1.27%
Delinquency Trends	0.25%
Charge-off Recovery Experience	
Underwriting Trends	
Management Experience	
Economic Concentrations	
Industry Conditions	
Quantitative and Qualitative Loss Factors	1.52%



ALLL Checklist

- Are effective loan review/credit grading systems in place?
- Are loans deemed uncollectible promptly charged-off?
- Are policies and procedures in place that describe how loan portfolio is segmented?
- Does the ALLL evaluation include an analysis of impairment for individual loans under FAS 114?
- Does the ALLL evaluation include an analysis of impairment for pools of loans under FAS 5?
- Are FAS 5 loss rates reasonable, well supported, and incorporate historical loss experience and other factors?
- Is the ALLL analysis performed at least quarterly?
- Does the reported ALLL level differ significantly from most recent quarterly calculation?



Regulatory Guidance

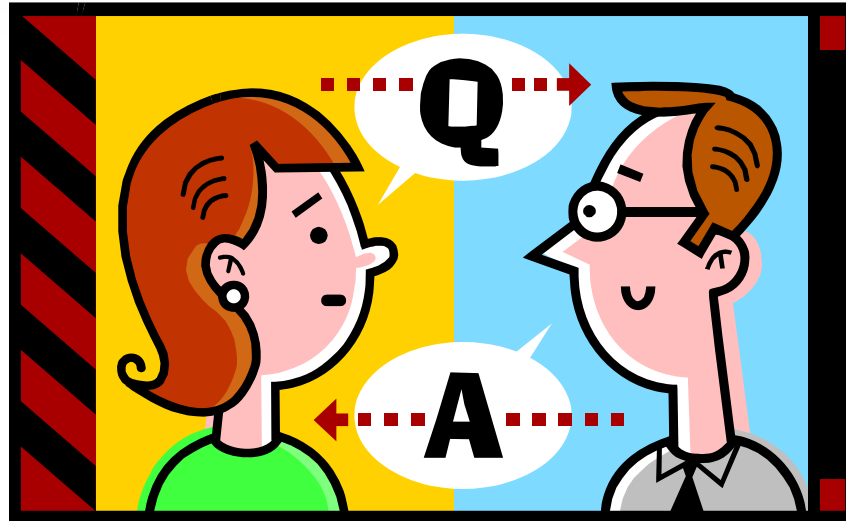
- July 2001 “Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Associations” – FIL 63-2001
- December 2006 “Allowance for Loan and Lease Losses Revised Policy Statement and Frequently Asked Questions” – FIL 105-2006

Website: <http://www.fdic.gov/news/news/financial/index.html>



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Questions ?



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**Thanks for
Attending!!!**



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