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Working with Borrowers Affected by the COVID-19 Pandemic

NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

Date
April 2020
Letter No
20-CU-13
20-CU-13 / April 2020
Working with Borrowers Affected by the COVID-19 Pandemic
To
Federally Insured Credit Unions
Subject
Consumer Lending

Status
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To
Federally Insured Credit Unions
Subj
Consumer Lending

Dear Boards of Directors and Chief Executive Officers:

On April 7, 2020, the NCUA joined with other federal financial institutions regulators, in consultation with state financial regulators, to issue a revised [Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus \(opens new window\)](#) that discusses accounting and reporting considerations related to passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

This letter describes a variety of strategies credit unions can use to work with borrowers who experience financial hardship because of the COVID-19 pandemic, from offering additional funding to making temporary or permanent loan modifications. It also describes how credit unions should monitor and report loan modifications.

As a reminder, the NCUA encourages credit unions to work with impacted borrowers.¹ NCUA examiners will not criticize a credit union's efforts to provide prudent relief for borrowers when such efforts are conducted in a reasonable manner with proper controls and management oversight.

The financial hardships experienced by borrowers during the COVID 19 pandemic will vary. When evaluating available strategies to work with borrowers, credit unions should use a strategy appropriate for a borrower's needs and the degree of hardship. Borrowers may benefit from new funds, temporary loan modifications, or permanent loan modifications. However, a credit union's strategies for working with borrowers should also take into account the financial effects these actions will have on the credit union and its ability to serve all members.

New Funds to Borrowers

Strategies to provide new funds to borrowers negatively impacted by the COVID-19 pandemic include, but are not limited to:

- **Emergency Small-Dollar, Unsecured Loans.** These loans are generally offered in amounts up to \$5,000 with no payment required up to 90 days, and maturities of 24-36 months. Terms are intended to quickly provide borrowers with enhanced cash flow.
- **Small Business Administration's Paycheck Protection Program and [Economic Injury Disaster Loan \(opens new window\)](#) Programs.²** All current SBA 7(a) lenders are automatically approved to make [Paycheck Protection Program \(opens new window\)](#) loans. These loans are 100 percent guaranteed, and the full principal amount may qualify for loan forgiveness.
- **Payday Alternative Loans (PALs) I and II.** NCUA regulations [§§ 701.21\(c\)\(7\)\(iii\) \(opens new window\)](#) and [701.21\(c\)\(7\)\(iv\) \(opens new window\)](#) address the requirements for PALs programs.³ PALs I are limited to a maximum of \$1,000 and a 6-month maturity, while PALs II are limited to a maximum of \$2,000 and a 12-month maturity.
- **Increased Revolving Credit Limits.** Increasing credit lines for credit cards, home equity lines, and other revolving credit products provides borrowers with quick access to additional funds.

The NCUA also encourages credit unions to work with borrowers to restructure their debt obligations, where beneficial. Such efforts can ease financial pressure on borrowers and reduce a credit union's credit risk exposure. Credit unions should comply with federal and state consumer financial protection requirements, including fair lending laws, and supply borrowers with accurate disclosures for all loan modifications.

Temporary Loan Modifications

Strategies to temporarily modify existing loans include, but are not limited to:

- **CARES Act Forbearance.**⁴ For federally backed transactions, the CARES Act provides forbearance relief for borrowers financially impacted by the pandemic. For example, if a covered borrower requests a hardship forbearance, the servicer has to provide the forbearance for up to 180 days and, if requested, up to an additional 180 days. No additional fees, penalties, or interest beyond contractual payments can be assessed during this forbearance period. The CARES Act also provides for a moratorium on foreclosure of these loans.
- **Payment Forbearance.** A credit union may allow a borrower to defer monthly payments, with an agreement to repay the missed principal and interest at a later date. For example, the credit union may allow a three-month period of no payments, after which the payment increases to repay the missed principal and interest.
- **Waiving Late Payment or Modification Fees.** Waiving fees or doing so in combination with payment forbearance may help ease financial pressures on borrowers. Because fees are often added to the unpaid loan balance, waiving them avoids increasing the borrower's overall debt obligation and payment.
- **Interest-only Payments.** This strategy results in lower payments for a defined period while preventing negative amortization. After the interest-only period, the payment would increase or the missed principal payments would be due at the end of the loan term.
- **Reducing the Interest Rate.** Reducing the interest rate for a defined period can temporarily provide financial relief by lowering a borrower's payment. After the defined period, credit unions would reinstate the original interest rate or some other agreed-upon rate with the borrower and adjust the borrower's payments accordingly.

When providing temporary loan modifications, credit unions should consider the borrower's ability to repay the debt at the end of the temporary modification period, especially if the modification will result in higher payments or a balloon payment. Prior to providing the relief, credit unions should ensure borrowers are aware of the terms of any temporary modification and potential impact on the loan balance and future payment. Credit unions must be aware of the applicable Truth in Lending Act and Regulation Z disclosure requirements for some modifications.

Permanent Loan Modifications

Strategies to permanently modify or refinance an existing loan include, but are not limited to:

- **Consolidating Loans.** Combining multiple loans, especially with an improved interest rate or extended amortization, can result in lower payments for a borrower.
- **Extending the Maturity Date.** This strategy results in lower payments for a borrower. When extending maturities, credit unions should consider whether the value of any collateral would remain sufficient through the extended term. Federal credit unions must also ensure such extensions are consistent with the maximum maturity limits in the Federal Credit Union Act and the NCUA's regulations.⁵
- **Reducing the Interest Rate.** Reducing the interest rate can provide financial relief to a borrower by lowering their payment without extending the term of the loan.
- **Forgiving Principal.** This strategy lowers the loan balance and can reduce the borrower's payment, through an immediate loss to the credit union. The forgiving of principal is generally a last-resort concession, typically used only in cases where a borrower has negative equity in a home or business, is unable to make the required payment, and a financial impact analysis indicates this modification appears favorable over foreclosure action.⁶
- **Restructuring into A-B Notes.**⁷ Credit unions can restructure existing debt into two standalone loans through an A-B note arrangement. To do this, a credit union will structure an "A" note with a loan amount that meets a borrower's ability to repay the loan. The credit union will typically charge off the "B" note,

which the borrower will make payments on when the “A” note is paid off or when the member’s ability to repay improves. The “A” and “B” notes may have different interest rates, terms, or payment options. This modification is generally only used when the financial impact analysis favors this arrangement over foreclosure action.

Credit unions may also combine some of these strategies with a balloon payment. For example, a credit union may establish a 24-month balloon payment to lower the borrower’s payment in the short term and provide an opportunity to restructure the loan in accordance with the borrower’s ability to repay at a later date. Again, credit unions must make sure they provide required Regulation Z disclosures for certain consumer transactions.

Monitor and Report Loan Modifications

Credit union policies should address the use of loan workout strategies and outline risk management practices.⁸ Policies should clearly define borrower eligibility requirements, set aggregate program limits, and establish sound controls to ensure loan workout actions are structured properly.⁹ A credit union’s risk-monitoring practices for modified loans should:

- Be commensurate with the level of complexity and nature of its lending activities;
- Maintain safe and sound lending practices; and
- Comply with regulatory reporting requirements.

Success is measured by the performance of a loan after it has been modified. Effective credit risk-monitoring practices should include periodic reports to the chief executive officer and the board of directors on all modified loans, support a successful collection process, and ensure the prompt recognition of loan losses. A credit union’s monitoring practices may include reports of the following:

- Delinquencies,
- Charge-offs,
- Number and volume of modifications, by loan type,
- First payment defaults,
- High loan-to-value and debt-to-income ratios,
- Credit quality,
- Number of times each loan has been modified, and
- Expected loss exposure.

Credit union management must comply with regulatory reporting requirements and generally accepted accounting principles, as applicable. A credit union’s decisions related to loan modifications may affect regulatory reporting, including interest accruals, troubled debt restructurings (TDRs), and credit loss estimates. As discussed in the revised [Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus \(opens new window\)](#), Section 4013 of the CARES Act allows financial institutions to suspend the requirements to classify certain loan modifications as TDRs. Management should ensure loan modifications are reported properly on the Call Report to convey the credit union’s risk profile accurately.

If you have questions about this letter or the additional resources listed in its footnotes, please contact your district examiner, regional office, or state supervisory authority.

Sincerely,

/s/

Rodney E. Hood
Chairman

¹ In March 2020, the NCUA issued Letter to Credit Unions, 20-CU-02, [NCUA Actions Related to COVID-19 \(opens new window\)](#), to encourage credit unions to work with members impacted by COVID-19.

² See NCUA Letter to Credit Unions, 20-CU-06, [Small Business Administration Loan Programs to Help Small Businesses and Members During the COVID-19 Pandemic](#).

³ See NCUA Risk Alert, 10-RA-13, [Final Rule - Part 701, Short-term, Small Amount Loans](#), that accompanied the PALs I program, for additional discussion on the benefits of offering short-term small-dollar loans.

⁴ See the Consumer Financial Protection Bureau's [Guide to Coronavirus Mortgage Relief Options \(opens new window\)](#) for detailed information on this relief effort and mandatory requirements.

⁵ 12 U.S.C. § 1757(5); 12 C.F.R. § 701.21(c)(4).

⁶ See the [Evaluating Residential Real Estate Mortgage Loan Modification Programs \(opens new window\)](#) Supervisory Letter enclosed with NCUA Letter to Credit Unions, 09-CU-19, Evaluating Residential Real Estate Mortgage Loan Modification Programs.

⁷ See NCUA Letter to Credit Unions, 10-CU-07, [Commercial Loan Workouts](#).

⁸ See NCUA regulations §741.3(b)(2), Appendix B to Part 741, and NCUA Supervisory Letter 13-02, [Examiner Review of Loan Workouts, Nonaccrual, and Regulatory Reporting of Troubled Debt Restructured Loans \(opens new window\)](#) enclosed with NCUA Letter to Credit Unions, 13-CU-03, Supervisory Guidance on Troubled Debt Restructuring.

⁹ See NCUA Letter to Credit Unions, 08-CU-20, [Evaluating Current Risks to Credit Unions and the attached Supervisory Letter, Evaluating Current Risks to Credit Unions](#).

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