

7500. LOAN MODIFICATION & TROUBLED DEBT RELIEF POLICY

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Overview

The purpose of this Board of Directors approved policy is to create policy and procedures to work with borrowers who are facing financial difficulties or potential default on their loans. The credit union takes the position to help members maintain their financial well-being as well as remain members in good standing with the credit union.

It is the intent Resource One to comply with NCUA Regulation Part 741 and Appendix C to Part through the use of prudent loan workouts as an effective tool to enhance collectability while assisting borrowers experiencing financial difficulty. NCUA's updated reporting and regulatory requirements improve consistency of reporting for depository financial institutions.

The authority to approve workout loans is delegated by the Board of Directors to the President/CEO, who may further designate such authority to other operational staff.

Any rate or term concessions that are outside lending guidelines will require approval of the President/CEO or the official designee.

Under separate cover, see the collection policies and procedures for modified loans and TDR loans as they have different likelihoods of re-default. These policies and procedures comply with applicable federal and state laws and require close monitoring and aggressive follow-up on missed payments.

POLICY

It is the policy of Resource One Credit Union to maintain an effective program that improves loan collectability without delaying loss recognition or masking deteriorating loan quality.

The credit union's policy is to be commensurate with the credit union's size and complexity, while considering overall risk factors including, our field of membership, present and anticipated economic conditions, internally established impairment thresholds, borrower specific conditions, risk limits to the loan workout activity and the credit union's net worth.

Loan Workout Eligibility Requirements

1) Loan types included in the program:

- Secured consumer loans
 - Share Secured
 - New Vehicle
 - Used Vehicle
 - Refinance Vehicle
 - Recreational Vehicle
 - Boat/Motorcycle
 - Other Collateral (trailers/tractors/ATVs)
- Unsecured consumer loans
 - Credit Card
 - Personal Loan
 - Personal Line of Credit
- Secured and unsecured commercial loans
- Secured real estate loans
 - 1st Mortgage
 - Home Improvement
 - Unimproved Property
 - Non-homestead Property
- Indirect Loans
- Other Types of Loans Brought In-house

2) Number of Times R1CU Will Modify an Individual Loan

Generally, the credit union will allow a one-time loan modification on a loan. Any deviation from this policy will have approval from the President/CEO.

In the event there is a loan with multiple restructure strategies, the credit union will:

- Perform a validation or “look back” to past multiple restructures,
- Track in aggregate and by loan type,
- Relative re-default rates,
- Number of times the loan has been restructured,
- Dates of restructuring, and
- Any other pertinent information related to the restructurings.

3) Valuation of Underlying Collateral for Collateralized Loans

The credit union will refer to the Board approved Loan Policy, access publications such as the NADA, county tax values, appraisals, neighborhood comparable values and other viable legitimate means to value collateral.

4) Provisions for requesting additional collateral

The credit union may request additional collateral as needed. The forms of additional collateral may include an additional qualified co-signer/borrower, additional funds on deposit, or other free and clear collateral.

5) Balloon Payments

The credit union shall comply with guidelines under the Dodd-Frank Rules.

6) Principal Amortization

The credit union shall follow current established policy and procedure for amortizing principal while remaining in compliance with NCUA Part 741.

7) Delinquency on a Loan for the Credit Union to Consider a Workout Arrangement

In the event a member is not delinquent on their loan but there is a pending event that will result in delinquency, the credit union will consider a workout arrangement.

Generally, credit union Collection Processes and Procedures take effect when a loan is delinquent and based on a case-by-case decision a work out arrangement may be considered.

8) Adequate Documentation to Demonstrate Financial Hardship

The credit union may require adequate documentation to demonstrate financial hardship such as but not limited to:

- Bankruptcy documents
- Lay-off or loss of job documents
- Medical documents
- Death certificate

9) Other Verifications Required for Underwriting Workout and TDR Loans

- Verify identification of the member.
- Complete new loan application.
- Verification of employment.
- Verification of income. (see below)
- Verification of ability to make new payment amount.
- Verification of ability to handle new term of the loan.
- Sign loan agreement form.

10) Income Verification Requirements

The credit union may require income verification for workout loans to include but not limited to:

- Payroll stub
- Direct deposit
- Written or Electronic Employer verification

11) Debt to income ratio limits for workout loans

Generally, the credit union's Loan Policy shall be followed. Exceptions to the Loan Policy are approved by the President/CEO.

12) The borrower must demonstrate renewed ability and willingness to repay the revised note amount.

The above list of eligibility requirements for a workout loan (1 – 11), define and demonstrate the borrower's willingness to repay the loan.

Internal Controls

Based on the size and complexity of the credit union's loan program:

- The President/CEO and designated officers are responsible for:
 - Ensuring appropriately structured loan workouts.
 - Monitoring trending factors such as delinquency, net charge offs
 - Monthly reporting to Board of Directors
 - No additional advances or financing of interest and fees other than advances to cover third-party fees or forced place insurance or property taxes.
 - Renewed underwriting and repayment verification at the time the loan is restructured to support the credit union's loan workout decision.
 - Retention of documents to support the credit union's loan workout decision.
 - Ongoing communications with Collections to ensure proper accounting policy elections, TDR identification, proper nonaccrual & impairment measurement, timely charge-offs.
 - Segregation of duties as needed.
 - Accuracy of data for the 5300 Call Report.

Tracking Systems

The credit union's data processing system captures historical data elements related to principal reductions and charge-offs for financial reporting purposes, collection and 5300 Call Report.

Effective Date: July 18, 2013

Ratified Date: April 18, 2019

For tracking purposes, some elements of the program are manual while other parts of the program are part of the data processing system.

- TDR identification, re-aged, extended, deferred, renewed, or rewritten, manual process.
- Nonaccrual triggers, data processing system.
- Restoration to accrual triggers, data processing system.
- Cash or Cost Recovery basis policy implementation,
- Application of payments when collection of principal and/or interest is in doubt, manual process.
- Impairment methodology, see ALLL Policy.

Workout loans are tracked by the credit union until the loan is paid off or charged off.

Regulatory Reporting

Resource One Credit Union shall comply with the reporting regulatory requirements of Appendix C to Part 741 which allows credit unions to calculate the past due status of all loans consistent with loan contract terms, including amendments through a formal restructure.

The credit union's 5300 Call Report data collection will focus on loans meeting the definition of TDR under GAAP.

The credit union shall develop a process of review to ensure accurate reporting of TDR activity consistent with revised Call Report instructions.

Nonaccrual Requirements

Resource One Credit Union shall ensure appropriate income recognition by placing loans in nonaccrual status consistent with the requirements in Appendix C to Part 741. The Board approved Loan Nonaccrual Policy, under separate cover, demonstrates how the credit union will comply with loan nonaccrual requirements not accruing interest on any loan upon which principal or interest has been in default for a period of 90 days or more, unless the loan is both " *well secured* " and "in the *process of collection*. " Additionally, loans will be placed in nonaccrual status if maintained on a Cash (or Cost Recovery) basis because of deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected.

Resource One Credit Union shall adhere to the GAAP guidelines when applying a payment to loans in nonaccrual status. The credit union shall make a determination about whether the payment received should be recorded as a reduction of the principal balance or as interest income.

The credit union shall follow FASB ASC 942-310. If the ultimate collectability of principal, wholly or partially, is in doubt, any payment received on a loan on which the accrual of interest has been suspended shall be applied to reduce principal to the extent necessary to eliminate such doubt.

Payment application options include:

- Recognizing income on the Cash Basis. The credit union may treat some or all of the cash interest payments received as interest income on a Cash Basis as long as the remaining recorded investment in the loan is deemed fully collectable.
- Applying cash payment to principal. If the ultimate collectability of principal, wholly or partially, is in doubt, any payment received shall be applied to reduce principal to the extent necessary to eliminate such doubt.
- Recognizing income on the Cost Recovery Basis. Where assets are collectable over an extended period of time and, because of the terms of the transaction or other conditions, there is no reasonable basis for estimating the degree of collectability—when such circumstances exist, and as long as they exist—consistent with GAAP, the Cost Recovery method of accounting must be used.²³ Under this method, equal amounts of revenue and expense are recognized as collections are made until all costs have been recovered, postponing any recognition of profit until that time.

Appendix C, Part 741 Glossary of Terms Defined

“Past Due” means a loan is determined to be delinquent in relation to its contractual repayment terms including formal restructures, and must consider the time value of money. Credit unions may use the following method to recognize partial payments on “consumer credit,” i.e., credit extended to individuals for household, family, and other personal expenditures, including credit cards, and loans to individuals secured by their personal residence, including home equity and home improvement loans. A payment equivalent to 90 percent or more of the contractual payment may be considered a full payment in computing past due status.

“Recorded Investment in a Loan” means the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

“New Loan” means the terms of the revised loan are at least as favorable to the credit union (i.e., terms are market-based, and profit driven) as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the credit union, and the revisions to the original debt are more than minor.

“Generally accepted accounting principles (GAAP)” means official pronouncements of the FASB as memorialized in the FASB Accounting Standards Codification; as the

Effective Date: July 18, 2013

Ratified Date: April 18, 2019

source of authoritative principles and standards recognized to be applied in the preparation of financial statements by federally-insured credit unions in the United States with assets of \$10 million or more.

“In the process of collection” means collection of the loan is proceeding in due course either: (1) Through legal action, including judgment enforcement procedures, or (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future, i.e., generally within the next 90 days.

“Charge-off” means a direct reduction (credit) to the carrying amount of a loan carried at amortized cost resulting from un-collectability with a corresponding reduction (debit) of the ALLL. Recoveries of loans previously charged off should be recorded when received.

“Cost Recovery” method of income recognition means equal amounts of revenue and expense are recognized as collections are made until all costs have been recovered, postponing any recognition of profit until that time.

“Cash Basis” method of income recognition is set forth in GAAP and means while a loan is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in the loan (i.e., after charge-off of identified losses, if any) is deemed to be fully collectible.

- *“Workout Loan”* as a loan to a borrower in financial difficulty that has been formally restructured so as to be reasonably assured of repayment (principal and interest) and of performance according to its restructured terms. A workout loan typically involves a re-aging, extension, deferral, renewal, or rewrite of a loan.
- *“Re-Age”* means returning a past due account to current status without collecting the total amount of principal, interest, and fees that are contractually due.
- *“Extension”* means extending monthly payments on a closed-end loan and rolling back the maturity by the number of months extended. The account is shown current upon granting the extension. If extension fees are assessed, they should be collected at the time of the extension and not added to the balance of the loan.
- *“Deferral”* means deferring a contractually due payment on a closed-end loan without affecting the other terms, including maturity, of the loan. The account is shown current upon granting the deferral.
- *“Renewal”* means underwriting a matured, closed-end loan generally at its outstanding principal amount and on similar terms.
- *“Rewrite”* means significantly changing the terms of an existing loan, including payment amounts, interest rates, amortization schedules, or its final maturity.

“Well secured” means the loan is collateralized by: (1) A perfected security interest in, or pledges of, real or personal property, including securities with an estimable value, less cost to sell, sufficient to recover the recorded investment in the loan, as well as a

reasonable return on that amount, or (2) by the guarantee of a financially responsible party.

“Troubled Debt Restructuring” is as defined in GAAP and means a restructuring in which a credit union, for economic or legal reasons related to a member borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.¹⁸ The restructuring of a loan may include, but is not necessarily limited to: (1) The transfer from the borrower to the credit union of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan, (2) a modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or (3) a combination of the above. A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured troubled loan.

Troubled Debt Restructuring

Resource One Credit Union shall maintain documented analysis that illustrates

- (1) whether the borrower is experiencing financial difficulty and
- (2) whether the credit union granted a concession it would not otherwise consider except for the borrower's financial difficulty.

The credit union's conclusion and rationale shall be clearly stated in supporting documents.

When analyzing the two elements for a TDR determination -- financial difficulty and granting a concession – the credit union shall draw from GAAP guidance and a high degree of good judgment

Loan Workouts

When a credit union member meets the “experiencing financial difficulty” criteria, additional analysis is performed to determine whether there is a concession.

A restructured loan at a below-market rate would be indicative of a concession. But, a restructuring that results in only a delay in payment that is insignificant is not a concession.

The credit union shall follow GAAP, when considered together, may indicate that a delay in payment is insignificant:

- a. Amount. The amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due.

b. Timing. The delay in timing of the restructured payment period is insignificant relative to any one of the following: (1) the frequency of payments due under the debt; (2) the debt's original contractual maturity; or (3) the debt's original expected duration.

Allowance for Loan and Lease Loss (ALLL)

Due to the higher probability of default on workout loans and TDR loans, the credit union shall reserve separately for these loans in the Allowance for Loan and Lease Loss.

Consumer (secured and unsecured) Loans:

Allowance for ALLL is calculated at 5% (which is approximately 10 times the portfolio loss average) of this type of modified loans and is maintained on the internal ALLL calculation spreadsheet for accounting purposes, unless the loan is delinquent, then the normal Doubtful Loss Calculation will be utilized. Documents maintained in loan file.

Indirect (secured and unsecured) Loans or Other Outside Loans Brought In-house:

Allowance for ALLL is calculated at 5% (which is approximately 10 times the portfolio loss average) of this type of modified loans and is maintained on the internal ALLL calculation spreadsheet for accounting purposes, unless the loan is delinquent, then the normal Doubtful Loss Calculation will be utilized. Documents will be maintained in the member's loan file.

Real Estate:

Allowance for ALLL is calculated at 5% (which is approximately 10 times the portfolio loss average) of this type of modified loans and is maintained on the internal ALLL calculation spreadsheet for accounting purposes, unless the loan is delinquent, then the normal Doubtful Loss Calculation will be utilized. Documents maintained in loan file.

Fair Market Value (Interest Rate)

Loans written to FMV are not reported on the Loan Modification Report or on the Call Report. When a member tells the credit union, "I can get a better deal down the street!" the credit union has the option of meeting competition. If the credit union chooses to meet the competition, the modified loan is not reported or monitored.

Real Estate

The credit union realizes there are two objectives of a residential real estate loan modification:

- Help members who are struggling financially to maintain ownership of their homes.
- Minimize the credit union's default and foreclosure costs.

Effective Date: July 18, 2013

Ratified Date: April 18, 2019

Affordable and Sustainable Mortgage Loan Payment

Resource One Credit Union may lower the monthly payment sufficiently to make it affordable in the long term, or extend the term of the loan or reduce the principal balance to create greater borrower equity; this may result in a more sustainable loan modification. The loan modification process includes the following:

- Verify identification of the member.
- Verification of employment.
- Verification of income.
- Valid verification of the value of the collateral.
- Verification of ability to make new payment amount.
- Verification of ability to handle new term of the loan.
- Cash advances or release of new money to borrowers as part of the modification, except for settlement of delinquent real estate taxes, insurance, and other amounts that protect the credit union's collateral position is prohibited.
- An updated title search to confirm the credit union's lien position and verify that no one other than the borrower/member has title to the property is required.
- Prohibit subordination of the credit union's lien position to a new lender, unless a principal reduction or other significant financial benefit is received by the credit union.
- Mortgage loan modifications are restricted to loans secured by the borrowers' primary residence.
- Verification of homeowners insurance.
- Verification property taxes and any other related taxes are currently paid.
- Sign loan modification agreement form.

Under the FDIC's loan modification program, suggests that a mortgage loan payment based on a 31 to 38 percent housing (principal, interest, taxes, and insurance payment) to gross income (HTI) ratio is affordable. The Making Home Affordable program targets a 31 percent HTI ratio and requires borrowers with a total debt to gross income (DTI) ratio of 55 percent or more to enter a HUD-certified counseling program as a condition to modification. Prudent underwriting standards require that the credit union consider both the HTI ratio and DTI ratio when determining affordability.

Credit union documentation includes reversion clauses allowing for the reversion of terms and continuance of deferred foreclosure processes when payments are delinquent or the borrower defaults on the modification.

Test for Financial Impact of Modification

Once the credit union establishes the real estate loan modification terms, they may compare the cost of the concessions to the borrower with the estimated loss given foreclosure. One way to accomplish this is by employing a net present value (NPV) test that compares the NPV of expected cash flows from the modification with the NPV of the cash flows from foreclosure. In most cases, the credit union should only modify the loan if modification is less costly than foreclosure. NPV tests can be complex and require expertise in this area, thus, the credit union may seek outside assistance.

Effective Date: July 18, 2013

Ratified Date: April 18, 2019

Legal Review

The credit union may consult an attorney versed in the laws of the state in which the real estate is located to make sure all the loan modification documents meet state law standards (including state real estate, lien, consumer protection, and Federal Trade Commission laws and regulations). The analysis by the attorney should focus on protecting the credit union's interest in the property that is securing the loan, including any future appreciation in value if the property is sold and is subject to a 'shared appreciation' agreement. The legal review should also ensure that loan modification documents comply with applicable NCUA and state regulations and consumer protection laws (e.g., Truth-in-Lending, Equal Credit Opportunity, Fair Lending, Real Estate Settlement Procedures Act, etc.). The legal review should address state laws applicable to foreclosure and other debt collection options.

Historical Record of Policy Changes

This is a new policy. The policy addresses loan workouts, loan non-accrual practices and troubled debt restructure loan procedures. The policy was developed to meet federal regulations as is required to be updated per the document of response (DOR).

Date Ratified: July 2013