

Division FAQs on the Montana Loan Deferment Program

Last Updated June 24, 2020

The Montana Loan Deferment Program is facilitated by Montana banks, credit unions, and lending institutions in partnership with the State of Montana. Coronavirus Relief Funds (CRF) will be used to provide payments to participating lenders to convert existing commercial loans to interest only status, with the result being an existing borrower will be able to defer principal and interest payments on existing loans for a period of 6 to 12 months, thereby freeing up a significant amount of otherwise-dedicated capital for the borrower on a monthly basis.

Included in this document is general regulatory information and FAQs that may assist financial institutions in determining how to handle certain regulatory issues that may arise in conjunction with this program. The FAQs will be updated and amended as additional regulatory questions arise in relation to the loan deferment program.

Troubled Debt Restructure (TDR) Accounting

In response to the COVID-19 pandemic, regulatory agencies and Congress provided financial institutions TDR relief. The guidance from each is different and thus results in two options for TDR relief when an institution engages in a loan modification for a borrower.

- 1) [TDR Relief under CARES Act Section 4013](#) signed into law March 27, 2020 (scroll to pdf page 200)
- 2) [Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus \(Revised\)](#) issued April 7, 2020

The CARES Act relief for TDRs is much broader and it is the statutory language we are relying on in relation to this program. Section 4013 of the CARES Act allows an institution to suspend TDR accounting rules for a loan modification if the modification:

- 1) is related to the COVID-19 pandemic,
- 2) is on a loan that was not more than 30 days past due as of December 31, 2019, and
- 3) is executed between March 1, 2020, and December 31, 2020 (or 60 days after the national emergency declared by the President on March 13, 2020, is terminated.)

The eligibility requirements of the Montana Loan Deferment Program use criteria from Section 4013 of the CARES Act, so that all loan modifications made through the program should allow the financial institution to utilize the CARES Act TDR relief option. Institutions must document that the modification is being made pursuant to CARES Act Section 4013 to suspend TDR accounting.

Refer to FAQs on page 3 for more information.

Nonaccruals

The Division's position is that loans modified under this program should not be placed on nonaccrual status solely because they are participating in the program. This program is intended to allow the borrower time to recover from the impact of COVID-19 shutdowns and financial institutions are

encouraged to utilize the program to stabilize their loan portfolios and assist their borrowers. This does not mean that a loan modified under the program is exempt from being placed on nonaccrual, rather that the nonaccrual determination should not be based on participation in this program.

Institutions should continue the normal practice of evaluating individual loans within the loan portfolio to determine which loans should be on placed on nonaccrual in accordance with applicable accounting principles and the Report of Condition and Income Instructions (Call Report Instructions). The Call Report Instructions glossary state a loan should be placed on nonaccrual if:

- 1) it is maintained on a cash basis because of deterioration in the financial condition of the borrower;
- 2) payment in full of principal or interest is not expected; or
- 3) principal or interest has been in default for 90 days or more unless the loan is both well-secured and in the process of collection.

The State program guarantees the financial institution will collect interest on the loan, provides immediate cash flow benefits to the borrower, and allows time for the lender to assess the financial health of the borrower under a more normalized operating environment in the future. The Division believes that the use of this program aligns with the Interagency Statement on Loan Modifications and Reporting Financial Institutions Working with Customers Affected by the Coronavirus (Revised) issued April 7, 2020, which indicates that short-term arrangements* should generally not be reported as nonaccrual until more information becomes available indicating a specific loan will not be repaid. For many borrowers entering the program, more information will be necessary for the financial institution to fully analyze if collection of full principal and interest is, or is not, expected.

*It should be noted that the phrase “short-term” is used throughout the regulatory guidance, but the guidance does not give a definition for the phrase. To date, no regulatory agency has formalized the definition of short-term. The term is therefore subjective and when determining if an arrangement is short-term, all relevant factors should be considered including, but not limited to, the length of the pandemic and subsequent recovery period.

Refer to FAQs on page 4 for more information.

Compliance Topics

The Division encourages lenders to work with their internal compliance personnel and reach out to appropriate compliance regulators with specific questions. Below is a list of general topics of which to be aware.

Disclosures

As with any modification a financial institution engages in, whether under this State program or otherwise, the lender should ensure the borrower is given a clear understanding of the terms of the loan.

Fair lending

The State program, rather than the individual financial institution, has defined the eligibility criteria for borrowers participating in the program, which helps ensure applicants receive consistent underwriting treatment. If the financial institution decides not to offer the program to borrowers with a loan interest rate exceeding 6%, that decision should be a uniform standard/procedure for the financial institution. To

avoid any potential disparate impact issues, financial institutions should ensure they do not inadvertently exclude a group of customers from the program based on interest rates that could cause fair lending issues. As an example, if the financial institution has a group of businesses that it tends to price over 6% based on risk, such as restaurants, and that group of businesses is primarily women or minority owned, the financial institution should consider whether it may have fair lending risks by excluding those businesses from the program. The financial institution should also ensure it complies with Equal Credit Opportunity Act regulations for providing adverse actions to denied applicants.

Reg B Adverse Action Notice

If a borrower applies and is ineligible for the program, the financial institution may need to provide a statement of the action taken, either orally or in writing. Refer to [Regulation B](#) / ECOA for further information.

Flood Requirements

This program requires a loan to be modified and the terms extended. When a loan is extended, the financial institution must make a new flood determination unless the loan meets criteria to rely on a previous determination. Refer to FRB Part 208 Subpart B or FDIC Part 339 for more information. The financial institution should also ensure that it has adequate flood insurance in place, if required under applicable flood insurance regulations.

Other Considerations

- Institutions should consider implementing a periodic audit of modified loans to ensure they are set up correctly in the system.
- Financial institutions should ensure their systems are capable of handling deferrals for adjusting pay-off statements.

FAQs

1. **TDRs. Most of these modifications will be for a term that extends beyond December 31, 2020. Does that mean the loan will not qualify under CARES Act Section 4013 to suspend TDR accounting?**

No. The loan will still qualify for suspension of TDR accounting under CARES Act Section 4013 if the modification is entered into before December 31, 2020 (or 60 days after the emergency ends). The CARES Act language refers to the date that the loan modification is executed and allows the suspension of TDR accounting for the entire term of the modification.

2. **TDRs. How should an institution maintain records of the loans that were modified under Section 4013 of the CARES Act?**

The language in the Act does not address how an institution should maintain the records. From a regulatory examination perspective, it would be helpful on an individual loan basis to see documentation in the loan file stating that the modification was made utilizing the CARES Act Section 4013 TDR relief. On a portfolio-wide basis, management should be aggregating the data to track all loans modified under the CARES Act TDR relief. The 2nd Quarter 2020 Call Report will include additional reporting requirements on Call Report Schedule RC-C, Part I, Loans and Leases, and Schedule RC-M, Memoranda. These additional reporting items include:

- a. Eligible loan modifications under Section 4013, Temporary Relief from Troubled Debt Restructurings, of the 2020 CARES Act, with these items collected on a confidential basis;
- b. U.S. Small Business Administration (SBA) Paycheck Protection Program (PPP) loans and borrowings under the Federal Reserve PPP Liquidity Facility (PPPLF); and,
- c. Holdings of assets purchased under the Money Market Mutual Fund Liquidity Facility (MMLF).

3. **General Program and Nonaccrual. My financial institution has already entered into deferment modifications for several borrowers. The State program indicates the funds can be used for any interest payment due dating back to March 12, 2020. Can I use the funds to pay interest current when doing the new modification?**

Yes, with some restrictions. The financial institution can apply the funds to accrued interest for borrowers that are already in deferral, but only at the 6% interest rate (or lower if applicable). The example below discusses options for a deferred loan that had a higher rate before entering the program.

Financial institutions should be aware that if they are taking some sort of charge-off of principal or interest, it puts the accrual status of the loan in jeopardy. Where this is most likely to be an issue is for a loan that is already in deferral and then enters this program.

Example:

- Borrower has a \$1,000,000 loan at an institution with a rate of 6.5%.
- Institution and borrower entered into a P&I deferral starting May 1, 2020.

- Borrower, through institution, enters into the State program beginning August 1, 2020, at which time the loan is modified to interest-only payments through May 1, 2021, at a rate of 6%
- State sends the institution the full \$60,000 (12 months interest on the note at 6%) up front.
- As of August 1, 2020, when the borrower enters the deferral with the State program, there is 3 months of accrued interest on the note totaling \$16,250.
- The State program allows the institution to use the funds “retroactively” for accrued interest due on a loan already in deferral, but at the 6% rate. The institution can use \$15,000 of the money (3 months of interest at 6%) to pay down the accrued interest. The loan is left with \$1,250 accrued interest owing. How is that remaining accrued interest due handled?
- Ideally, the borrower would pay that relatively small amount to give the loan a “clean slate” going into this arrangement. If not, the institution could collect it when P&I begins or defer it to the back of the note. We do not want to see an institution capitalize the remaining interest.

Another option is to charge off this amount; however, this could cause issues with the loan potentially needing to be put on nonaccrual because the institution is no longer going to collect the full amount of principal and interest.

Using this same example, let’s assume the borrower was able to pay the \$1,250 of remaining interest. The borrower was approved through the program for a 12-month deferral, so now the borrower has 9 remaining months of P&I deferral (3 months backwards and 9 months forward) for a total of 12 months.

4. *Nonaccrual.* If my institution has a borrower that is currently on nonaccrual, are they excluded from applying for the program?

No. If an institution has a loan that is nonaccrual but meets the eligibility requirements, nothing precludes them from entering the program. These situations will likely be rare since one eligibility requirement is the loan be current as of December 31, 2019, but it is possible.