



[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 615, and 621

RIN 3052-AD09

Criteria to Reinstate Non-Accrual Loans

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) proposes amending existing regulations governing how the Farm Credit System (System) classifies high-risk loans to improve the loan classification and reinstatement process. The proposed rule would clarify the factors considered when categorizing high-risk loans and placing them in nonaccrual status. The rule would also revise both the reinstatement criteria and its application to certain loans in nonaccrual status to distinguish between the types of risk that led to a loan being placed in nonaccrual status.

DATES: You may send us comments on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the

Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Click inside the "I want to..." field near the top of the page; select "comment on a pending regulation" from the dropdown menu; and click "Go." This takes you to an electronic public comment form.

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of comments we receive at our office in McLean, Virginia, or on our Web site at <http://www.fca.gov>. Once you are on the Web site, click inside the "I want to..." field near the top of the page; select "find comments on a pending regulation" from the dropdown menu; and click "Go." This will take you to the

Comment Letters page where you can select the regulation for which you would like to read the public comments. We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Technical information: Ryan Leist, Senior Accountant, Office of Regulatory Policy, (703) 883-4223, TTY (703) 883-4056.

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of the proposed rule are to:

- Enhance the usefulness of high-risk loan categories;
- Replace the subjective measure of "reasonable doubt" used for reinstating loans to accrual status with a measurable standard;
- Improve the timely recognition of a change in a loan's status; and
- Update existing terminology and make other grammatical changes.

II. Background

In 1993, we issued subpart C of part 621, "Loan Performance and Valuation Assessment," in part to establish standard performance categories for high-risk loans and set the criteria for reinstating those loans to accrual status.¹ The existing loan performance categories are in § 621.6 and the criteria for reinstating loans to accrual status are in § 621.9. Neither rule section has been substantively updated since 1993.²

Existing § 621.6 sets forth three performance categories for high risk loans: 1) Nonaccrual loans, 2) Formally restructured loans, and 3) Loans 90-days past due still accruing interest. There are several conditions listed in paragraph (a) of § 621.6 for moving a loan to "nonaccrual" (noninterest-earning) status. Among them are: delinquency, questions regarding future ability to pay, loan servicing that resulted in a portion of the debt being charged off, and the value of security for the loan. Only one of these conditions needs to exist to categorize a loan as nonaccrual. If a loan satisfies the criteria for more

¹ 58 FR 48780, September 20, 1993.

² The existing regulatory performance category in 12 CFR 621.6(b) was amended in 2013 to cite the Financial Accounting Standards Board's (FASB) "Statement of Financial Accounting Standards No. 168," dated June 30, 2009. See 78 FR 21037, April 9, 2013. The reinstatement criteria of 12 CFR 621.9 has not been amended since 1993.

than one performance category, the rule requires using the nonaccrual category, resulting in the nonaccrual category being the primary performance category of high-risk loans.

Under § 621.9, a loan in nonaccrual status may only be reinstated to accrual (interest-earning) status if four criteria are satisfied:

- 1) The loan is now current on payments,
- 2) Certain prior charge offs have been recovered,
- 3) There remains "no reasonable doubt" as to a borrower's willingness to remain current on payments, and
- 4) The borrower has remained current on payments for a sustained period.

When developing these criteria in 1993, FCA explained the intent of the criteria was to verify resolution of the factor(s) causing the loan to be placed in nonaccrual status before its reinstatement to accrual status.³

The use of nonaccrual status to address high risk loans is common among financial institutions, with most commercial lenders applying the Federal Financial Institutions Examination Council (FFIEC)⁴ reporting

³ Refer to: Preamble, proposed rule, 58 FR 32071, 32074 (June 8, 1993).

⁴FFIEC was created in 1979 through title X of Public Law 95-630. FFIEC facilitates uniformity in those federal examinations of financial institutions conducted by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency,

standards. The FFIEC standards include the criterion of moving loans into nonaccrual status when there is a deterioration in the financial condition of the borrower, payment in full of principal or interest is not expected, or a loan is 90 days or more past due. Under FFIEC's standards, those loans that are 90 days past due and both well secured and in the process of collection do not have to be placed into nonaccrual status. Reinstating a loan to accrual status under the standards of FFIEC requires either: (1) the loan to be current and an expectation by the bank that repayment of the remaining principal and all accrued interest will occur, or (2) the loan is well secured and is in the process of collection.

FCA's present accounting classification rules are generally similar, although not identical, to FFIEC standards.⁵ Notably, a key difference from FFIEC standards is that our rule requires there be no reasonable doubt of the "willingness" of the borrower to repay before reinstatement to accrual status. Our rule makes no exception to this requirement for loans that are well

and the Consumer Financial Protection Bureau. FFIEC issues uniform principles, standards and reporting formats used by these regulators.

⁵ FCA is not a FFIEC regulatory agency and therefore not required to follow FFIEC standards. However, we consider the policy positions of other regulators to decide if we should follow them or take a different approach if appropriate to implement the requirements and expectations of the Farm Credit Act of 1971, as amended.

secured and receiving servicing (i.e., "in the process of collection"). Additionally, our rules allow placing, and retaining for an indefinite period, a current loan in nonaccrual status when questions exist on the future collection of the debt.

III. Input received

In the past few years FCA has received requests from System institutions, as well as member-borrowers of the System, to reconsider the role that future debt collection plays when categorizing a high-risk loan. For the System, the issue is generally directed at income recognition for payments made while a loan is in nonaccrual status. Nonaccrual loans that are current on payments technically accrue no interest for the lender even though the borrowers are making contractually scheduled payments. While those contractual loan payments are based on both principal and interest, the lender may, in accordance with generally accepted accounting principles (GAAP), elect not to recognize the interest portion as income if future payments are in doubt.⁶ Further, under FCA regulation § 621.8(a), when the future collectability of a nonaccrual loan is in doubt, payments are applied in a manner "necessary to

⁶ Using cash-basis accounting under GAAP, earnings from nonaccrual loans may be recognized if the loan balance is deemed to be fully collectable.

eliminate such doubt." As a result, the interest portion of the scheduled payments is applied to principal in most cases. Then, after reinstatement to accrual status, those prior payments may be recognized against both accrued interest and principal consistent with the terms of the loan. From member-borrowers, requests to reconsider the role that future debt collection plays in allowing a current loan to be in nonaccrual status are most often directed at the loss of certain cooperative benefits or, in some instances, the misapplication of distressed loan servicing rights. This proposed rulemaking addresses the requests of both the System and its member-borrowers.

In developing this proposed rule, consideration was also given to a comment letter submitted for the 2016 Basel III capital rulemaking,⁷ where the commenter remarked on our nonaccrual regulations. Specifically, the commenter asserted that our regulations for reinstatement of nonaccrual loans to accrual status were more restrictive and subjective than the reinstatement rules applicable to other regulated financial institutions. Additionally, the System has previously expressed that our unique categorization and reinstatement requirements often result

⁷ 81 FR 49720, July 28, 2016.

in placing current loans into nonaccrual status and retaining them in that status for significantly longer periods than would be the case at a commercial bank. We believe our proposed changes to §§ 621.6 and 621.9 appropriately respond to these comments.

IV. Section-by-Section Analysis

We are proposing revisions to §§ 621.6 and 621.9 to reduce, but not remove, the emphasis on future debt collection when categorizing a high-risk loan. Instead of future debt collection, we propose using more measurable standards and aligning high-risk loan categories with the criteria used to determine when a loan is suitable for reinstatement to accrual status. As proposed, the rule would also emphasize the role loan servicing plays in addressing high-risk loans. In addition, we propose moving definitions currently located in the body of §§ 621.6 and 621.9 to the existing definition section of part 621.

We discuss the specifics of our proposal below.

A. Definitions

We propose moving four existing terms, whose meanings are currently located in the body of regulatory provisions, to the "Definitions" section in § 621.2. In moving the terms, we also propose contextual and grammatical changes to each of the four terms to improve clarity.

First, we propose moving the term "adequately secured" from its current location in § 621.6(a)(3)(i). We propose keeping the existing meaning and adding clarifying language to explain that the term describes collateral where there is a perfected security interest. We make the clarification because we want institutions to consider whether a lien on collateral is valid and enforceable when making "adequately secured" decisions. Should a particular security interest not be properly perfected, we expect institutions to look to other collateral when deciding if the loan is "adequately secured." We further propose replacing the existing phrase "discharge the debt in full," used when defining "adequately secured," with language clarifying it means repayment of the loan's outstanding principal and any accrued interest.

Second, we propose moving the term "in the process of collection" from its current location in § 621.6(a)(3)(ii). In doing so, we propose removing language on documented future collection of past due amounts. Instead, we propose language to clarify that the term "in the process of collection" includes both debt collection and loan servicing efforts expected to result in either the recovery of the loan balance (including accrued interest and penalties) or reinstatement of the loan to current status

in the near future. We believe the definition, as proposed, aligns with FASB Accounting Standards Codification (ASU) Subtopic 310-10-35 on Credit Impairment.⁸ While the current incurred loss methodology under GAAP is based on a probable and incurred notion, the measurement of credit losses is changing under FASB's new accounting standard "ASU No. 2016-13, Topic 326, Financial Instruments - Credit Losses." This new accounting standard introduces the current expected credit losses methodology for estimating allowances for credit losses. Although FASB's new accounting standard does not address when a financial asset should be placed in nonaccrual status, we believe updating the meaning of the term "in the process of collection" to reflect current FASB accounting standards is appropriate.

Third, we propose moving the § 621.6(c)(2) meaning of "past due." As part of this relocation, we also propose replacing language regarding default after loan servicing with the phrase "remains due." We believe the intent behind the existing servicing language is captured with the proposed use of "remains due."

Lastly, we propose moving the § 621.9(d) meaning of "sustained performance" and clarifying that "sustained

⁸ FASB is an independent, private-sector, not-for-profit organization that establishes GAAP-based financial accounting and reporting standards for public and private companies.

performance" on a loan is based on contractual payment terms. That is, we propose clarifying sustained performance means not only making the payments listed in the loan contract on or before the due date but making payments in the amount listed in the loan note. For example, if the loan contract calls for unequal annual payments or an initial interest-only payment followed by equally amortized annual payments, those listed payments covered by the sustained performance period (e.g., the most recent 2 consecutive annual payments) are what demonstrate sustained performance, regardless of whether the scheduled payments are interest-only, partial payments, regularly amortized installments, or a mixture of payment amounts. This proposed clarification follows our past explanations to System institutions that all payments listed in the contract, regardless of amount, scheduled to be made during the sustained performance period must be considered when determining "sustained performance." We make no changes to the existing specified number of payments required to demonstrate performance.

As a conforming technical change, we propose removing the paragraph designations for all the terms in the "Definitions" section. No change to any term not discussed above is proposed beyond this format change. We also

propose removing the parenthetical designations in the references to § 621.2 currently located in §§ 611.1205 and 615.5131.

B. Categorizing High-risk Loans

We are proposing clarifying changes to the § 621.6 categories for high-risk loans, including removing redundancies. Further, we propose changes to § 621.6(a), (b), and (c) to align them with proposed changes to § 621.9 discussed later in this preamble. Also, we propose a format change to the high-risk loan category of "other property owned" located in § 621.6(d) by removing the word "means" and adding punctuation to distinguish the heading from its contents. To ensure clarity, we also propose adding the word "legal" to § 621.6(d) when describing the various methods of acquiring property.

1. General

We propose renaming § 621.6 as "Categorizing high-risk loans and other property owned" to add clarity. We also propose removing the last sentence of this section's introductory paragraph. This sentence requires loans meeting more than one performance category to be, in all cases, categorized as "nonaccrual." We believe institutions should determine the most appropriate performance category

for a high-risk loan, understanding that no more than one category may be used at any given time. We also believe the other proposed changes to §§ 621.6 and 621.9 will facilitate this decision-making process. However, we caution institutions that restructuring a past due nonaccrual loan will typically not qualify the loan to immediately be reported under another performance category. Past due nonaccrual loans that are restructured should remain in nonaccrual until the reinstatement requirements of § 621.9 are met.

2. Identifying Nonaccrual Loans

We propose updating language in § 621.6(a) to clarify that a loan is properly categorized as a “nonaccrual loan” when there is a known risk to the continued collection of principal or interest. The updated language would also require a loan categorized as “nonaccrual” to remain in that category, regardless of payment status, until the loan is eligible for reinstatement. For those loans current on payments while in nonaccrual status, we propose adding language to remind institutions of the notice and review

provisions of part 617 of this chapter⁹ as a means of facilitating compliance with both part 621 and part 617.

Additionally, we are proposing changes to the conditions listed in § 621.6(a), which are used in determining if the "nonaccrual" performance category is appropriate. We believe the proposed changes to these conditions provide more objective measures and will facilitate improved consistency in using the nonaccrual performance category. We also propose clarifying that one or more of the conditions must exist before a loan is placed in nonaccrual status. We discuss the proposed changes to each of the conditions below.

a. Deterioration of Financial Condition

We propose clarifying that the requirements of § 621.6(a)(1) are not dependent upon whether a loan is past due. Instead, the focus is on the lender determining if collection of the loan is unlikely--over the full term of the loan contract--based on a deterioration of the borrower's financial condition. Institutions should be proactive in identifying problem loans while the loans are still current. Because this provision would allow a current

⁹ See 12 CFR 617.7400(d), which provides certain notice and review rights if a borrower's loan is current, in nonaccrual status, and the nonaccrual status may result in an adverse action. See also, 12 USC 2202d(d).

loan to be put in nonaccrual status, we expect the lender to have strong documented evidence supporting the forecast that collection of the loan is unlikely from all potential sources (e.g., farm and off-farm income, other revenue, or liquidation of collateral). For example, insufficient cashflow or earnings could merit nonaccrual consideration. Similarly, if the servicing plan includes partial liquidation of collateral to bring the account current but results in insufficient collateral to secure the remaining debt and the borrower lacks other assets to pledge, then nonaccrual status may be warranted.

When evaluating the collectability of a loan, we believe there are many risks affecting current or future payments on the loan, including, but not limited to, the following:

- A third-party lender initiating foreclosure action against the primary collateral securing the borrower's loan with the institution;
- A primary obligor filing a voluntary petition in bankruptcy, or an involuntary petition in bankruptcy has been filed against a primary obligor;
- Substantial collateral has been abandoned or is in danger of disappearing or losing its value.

- Loss of off-farm income serving as a primary income source for loan payments;
- A lawsuit against a primary obligor adversely affecting repayment of the borrower's loan with the institution;
- Illness or injury to a primary operator of the farm significantly hindering the continued long-term operation of the farm business; and
- The cessation of farming operations where the primary obligors have not made other arrangements to repay the loan.

We also expect the institution to consider the likelihood of current or future loan servicing actions improving collection of the loan.

b. Interest Charge offs

We propose amending the language of § 621.6(a)(2) to clarify that the existing phrase "taken as part of a formal restructuring" includes both distressed loan servicing as discussed in part 617 and troubled debt restructurings (TDR).¹⁰ The use of the term "charge off" in §§ 621.6 and

¹⁰ Under GAAP, a TDR is a restructuring in which the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that the lender would not otherwise consider. Distressed loan servicing is a type of servicing specific to the System that has formal, legal pre-requisites

621.9 refers to earned but uncollected interest income that was accrued and determined to be uncollectible. Proper accounting requires this interest to be backed out or reversed from the lender's income and the appropriate balance sheet accounts.¹¹ As part of a formal restructuring, the lender factors in recoupment of charged off amounts as well as reducing the risk associated with the loan. Thus, there is no need for a charge off already addressed by formal loan servicing to be a 'stand alone' factor in classifying the loan. However, the provision's applicability would continue to apply to loans with any portion charged off through means other than formal loan servicing as discussed in part 617 or a TDR.

c. Past Due More Than 90 Days

To simplify the categorization process for past due loans, we propose revising the existing three conditions that a loan be 90 days past due, under secured, and not in the process of collection. We instead propose that this provision capture those loans 90 days past due, but which cannot be categorized under § 621.6(c), "Loans 90 days past

and compliance requirements. The servicing available to a "distressed loan" includes formal restructurings of the types contemplated under a TDR action. However, not all "troubled loans" are "distressed loans" or vice versa.

¹¹ See Also, 12 CFR 621.5 on "Accounting for allowance for loan losses and charge offs."

due still accruing interest." As such, those 90 days past due high-risk loans not otherwise categorized under § 621.6(c) would be categorized as "nonaccrual" under § 621.6(a)(3).

d. Legal Action has been Initiated

We propose moving to its own paragraph that portion of existing § 621.6(a)(3)(ii) discussing the role of legal actions when classifying a loan. As part of the relocation, we also propose to simplify, clarify, and expand coverage of this condition to allow placing a loan into nonaccrual status if the loan is subject to legal collection action initiated by the lender or other forms of collateral conveyances used to collect the debt (including those initiated by the borrower). As proposed, the specific reference to a bankruptcy filing would be removed in recognition that bankruptcies may not always involve conveyances of collateral. Instead, loans in bankruptcy where collateral is not liquidated may be considered for nonaccrual status based on concerns regarding future collectability, depending on the type of bankruptcy filing and similar considerations. We also propose removing existing language requiring an expectation of debt collection within 180 days before placing a loan in nonaccrual status. We believe removing the 180 days

criteria allows System institutions additional discretion in both determining the status of a loan and setting a reasonable time period for collection that is based on the type of operation or source of repayment for the loan. As a general matter, the proposed changes would put focus on collection efforts arising after loan servicing has failed to resolve the financial stress to the loan (e.g., beginning loan liquidation).

3. Categorizing Troubled Debt Restructurings

Existing § 621.6(b) identifies the loan performance category “Formally restructured loans” for those loans meeting the definition of a TDR under GAAP.¹² We propose adding a short explanation that borrowers of loans placed under this category are both experiencing financial difficulties and have received a financial concession from the lender. We believe adding this summary will improve the usefulness of the provision and the process used by an institution in determining whether the category may be applicable to the loan under consideration. We also propose removing specific reference to the FASB guidance document regarding TDR servicing to eliminate the need to revise the

¹² Under GAAP, a TDR is an accounting classification and involves a special set of accounting rules.

regulation solely because the FASB guidance has been modified.¹³

Additionally, we propose adding to the § 621.6(b) heading an abbreviation of "(TDR)." The abbreviation will provide a means of distinguishing these types of restructuring from other formal restructuring actions, such as those taken for distressed loans under part 617. The abbreviation should also add clarity that the accounting category is only for those loans receiving TDR assistance. While it is possible for a part 617 servicing action to also be subject to accounting treatment under GAAP rules for TDRs, institutions must make an individual assessment of each loan and the restructuring action it received to determine if it is appropriate to treat the loan servicing as a TDR. As explained by FASB, the determination of whether a restructuring of a debt instrument should be accounted for as a TDR requires consideration of all relevant facts and circumstances surrounding the transaction. Generally, no single characteristic or factor is determinative of whether the restructuring of a debt instrument is a TDR.

¹³ The regulation currently identifies "Financial Accounting Standards Board Accounting Standards Codification Subtopic 310-40, Receivables--Troubled Debt Restructurings by Creditors." As explained in footnote 2, the last change to this rule was solely to update the FASB reference.

We also explain in this preamble that a loan under this category can remain in accrual status. To do so, there should be a current, well-documented credit analysis showing collection of principal and interest is reasonably assured under the modified terms. Reasonable assurance of repayment can include both financial calculations and consideration of whether the borrower demonstrated sustained historical repayment performance for a reasonable period before the modification. For additional information using this loan category, refer to FCA Informational Memorandum, "Accounting and Disclosure of Troubled Debt Restructurings, as required under GAAP," issued March 14, 2011.

4. Classifying Loans 90 Days Past Due

We are proposing changes to the high-risk loan category at existing § 621.6(c)(1), "Loans 90 days past due still accruing interest," to improve readability and add clarity. We propose specifying in the rule that the past due payments under review are those identified in the loan contract. We also propose adding language to address loans that are under secured since an under secured loan tends to pose a different risk to collection than one that is fully secured. While loans under this category are generally adequately secured, there may be instances where a loan is

under secured. We propose language to explain that if a loan is under secured and 90 days past due, it may be placed in this category if there is a likelihood of the loan returning to current status within the near future. We would expect institutions to document the reasons for expecting a resolution of the delinquency, including identification of the source and timing of repayment, similar to what they do under the existing requirements of § 621.6(a)(3)(ii).

C. Reinstatement to Accrual Status

We propose replacing the existing § 621.9 requirement that a loan must satisfy all four of the following criteria before being reinstated to accrual status:

- The loan is now current on payments;
- Certain prior charge offs have been recovered;
- There remains "no reasonable doubt" as to a borrower's willingness to remain current on a debt; and
- The borrower, after becoming current on payments while in nonaccrual status, has remained current on payments for a sustained period.

Instead, we propose using different reinstatement requirements for loans based upon repayment patterns and loan security.

As proposed, the existing criteria that a loan must be current before being reinstated to accrual status would remain, but the loan would also have to have been considered for loan servicing before reinstatement. The servicing component would replace the existing requirement that "no reasonable doubt" remain as to the "willingness and ability of the borrower to perform in accordance with the contractual terms of the loan agreement," which we propose removing. In addition, we propose keeping the criteria requiring collection of certain charged off amounts. The existing sustained performance criteria would also remain to demonstrate future repayment capability, but we propose adding additional flexibility. By necessity, these proposed changes in reinstatement eligibility would result in rewriting the entirety of § 621.9.

1. Repayment Status, Loan Security, and Repayment Capacity.

a. Loans Continuously Current on Payments.

We propose those loans that are current when placed in nonaccrual status, and which remain current while in nonaccrual status, be reinstated after being offered servicing designed to improve the collectability of the

loan.¹⁴ As proposed, these loans would no longer have to show an additional period of sustained performance or have charged off amounts collected. This proposed change would more closely align our rules with the FFIEC standards that allow a loan to be reinstated to accrual status when no principal or interest is past due, and the lender expects repayment of the remaining contractual principal and interest. Loans current when placed in nonaccrual status but later becoming past due would not be eligible for this reinstatement path. We propose the different path for these loans because we believe a past due repayment pattern demonstrates additional risk to collection of the contractual principal and interest than what is posed by loans remaining current on payments. Therefore, loans remaining current on payments are allowed to be restated faster under the proposed rule than the present rule.

b. Loans Past Due on Payments when in Nonaccrual Status.

We propose keeping the existing requirement to have certain charged off amounts recovered for loans past due when placed in nonaccrual status or becoming past due while in nonaccrual.¹⁵ Also, we propose keeping the requirement

¹⁴ Institutions must offer servicing, however, a borrower is not required to accept it.

¹⁵ Refer to earlier discussion at section IV.B.2.b of this preamble explaining the use of the term "charge offs" in §§ 621.6 and 621.9

that these loans become, and remain, current on payments for a sustained period before being eligible for reinstatement to accrual status. However, we are proposing two different measures of repayment capacity based on the adequacy of loan collateral: sustained performance or past payment patterns.

i. Repayment Capacity and Fully Secured Loans.

As proposed, those nonaccrual loans that were formerly past due but now current would, if fully secured, be allowed to demonstrate future repayment capability either through sustained performance or through consideration of past payment patterns. We are proposing that, if loan servicing results in modified loan terms, an institution could consider on-time payments made immediately before the loan was serviced, but only if those payments were of the same amount or higher than contractual payments in effect after servicing assistance. For example, a borrower who made partial payments before servicing and the servicing reduced structured payments to the level of the past partial payments, that prior repayment pattern may be considered. We believe this change will allow System institutions to recognize the reduced risk to a borrower's

refers to earned but uncollected interest income that was accrued and determined to be uncollectible.

future performance capability on an adequately secured loan. We also consider this proposed change as responding to past comments asking us to make our rules more comparable to others within the financial services industry.

ii. Repayment Capacity and Under Secured Loans.

If a formerly past due loan is, or remains, under secured after becoming current, we propose only permitting consideration of sustained performance before reinstatement to accrual status. This means considering all contractual payments, whether the payments are interest-only or principal and interest, for the specified period of time. For example, a TDR for an under secured loan may require annual payments and list the first annual payment as an interest-only payment, with equally amortized principal and interest payments required for the remainder of the loan term. Under this payment structure, sustained performance would be demonstrated by the borrower timely making the interest-only payment in year one and the equally amortized payment in year two. After doing so, the loan may be reinstated to accrual status. However, as proposed, the consideration of past payment patterns would not be allowed for these under secured loans.

2. Servicing Actions for Reinstatement

Our proposal would remove the existing criteria requiring "no reasonable doubt" remain as to the "willingness" of the borrower to repay the loan. When reviewing our existing rule, we looked at this requirement and determined it placed a higher standard on reinstatement to accrual status than is used for the initial classification as a nonaccrual loan. Existing § 621.6(a) requires no similar finding on a borrower's willingness to pay before placing a loan in nonaccrual status. In addition, a person's "willingness" to repay a debt is extremely difficult to assess or document. We also considered the safety and soundness concerns behind the provision, which were mainly directed at ensuring the reasons for placing a loan in nonaccrual status were fully addressed before reinstatement to accrual status. As this remains a concern, we looked for alternative criteria that was more measurable and identified loan servicing as an appropriate substitute.

In proposing a servicing element, we chose to use existing servicing policies required under 12 CFR 614.4170 and part 617 of this chapter. FCA regulation § 614.4170 requires each direct lender to adopt loan servicing policies and procedures designed to assure that loans will be serviced fairly and equitably while minimizing risk to

the lender. Part 617 requires additional servicing policies specifically addressing distressed loans. Both servicing policies are expected to include specific plans for helping preserve the quality of sound loans and correct credit deficiencies as they develop. As such, we considered it appropriate to require institutions to apply those policies to nonaccrual loans before reinstatement to accrual status.

3. Reinstatement of Loans and the Credit Review Committee (CRC)

We are proposing to add language clarifying the impact CRC decisions may have on the accounting classification of loans. Section 4.14D(d) of the Farm Credit Act of 1971, as amended (Act), provides borrowers with current loans in nonaccrual status certain rights when the nonaccrual status results in adverse actions toward the borrower.¹⁶ These borrower rights include written notice of the loan being moved to nonaccrual status and, if the loan is current, the opportunity to request the lender reinstate the loan to accrual status. Should such a request be denied, the borrower may seek a CRC review of the decision. FCA

¹⁶ The term "adverse action" has broad meaning and should not be treated interchangeably with the more limited term "adverse credit decision." Adverse actions can include many things, including, but not limited to, denial of patronage, a restricted opportunity to serve on the institution's board as a director, or revoking undisbursed loan commitments.

regulation § 617.7310(e) provides that CRC decisions are the final decision of the institution when made in compliance with applicable laws and regulations. In consideration of these requirements, we propose adding a provision explaining an institution is not prevented by the requirements of § 621.9 from reinstating a loan to accrual status if the CRC decides such action is appropriate and the CRC decision complies with all applicable laws, regulations, and is made in accordance with GAAP. We believe adding this provision not only facilitates compliance with the Act but emphasizes the potential impact a borrower may experience from changes in a loan's accounting status.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

List of Subjects in 12 CFR Parts 611, 615 and 621

Accounting, Agriculture, Banks, banking, Government securities, Investments, Reporting and recordkeeping requirements, Rural areas.

For the reasons stated in the preamble, parts 611, 615 and 621 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

Part 611--ORGANIZATION

1. The authority citation for part 611 is revised to read as follows:

Authority: Secs. 1.2, 1.3, 1.4, 1.5, 1.12, 1.13, 2.0, 2.1, 2.2, 2.10, 2.11, 2.12, 3.0, 3.1, 3.2, 3.3, 3.7, 3.8, 3.9, 4.3A, 4.12, 4.12A, 4.15, 4.20, 4.21, 4.25, 4.26, 4.27, 4.28A, 5.9, 5.17, 5.25, 7.0-7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2002, 2011, 2012, 2013, 2020, 2021, 2071, 2072, 2073, 2091, 2092, 2093, 2121, 2122, 2123, 2124, 2128, 2129, 2130, 2154a, 2183, 2184, 2203, 2208, 2209, 2211, 2212, 2213, 2214, 2243, 2252, 2261, 2279a-2279f-1, 2279aa-5(e)); secs. 411 and 412 of Pub. L. 100-233, 101 Stat. 1568, 1638; secs. 414 of Pub. L. 100-399, 102 Stat. 989, 1004.

§ 611.1205 [Amended]

2. Section 611.1205 is amended by removing “§ 621.2(c)” and adding in its place “§ 621.2” each place it appears.

PART 615--FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

3. The authority citation for part 615 is revised to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b-6, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a), Pub. L. 100-233, 101 Stat. 1568, 1608; sec. 939A, Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 78o-7 note).

§ 615.5131 [Amended]

4. Section 615.5131 is amended by removing “§ 621.2(f)” and adding in its place “§ 621.2” each place it appears.

PART 621--ACCOUNTING AND REPORTING REQUIREMENT

5. The authority citation for part 621 is revised to read as follows:

Authority: Secs. 4.12(b)(5), 41.4, 4.14A, 4.14D, 5.17, 5.22A, 8.11 of the Farm Credit Act (12 U.S.C. 2183, 2202, 2202a, 2202d, 2252, 2257a, 2279aa-11); sec. 514 of Pub. L. 102-552.

6. Section 621.2 is amended by:

a. Removing the paragraph designations (a) through (n); and

b. Adding definitions in alphabetical order for "Adequately secured", "In the process of collection", "Past due", and "Sustained performance" to read as follows:

§ 621.2 Definitions.

* * * * *

Adequately secured means the loan is collateralized by either or both:

(1) A perfected security interest in, or pledge of, real or personal property (including securities with an estimable value) having a net realizable value sufficient to repay the loan's outstanding principal and accrued interest; or

(2) The guarantee of a financially responsible party in an amount sufficient to repay the loan's outstanding principal and accrued interest.

* * * * *

In the process of collection means debt collection and loan servicing efforts are proceeding in due course and, based on a probable and specific event, are expected to result in the recovery of the loan's principal balance, accrued interest and penalties or reinstatement of the loan to current status within a reasonable time period.

* * * * *

Past due means a contractually scheduled loan payment has not been received on or before the contractual due date and remains due.

* * * * *

Sustained performance means the borrower has resumed on-time payment of the full amount of scheduled contractual loan payments over a sustained period. In accordance with the contractual payment schedule, the sustained on-time repayment period is demonstrated by making 6 consecutive monthly payments, 4 consecutive quarterly payments, 3 consecutive semiannual payments, or 2 consecutive annual payments. The payments considered are those listed in the loan contract as due during the sustained performance period, regardless of whether scheduled payments are interest-only, unequally amortized principal and interest, equally amortized principal and interest, or a combination of payment amounts.

7. Revise § 621.6 to read as follows:

§ 621.6 Categorizing high-risk loans and other property owned.

Each institution must employ the practices of this section when categorizing high-risk loans and loan-related assets. A loan must not be put into more than one performance category.

(a) Nonaccrual loans. A loan is categorized as nonaccrual if there is a known risk to the continued collection of principal or interest. Once a loan is categorized as nonaccrual, it must remain in that category until reinstated to accrual status pursuant to § 621.9. Loans placed into nonaccrual status when current are also subject to the notice and review provisions of part 617 of this chapter. A loan must be categorized as nonaccrual if one or more of the following conditions exist:

(1) The loan may or may not be past due, but the institution has determined collection of the outstanding principal and interest, plus future interest accruals, over the full term of the loan is not expected because of a documented deterioration in the financial condition of the borrower;

(2) Any portion of the loan has been charged off, except in cases where the charge off resulted from a formal

restructuring of the loan under part 617 of this chapter or troubled debt restructuring (TDR);

(3) The loan is 90 days past due and is not otherwise eligible for categorization under paragraph (c) of this section; or

(4) Legal action, including foreclosure or other forms of collateral conveyance, has been initiated to collect the outstanding principal and interest.

(b) Formally restructured loans (TDR). A loan is categorized as a formally restructured loan (TDR) if the restructuring is determined to be a TDR under generally accepted accounting principles and the guidance issued by the Financial Accounting Standards Board. Borrowers with loans categorized as TDRs are experiencing both financial difficulties and have received financial concessions from the institution.

(c) Loans 90 days past due still accruing interest. A loan is categorized as 90 days past due still accruing interest when it is 90 days contractually past due, adequately secured, and in the process of collection. If the loan is not adequately secured, it cannot be categorized under this category unless there is evidence to suggest repayment within a reasonable time period of either

the past due amount or the remaining principal and interest owed.

(d) Other property owned. Any real or personal property, other than an interest-earning asset, that has been acquired as a result of full or partial liquidation of a loan, through foreclosure, deed in lieu of foreclosure, or other legal means.

8. Revise § 621.9 to read as follows:

§ 621.9 Reinstatement to accrual status.

(a) Before being reinstated to accrual status, a loan must be current on contractual payments and the borrower offered servicing in accordance with the institution's policies maintained under either § 614.4170 or part 617 of this chapter, whichever is applicable. Additional reinstatement eligibility requirements are dependent upon certain characteristics of the loan under review.

(1) Loans that were current when placed in nonaccrual status may be reinstated to accrual status if the loans did not become past due while in nonaccrual status and known risks to the continued collection of principal or interest have been addressed through servicing efforts. If the loan became past due while in nonaccrual status, it may only be reinstated under paragraphs (a) (2) and either (a) (3) or (a) (4) of this section, as applicable.

(2) Loans past due when placed in nonaccrual status, or becoming past due while in nonaccrual status, must have prior charge offs recovered prior to reinstatement to accrual status. Charge offs resulting from formal restructuring of the loan under part 617 of this chapter or a TDR are exempt from recovery under this provision.

(3) Loans that are not adequately secured and were past due when placed in nonaccrual status, or became past due while in nonaccrual status, must remain current on contractual payments for a period of sustained performance before they may be reinstated.

(4) Loans that are adequately secured but were past due when placed in nonaccrual status, or became past due while in nonaccrual status, must have a recent repayment pattern demonstrating future repayment capacity to make on-time payments before the loans may be reinstated. The repayment pattern is established in one of two ways:

(i) Sustained performance in making on-time contractual payments, or

(ii) A recent history of making on-time partial payments in amounts the same or greater than newly restructured payment amounts.

(b) Nothing in this section prevents a current loan from being reinstated to accrual status in response to a

Credit Review Committee decision issued under section 4.14D(d) of the Farm Credit Act of 1971, as amended, when that decision was made in compliance with applicable laws, regulations, and in accordance with generally accepted accounting principles.

Dated: March 26, 2019.

Dale Aultman,
Secretary,
Farm Credit Administration Board.

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