



## RISK SHARING ASSET MANAGEMENT GUIDANCE

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### SUBMITTING CHARGE-OFFS OF PERFORMING COMMERCIAL REAL ESTATE SHARED-LOSS LOANS FOR REIMBURSEMENT

**Summary:** Performing commercial real estate loans generally should not have charge-offs submitted for reimbursement under a Commercial Shared Loss Agreement (CSLA). However, Assuming Institutions (AIs) may encounter situations where it is probable an AI will not be able to collect all contractual amounts due per the loan agreement on a performing loan. AIs should evaluate and measure the impairment of performing loans with well-defined weaknesses that jeopardize full repayment. Submitting charge-offs on a performing commercial real estate loan are considered exceptions, and require the AI to determine that the loan is collateral dependent, not simply impaired.

**Distribution:**

Assuming Institutions  
RSAM Specialists and Managers  
Oversight Managers  
Compliance Monitoring Contractors

**FROM:**

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**Related Topics:**

- *Interagency Policy Statement on Prudent Commercial Real Estate On Workouts (October 2009)*
- *Interagency Guidelines Establishing Standards for Safety and Soundness, Section II C – Loan Documentation, D – Credit Underwriting (2001); Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices (December 2010);*
- *Interagency Appraisal and Evaluation Guidelines (December 2010)*
- *Interagency Questions and Answers on Accounting for Allowance for Loan and Lease Losses (December 2006)*
- *OCC Bank Accounting Advisory Series, (June 2012)*
- *ASC Topic 310, Receivables, and ASC Topic 820, Fair Value Measurements and Disclosures; and*
- *Call Report FFIEC 031 and 041, Glossary.*

**Highlights:**

The interagency *Policy Statement on Prudent Commercial Real Estate Loan Workouts* states performing loans will not be adversely classified solely because the value of the underlying collateral has declined to an amount that is less than the loan balance. However, it is appropriate to classify a performing loan when well defined weaknesses exist that will jeopardize repayment in full.

AIs should evaluate commercial real estate loans under a CSLA for impairment in accordance with examination criteria, supervisory guidance, and Accounting Standard Codification (ASC) Topic 310, Receivables, and Topic 820, Fair Value Measurements and Disclosures per the terms of the respective CSLA. A performing loan is impaired when, based on current information and events, it is probable the AI will not be able to collect all amounts due according to the contractual terms of a loan agreement.

AIs also should measure collateral dependent loans for impairment based on regulatory guidance and in accordance with ASC Subtopic 301-10. A loan is collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment.

AIs can submit charge-offs of performing commercial real estate loans only after determining the loans are collateral dependent, with no repayment ability expected from the borrower(s) or guarantor(s).

*This information is provided for general guidance and clarity on the matters contained therein. The information is not intended to modify, or otherwise supplant, any provisions or definitions contained with the applicable Shared-Loss Agreements. The Assuming Institution is strongly encouraged to seek appropriate legal counsel for a comprehensive analysis and understanding of the matters contained within Shared-Loss Agreements.*

## SUBMITTING CHARGE-OFFS OF PERFORMING COMMERCIAL REAL ESTATE SHARED-LOSS LOANS FOR SHARED-LOSS COVERAGE

### PURPOSE

To clarify that charge-offs of performing commercial real estate Shared-Loss Loans may be submitted for loss share coverage in rare instances when well defined weaknesses threaten the full collection of all contractual amounts due per the loan agreement.

### STATEMENT

Shared-Loss Loans should be evaluated for impairment in accordance with examination criteria, supervisory guidance, and Accounting Standard Codification (ASC) Topic 310 Receivables and Topic 820, Fair Value Measurements and Disclosures per the terms of the respective Commercial Shared-Loss Agreements (CSLA).

The Interagency Policy Statement on Prudent Commercial Real Estate On Workouts (October 2009) states that performing loans will not be adversely classified solely because the value of the underlying collateral has declined to an amount that is less than the loan balance. However, in specific instances, it is appropriate to adversely classify a performing loan when well defined weaknesses exist that will jeopardize repayment in full.

Performing commercial real estate loans generally should not have charge-offs submitted for loss sharing reimbursement under a CSLA. A performing loan is impaired when, based on current information and events, it is probable the AI will not be able to collect all amounts due according to the contractual terms of a loan agreement.

A loan is collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment<sup>1</sup>. The collateral dependent loan should be measured for impairment based on regulatory guidance<sup>2</sup> and in accordance with ASC Subtopic 310-10.

Charge-offs on performing shared-loss loans should only be submitted for loss share coverage, and will only be paid, when a determination has been made that there is no repayment ability of the borrower(s) and guarantors(s), and that repayment of the loan is based solely on the sale or operation of the underlying collateral.

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<sup>1</sup> *Call Report FFIEC 031 and 041, Glossary, A-57 (6-12)*

<sup>2</sup> *Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts (October 2009)*

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### ***Impairment Assessment***

AIs' risk management practices and loan portfolio management require ongoing risk evaluation of the individual shared-loss assets and shared loss portfolio. AIs are expected to establish criteria for determining loans to be reviewed for impairment in accordance with ASC 310-10-35 and apply the criteria in their normal loan review process.

ASC 310-10-35 states that a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Probable is defined as an area within a range of the likelihood that a future event or events will occur confirming the fact of the loss. That range is from probable to remote, as follows:

- a. Probable: The future events or events are likely to occur.
- b. Reasonably possible: The chance of the future event or events occurring is more than remote but less than likely
- c. Remote: The change of the future event or events occurring is slight

Impairment analysis is case-by-case, and loans often have risk characteristics that are unique to an individual borrower or loan structure. Generally, in supporting a charge-off and thus a loss share claim on a performing loan, the probability of loss should be considered a near-term event.

### ***Impairment Measurement***

ASC Subtopic 310-10-35 describes the impairment measurement and states that there are three acceptable methods under ASC 310-10-35 measuring the impairment:

- The present value (PV) of expected future cash flows discounted at the loan's effective interest rate;
- The loan's observable market price; or
- The fair value of the underlying collateral, if the loan is collateral dependent.

An AI may choose the appropriate ASC Subtopic 310-10 measurement method on a loan-by-loan basis for an individually impaired loan, except for an impaired collateral dependent loan.

### ***Exception to the ASC 310-10 Accounting Treatment***

ASC Subtopic 310-10 states that estimated costs to sell may be used in the measurement method. However, the **CSLA allows payment only for expenses incurred and actually paid**, even though estimated expenses are contemplated for regulatory reporting purposes.

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### ***Impairment Documentation***

AIs are required to provide current, well documented credit evaluation of the borrower's financial condition, resources, and prospects for repayment according to the contractual terms of the loan agreement. Appraisals on collateral dependent loans must be based on a fair value of collateral method as required by ASC 310-10. As with other charge-offs of Shared-Loss Assets, AI's supporting charge-offs of performing loans should provide sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision and be documented in the credit file accordingly.

### ***References***

Further information is available from:

- *Interagency Policy Statement on Prudent Commercial Real Estate On Workouts* (October 2009)
- *Interagency Guidelines Establishing Standards for Safety and Soundness, Section II C – Loan Documentation, D – Credit Underwriting* (2001);
- *Interagency Appraisal and Evaluation Guidelines* (December 2010)
- *Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* ( (December 2010);
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