

Script for 9/29/2011 New York Regulatory Conference Call

TROUBLED DEBT RESTRUCTURINGS (TDRs)

Introduction

Slide 1

Good afternoon. My name is Doreen Eberley, Regional Director for the FDIC's New York Region. I would like to welcome you to the New York Regulatory Conference Call covering troubled debt restructurings and related issues.

Many institutions are restructuring or modifying the terms of loans to provide payment relief for those borrowers who have suffered deterioration in their financial condition. Such loan restructurings may include, but are not limited to, reductions in principal or accrued interest, reductions in interest rates, and extensions of the maturity date. Many of these loan modifications meet the definition of a troubled debt restructuring (TDR). Today, we will cover a variety of issues regarding TDRs, including relevant guidance, identification, impairment, accrual status, and call reporting. We hope this call will provide helpful information to assist your institution in identifying and properly reporting TDRs. We appreciate very much your participation in today's call.

Your telephone confirmation notice included an agenda for today's presentation, as well as the PowerPoint slides for the various topics being covered. The PowerPoint slides should aid you in following today's presentation and can be used for future reference. If

you have questions relating to this presentation, you may contact the individuals listed at the end of the PowerPoint slides.

There will be a question and answer session at the end of the presentation. Please note that you may also send e-mail questions at any time during the presentation to NYCalls@fdic.gov. At the end of the presentation, the operator will provide procedures for calling in a question.

With me today are the presenters: Regional Accountants George Herger and Shannon Beattie.

It is my pleasure now to turn the program over to Shannon Beattie, who will begin the presentation.

Agenda

Slide 2

Thank you, Doreen. Good afternoon everyone. First, I would like to quickly go over the agenda for today's call. We will start by giving you some resources for additional guidance on troubled debt restructurings. Next, we will cover the challenges of identifying which loan modifications should be treated as troubled debt restructurings or TDRs. Once identification issues have been discussed, we will turn to measuring impairment and determining accrual status. We will conclude by addressing appropriate documentation and call report treatment. Please take note of any questions that may

come up during the presentation, as we will have a question and answer session at the end.

TDRs -Applicable Guidance

Slide 3

Slide 3 lists current accounting resources for TDRs. We will spend some time this afternoon discussing the call report guidance and the recent Accounting Standards Update issued by the FASB in later slides. The Accounting Standards Codification Topic 310 includes the guidance from the former FAS 15, FAS 114 and FAS 118 which are the statements that provide the basis for identifying TDRs and treating TDRs as impaired loans when estimating allocations to the allowance for loan losses.

There is an asterisk following Emerging Issues Task Force number 02-4 which is currently coded as Topic 470-60 in the Accounting Standards Codification or ASC. The notation is meant to highlight that this guidance is intended for the borrower and not the lender. Current guidance prohibits financial institutions from using the effective interest rate test included in the TDR guidance for borrowers in ASC Subtopic 470-60, when determining whether the creditor has granted a concession as part of a loan modification. This suggests that there could be a lack of symmetry in how a borrower and a lender treat the same loan modification. FASB Technical Bulletin Number 80-2, Classification of Debt Restructurings by Debtors and Creditors tackled this issue in 1980 and the guidance is currently addressed in ASC Topic 310 for lenders and ASC Topic 470 for borrowers. Technical Bulletin 80-2 states that “a debtor may have a TDR even though the related

creditor does not have a TDR. The debtor and creditor must individually apply [generally accepted accounting principles,] to the specific facts and circumstances to determine whether a troubled debt restructuring has occurred... Thus, [current accounting guidance] establishes tests for applicability that are not symmetrical as between the debtor and the creditor [in certain circumstances].” For the remainder of today’s presentation, we will be addressing TDRs from the lender’s perspective.

The final resource listed is the Bank Accounting Advisory, a publication of the Comptroller of the Currency. This resource may be accessed on the OCC’s website, and it provides questions and answers specifically related to TDRs among other accounting topics.

TDR vs. Loan Modification

Slide 4

Moving onto Slide 4 - The TDR accounting and reporting standards for lenders are set forth in ASC Subtopic 310-40, titled “Troubled Debt Restructurings by Creditors,” which is the former FAS 15. This guidance specifies that a restructuring of a debt constitutes a TDR if, at the date of restructuring, the creditor for economic or legal reasons related to a debtor’s financial difficulties grants a concession to the debtor that it would not otherwise consider. Legal reasons could include a ruling by a bankruptcy judge. Various types of concessions could result in a TDR including:

- A reduction of the stated interest rate for the remaining original life of the debt;

- An extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;
- A reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement; or
- A reduction of accrued interest.

The creditor's concession may include a restructuring of the loan terms to alleviate the burden of the debtor's near-term cash requirements, such as a modification of terms to reduce or defer cash payments required in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor. While an institution that restructures a loan to a borrower experiencing financial difficulties at a rate **below a market interest rate** has granted a concession to the borrower that results in the restructured loan being a TDR, a change in the interest rate on a modified or restructured loan does not necessarily mean that the modification is a TDR. For example, a creditor may lower the interest rate to maintain a relationship with a borrower that can readily obtain funds from other sources. Consequently, a loan extended or renewed at a stated interest rate **equal to the current interest rate** for new debt with similar risk is not a TDR.

TDRs - Identification

Slide 5

The next slide considers loan pools.

Loan Pools: "Purchased impaired loans" is the accounting term used to describe loans that an institution has purchased, including those acquired in a purchase business

combination, where there is evidence of deterioration of credit quality since the origination of the loan and it is probable, at the purchase date, that the institution will be unable to collect all contractually required payments. Such loans must be accounted for in accordance with ASC Subtopic 310-30, titled, “Loans and Debt Securities Acquired with Deteriorated Credit Quality,” which is the former AICPA Statement of Position 03-3 or SOP 03-3. For purchased impaired loans that are being **accounted for on a pool basis**, the individual loans in the pool whose terms have been modified would not be reported as TDRs in the Call Report because the ASC states that modifications of loans within a pool accounted for in accordance with ASC Subtopic 310-30 are not considered TDRs. These modified loans remain part of the pool and are not separately identified as TDRs.

When purchased impaired loans are accounted for on a pool basis, nonaccrual status should be determined at the pool level rather than at the individual loan level. If the pool as a whole is in nonaccrual status, the carrying amount of the pool before any loan loss allowance would be reported in Schedule RC-N of the Call Report in the loan category line item appropriate to the loans in the pool. Schedule RC-N collects information on Past Due and Nonaccrual Loans. If the pool is not in nonaccrual status, past due status should be determined for each individual loan in the pool in accordance with its contractual repayment terms. Past due status of modified loans should be reported on a loan-by-loan basis in Schedule RC-N of the Call Report.

Slide 6

Let's breakdown the two criteria required for a loan to be considered a TDR. The first criterion is a debtor experiencing financial difficulty. Although not all inclusive, Slide 6 shows factors that may indicate a debtor is experiencing financial difficulties. These factors include defaulting on current obligations or filing for bankruptcy. There may be doubt as to whether the debtor will continue as a going concern, which may be documented by the debtor's auditor. The de-listing of the debtor's securities would be an indication of financial troubles, as would insufficient cash flows to service the debt. The latter would require lenders to exercise judgment in evaluating the borrower's capacity to service its debt. Similarly, when the primary source of repayment is insufficient to service the debt, and there is reliance on any guarantors, the debtor is likely experiencing financial difficulties. Finally, a borrower's inability to obtain funds from other sources at a market rate for similar debt to a non-troubled borrower would demonstrate financial difficulty. (Office of the Comptroller of the Currency BAAS October 2010)

Slide 7

In April 2011, the FASB issued Accounting Standards Update No. 2011-02, "A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring," to provide additional guidance to help creditors determine whether a concession has been granted to a borrower and whether a borrower is experiencing financial difficulties. The guidance is also intended to reduce diversity in practice in identifying and reporting TDRs. For most public institutions, the Accounting Standards Update or ASU took effect July 1, 2011. For most nonpublic institutions, the ASU will take effect January 1, 2012. Early adoption of the ASU is permitted for both public and nonpublic entities.

Institutions are expected to continue to follow existing accounting and reporting guidance on TDRs in the Call Report Instructions. To the extent the guidance in the ASU differs from an institution's existing accounting policies and practices for identifying TDRs, the institution will be expected to apply the ASU for Call Report purposes in accordance with the standard's effective date and transition provisions. To the extent that an institution's existing accounting policies and practices are consistent with guidance in the ASU, the institution should continue to follow its existing policies and practices.

ASU 2011-02 reiterates that two conditions must exist in order for a loan modification to be deemed a TDR: (1) the borrower must be experiencing financial difficulties, which we have addressed, and (2) an institution must grant a concession to the borrower as part of the modification. The ASU explains that an institution may determine that a borrower is experiencing financial difficulties if it is probable that the borrower will default on any of its debts in the foreseeable future. The borrower does not have to be in default at the time of the modification.

Market Rate: Let's look a little more closely at the second criterion required for a loan to be considered a TDR, the granting of a concession to the debtor that the creditor would not otherwise consider. The ASU prohibits financial institutions from using the effective interest rate test included in the TDR guidance for borrowers in ASC Subtopic 470-60, Debt – Troubled Debt Restructurings by Debtors, when determining whether the creditor has granted a concession as part of a loan modification. However, as explained in ASU

2011-02, if a borrower does not have access to funds at a market rate of interest for similar debt, the rate on the modified loan is considered to be a below-market rate and may be an indicator that the institution has granted a concession to the borrower.

Slide 7 considers market rates. Determining a market rate can be challenging because there is a lack of publicly available information on both troubled loan rates and current trades of troubled loans. Gathering current relevant data in the commercial mortgage markets is particularly difficult.

The stated interest rate charged the borrower after a loan restructuring may be greater than or equal to interest rates available in the marketplace for similar types of loans to **nontroubled** borrowers at the time of the restructuring. Some institutions have concluded that these restructurings are not TDRs, which may not be the case. In reaching this conclusion, these institutions may not have considered all of the facts and circumstances associated with the loan modification besides the interest rate. An interest rate on a modified loan greater than or equal to those available in the marketplace for similar credits to **nontroubled** borrowers does not in and of itself preclude a modification from being designated as a TDR. Rather, when evaluating a loan modification to a borrower experiencing financial difficulties, an analysis of all facts and circumstances is necessary to determine whether the institution has made a concession to the borrower with respect to the market interest rate or has made some other type of concession that could trigger TDR accounting and disclosure. An example would be if the terms or conditions are outside of the institution's policies or common market practices.

Generally, a restructured loan yields a current market interest rate if the restructuring agreement specifies an interest rate greater than or equal to the rate that the institution was willing to accept at the time of the restructuring for a new loan with comparable risk. A restructured loan does not yield a market interest rate simply because the interest rate charged under the restructuring agreement has not been reduced. In addition, when a modification results in either a temporary or permanent increase in the contractual interest rate, the increased interest rate cannot be presumed to be an interest rate that is at or above market. Therefore, in determining whether a loan has been modified at a market interest rate, an institution should analyze the borrower's current financial condition and compare the rate on the modified loan to rates the institution would charge customers with similar financial characteristics on similar types of loans. This determination requires the use of judgment and should include an analysis of credit history and scores, loan-to-value ratios or other collateral protection, the borrower's ability to generate cash flow sufficient to meet the repayment terms, and other factors normally considered when underwriting and pricing loans.

Slide 8

The next slide addresses delays in payment.

“Insignificant” Delay in Payment: ASU 2011-02 also provides new guidance regarding **insignificant delays in payment** as part of a loan modification.

If, after analysis of all facts and circumstances, a creditor determines that a delay in payment is insignificant, the creditor has not granted a concession to the borrower. This

determination requires judgment and should consider many factors, including, but not limited to, the amount of the delayed payments in relation to the loan's unpaid principal or collateral value, the frequency of payments due on the loan, the original contractual maturity, and the original expected duration of the loan.

For additional information, institutions should refer to ASU 2011-02, which is available at the FASB website and the Supplemental Call Report Instructions in Financial Institutions Letter 52-2011 dated June 30, 2011.

One common question asks whether the following is a TDR - an extension at the current loan rate to a borrower who is experiencing financial difficulty? This example acknowledges that the borrower is experiencing financial difficulty; therefore, the answer is dependent on whether there is a concession. In this example the interest rate and loan term should be evaluated.

1. The rate on the extended loan should be compared to rates the institution would charge customers with similar financial characteristics on similar types of loans. In other words, the interest rate should be compared to the rate for a new loan with comparable risk. An interest rate on an extended loan equal to those available in the marketplace for similar credits to **nontroubled** borrowers does not in and of itself preclude a modification from being designated as a TDR. A restructured loan does not yield a market interest rate simply because the interest rate charged under the restructuring agreement has not been reduced.

2. The extended loan term should be compared to the guidance for an insignificant delay in payments which considers the original loan term and frequency of payments.

TDRs – ASU Example 1

Slide 9

On the next slide we'll take a look at some examples from the ASU in applying the "insignificant delay" guidance. A creditor originates a seven-year loan with a fixed interest rate, collateralized by commercial real estate, requiring monthly interest payments, and requiring a balloon principal payment at maturity. At origination, the borrower expects to repay the principal by refinancing the loan with the real estate held as collateral. In other words, the collateral is the primary source of payment of the loan's principal balance, whether through a refinancing of the debt or a sale of the property. Before the maturity of the original loan, the fair value of the collateral drops to less than the principal amount due at maturity, and as a result of market conditions, the borrower is unable to refinance the debt. The borrower plans to sell the property to repay the debt and requests an extension of the loan's maturity date to allow time to liquidate the property. In response to the borrower's financial difficulties, the creditor grants a three-month extension of the loan maturity date. At the time that this extension was granted, the borrower had not yet identified a buyer for the collateral. The restructuring results in a delay in payment that is **not insignificant**. Although the delay in the timing of the payment is insignificant relative to the frequency of payments due, the loan's original contractual maturity, and the loan's original expected duration, the creditor expects a significant shortfall in cash flows relative to the contractual amount due when the

property is sold because the property is the sole source of repayment. (ASU No. 2011-02, April 2011).

TDRs – ASU Example 2

Slide 10

The next example from the ASU demonstrates a restructuring that results in only a delay in payment that is insignificant, which is not a concession. A borrower obtains a 30-year mortgage loan that requires monthly principal and interest payments. In year 4, the borrower experiences financial difficulties and misses two payments. On the basis of the borrower's financial hardship, the borrower and the creditor agree on a forbearance arrangement and repayment plan. Under the terms of the forbearance arrangement and repayment plan, the creditor agrees not to take any foreclosure action if the borrower increases the next four monthly payments such that each payment includes one fourth of the delinquent amount plus interest. The agreement does not result in the creditor charging the borrower interest on past due interest. At the end of the forbearance arrangement, the borrower will have repaid all past due amounts, be considered current in relation to the loan's original terms, and have resumed making monthly payments set out under the loan's original terms. This restructuring results in a delay in payment that is **insignificant**. At the time of the forbearance arrangement, the creditor expects to collect all amounts due for the periods of delay. Furthermore, the length of delay resulting from the forbearance arrangement is considered **insignificant** in relation to the frequency of payments due, the loan's original contractual maturity, and the loan's original expected duration (ASU No. 2011-02, April 2011).

TDRs – ASU Example 3

Slide 11

In the final ASU example, a restructuring results in only a delay in payment that is **insignificant**, which is not a concession. A commercial borrower has a revolving line of credit with an original term of five years. The terms of the line require interest payments every 90 days on the average daily balance of the line. As the line of credit nears maturity, the borrower and creditor begin renegotiating the terms of a new line of credit. The borrower experiences a temporary cash shortfall due to a delay in collections from two key customers and is unable to make the final interest payment before the two parties finish renegotiating the terms of the new line of credit. The terms of the renegotiated line of credit are expected to be similar to the current line of credit, which are comparable to terms available to borrowers with similar risk characteristics. The creditor expects the borrower to recover quickly from this temporary cash flow shortage. Accordingly, the creditor extends a 3-month payment deferral by adding the missed interest payment to the balance of the line and requiring the borrower to make the first interest payment 90 days after the new line of credit is finalized, or 180 days after the due date of the missed interest payment. This restructuring results in a delay in payment that is **insignificant**. Although the borrower is unable to make the contractual payment at the time it is due, thereby resulting in the three-month deferral, the creditor still expects to collect all amounts due, including interest at the contractual rate. Furthermore, the delay in timing of payment represents only one payment cycle under the terms of the line, which is insignificant relative to the frequency of payments due, the line's original contractual maturity, and the line's original expected duration (ASU No. 2011-02, April 2011).

TDRs - Impairment

Slide 12

Slide 12 looks at the relevant guidance for allocating to the allowance for loan losses. All held for investment loans whose terms have been modified in a troubled debt restructuring, including both commercial and retail loans, must be evaluated for impairment under ASC Topic 310, Receivables, formerly FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan." This guidance applies even if the loan is otherwise scoped out of ASC Topic 310/FAS 114 as in the case of residential mortgages and smaller-balance homogeneous loans that are collectively evaluated for impairment. Accordingly, an institution should measure any loss on the restructuring in accordance with the guidance concerning impaired loans set forth in the Call Report Glossary entry for "loan impairment." Under ASC Topic 310, when measuring impairment on a restructured troubled loan using the present value of expected future cash flows method, the cash flows should be discounted at the effective interest rate of the original loan, that is before the restructuring. For a residential mortgage loan with a "teaser" or starter rate that is less than the loan's fully indexed rate, the starter rate is not the original effective interest rate. ASC Topic 310 also permits an institution to aggregate impaired loans that have risk characteristics in common with other impaired loans, such as modified residential mortgage loans that represent TDRs, and use historical statistics along with a composite effective interest rate as a means of measuring the impairment of these loans. (Call Report Glossary, "TDRs").

One question that is often raised is: Once an institution has determined that a loan is a TDR, and can quantify the amount of impairment, is it appropriate to keep the loan on the books at the existing amount and establish a specific allocation in the ALLL for the impairment? The answer is generally yes; however, the amount of the ASC Topic 310/FAS 114 allocation may change over time depending on the impairment measurement at each reporting date. If the loan is collateral dependent and there is a collateral shortfall that represents a confirmed loss, then this shortfall would need to be charged off in accordance with the 2006 Interagency Policy Statement on the Allowance.

Slide 13

An institution may choose the appropriate ASC Topic 310 measurement method on a loan-by-loan basis for an individually impaired loan, except for an impaired collateral dependent loan. For Call Report purposes, impairment of a collateral dependent loan must be measured using the fair value of collateral method. 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. A creditor should consider estimated costs to sell, on a discounted basis, in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan. In general, any portion of the recorded investment in an impaired collateral dependent loan, including recorded accrued interest, net deferred loan fees or costs, and unamortized premium or discount, in excess of the fair value of the collateral that can be identified as uncollectible should be promptly charged off against the allowance for loan losses. (Call Report Glossary, “ALLL” and “Loan Impairment”).

Slide 13 considers collateral dependent loans. According to ASC Topic 310, if a creditor uses the fair value of the collateral to measure impairment of a collateral-dependent loan and repayment or satisfaction of the loan is dependent only on the operation, rather than the sale, of the collateral, the measure of impairment shall not incorporate estimated costs to sell the collateral.

Example

Slide 14

Slides 14 and 15 demonstrate an example of measuring impairment on a TDR. This scenario is discussed in the OCC's Bank Accounting Advisory which sets up the following scenario: Borrower "A" cannot service a \$100,000 loan from the institution. The loan is secured and bears interest at 10%, which is also the current market rate. The loan is restructured, with interest-only payments of 5% required for two years and a final payment of \$105,000 which represents principal plus interest at 5%. The final payment is required at the end of the third year. The institution can reasonably expect Borrower "A" to pay in accordance with these restructured terms as evidenced by supporting documentation in the loan file.

This restructuring is deemed to be a TDR. The present value of the expected payments under the restructured terms, discounted at 10%, which is the original loan interest rate, totals \$87,500. The loan is neither collateral dependent nor readily marketable.

This modification of terms should be accounted for in accordance with ASC Topic 310, which requires that impairment be measured based on the present value of the expected future cash flows, discounted at the effective interest rate in the original loan agreement. If the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recognized through a valuation allowance. Accordingly, in this example, the difference between the present value of the expected restructured payments discounted at the loan's original rate of interest, which is, \$87,500, and the recorded value of the loan, which is, \$100,000 is recognized through a valuation allowance. In other words, the difference of \$12,500 is allocated for this restructured loan and is part of the ASC Topic 310/FAS 114 component of the overall allowance for loan losses.

Slide 15

The chart on the next slide depicts how an excel spreadsheet might be used to calculate the present value of discounted cashflows. Note that the cashflows in periods 1, 2, and 3 reflect the expected interest payments at 5% while the discount rate applied is the 10% original note rate as required by ASC Topic 310/FAS 114.

Now I will turn the presentation over to Regional Accountant George Herger who will address accrual status and call reporting.

TDRs - Accrual Status

Slide 16

FFIEC Consolidated Reports of Condition and Income Instructions, Glossary pages A-59 to A-61 (9-10)

Incorrect accrual accounting and impairment measurement may overstate net income or postpone loss recognition.

GAAP is not specific as to accrual of interest income.

The Call report Instructions provide detailed, specific standards for accrual which are in the range of generally accepted accounting principles.

General principle, a loan should be in nonaccrual when collectability is in doubt.

“General rule -- Banks shall not accrue interest, amortize deferred net loan fees or costs, or accrete discount on any asset

(1) which is maintained on a cash basis because of deterioration in the financial condition of the borrower,

(2) for **which payment in full of principal or interest is not expected,**

or (3) upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection.”

One-to-four family residential loans are exempted from (3) of the general nonaccrual rule. However, management needs to have in place a reasonable nonaccrual standard that ensures that net income is not materially overstated.

The federal bank regulators define six months as the standard period of sustained performance.

The October 30, 2009, Policy Statement on Prudent Commercial Real Estate Loan Workouts provides excellent guidance, including an illustration of how a two-note restructure may allow return to interest income accrual for a portion of a troubled debt restructure. We will discuss this in detail.

TDRs - Nonaccrual Income Recognition

Slide 17

FFIEC Consolidated Reports of Condition and Income Instructions, Glossary pages A-59 to A-61 (9-10):

Principal, when it is probable, i.e., more likely than not, principal is uncollectable = no interest income recognition.

Payments will be applied to principal until that balance is reduced to amount probable to be collected.

The standard is when there is doubt regarding collectability of principal, no interest income recognized.

Before interest income is recorded management should determine (well-documented analysis) that the remaining recorded investment is fully collectible. If so, you may recognize interest income for a nonaccrual loan on cash basis as payments are received.

When it is probable (more likely than not) that the entire principal balance is not collectable, payments received on nonaccrual loans should be applied to reduce principal to an amount that is probable to be collected. As long as there is doubt as to the collectability of the principal balance, no interest income should be recognized.

There may be cases where payments are received on nonaccrual loans where it is appropriate to recognize interest revenue when received, not when accrued. Then, the bank needs to have determined (be reasonably assured) that the principal balance will be collected.

Restoration to Accrual

Slide 18

General Rule (Call report Instructions Glossary pages A-61 and A-62 (9-10)):

All P & I due has been paid, OR

Becomes well-secured and in process of repayment – strict tests.

Do not reverse payments applied to reduce recorded investment while nonaccrual status.

Slide 19

Exceptions to general rule:

1. Asset was formally restructured and qualifies for accrual;
 2. Asset was an impaired loan or debt security and accounted for under ASDC Topic 310-30 (SOP 03-3);
 3. Asset acquired under AICPA PB 6 and meets the criteria therein for amortization;
- OR**
4. Borrower resumed payments and the full amount of contractual P & I payments, even though not brought fully current, provided two criteria are met: a) All P & I payments due are reasonably assured of repayment; **AND** b) there is a sustained period of repayment performance (six months) at the contractual terms

Even when meets criteria a) and b) and accruing interest, the loan should be reported as delinquent and accruing in RC-N.

Slide 20

October 30, 2009 Interagency Guidance on Prudent Commercial Loan Workouts gives the following on page 10.

A. Implications for Interest Accrual

Restructured loan not in nonaccrual status, management needs to consider whether loan should be in nonaccrual status to ensure that income is not materially overstated.

Restructured loan, reasonably assured of repayment and of performance according to prudent modified terms need not be in nonaccrual status, supported by a current, well-documented credit assessment of the borrower's financial condition and prospects for repayment under the revised terms.

Otherwise, the restructured loan must remain in nonaccrual status.

Must include repayment performance for a reasonable period, six months (payments received prior to the restructure date may be taken into account), prior to the date of return to accrual status.

This does not relieve the bank from promptly charging off identified losses.

Slide 21

Two notes: first note monthly payments amortize at a market rate of interest that provides for the incremental credit risk. Second note remaining principal balance with below-market interest-only loan that is scheduled to reset in five years to an amortizing payment

was charged-off - lack of repayment capacity. Now, reasonable collateral protection for the remaining on-book loan.

Since the restructuring, the borrower has made payments on both loans for more than six consecutive months.

Accrual for the on-book loan is appropriate. Interest payments for the charge-off note recorded as recoveries - full recovery of principal and interest is not reasonably assured.

Slide 22

When a nonaccrual loan is returned to accruing status, management may not reverse the previous application of interest payments that reduced principal

The correct accounting is to apply an effective interest rate method at a implied interest rate which will amortize the remaining balance and recognize appropriate interest income over the remaining term of the loan.

From OCC Accounting Advisory Series: an effective interest method would be appropriate for nonaccrual loans that have returned to accruing status.

This will result in accreting the amount of interest applied to principal over the remaining term of the loan

Slide 23/24

ADD Any comments on A/B Note slides?

TDR - Documentation

Slide 25

ADD any comments on Documentation? – from internal TDR Q&A:

3. Should banks have accounting policies and procedures for loan modifications?

Yes. Banks should establish accounting policies and procedures for assessing the accounting consequences of loan modifications that include determining whether the loan modification meets the definition of a troubled debt restructuring under FAS 15.

TDR Regulatory Reporting

Slide 26

GAAP – once a TDR always a TDR.

If a TDR (for example, because of a modification that includes a reduction in principal) is in compliance with its modified terms and yields a market interest rate, the TDR need not be reported in Schedule RC-C, part I, Memorandum item 1 as a TDR in calendar years after the year in which the restructure occurred.

For Call Report, until a TDR is paid in full or otherwise settled, sold, or charged off, the loan must be reported in the appropriate loan category in Schedule RC-C, part I, items 1 through 9, and in the appropriate loan category in:

Schedule RC-C, “Loans and Leases” Part I, Memorandum item 1, if it is in compliance with its modified terms, or

Schedule RC-N, “Past Due and Nonaccrual Loans, Leases, and Other Assets”, Memorandum item 1, if it is not in compliance with its modified terms.

However, a loan that is a TDR (for example, because of a modification that includes a reduction in principal) that yields a market interest rate at the time of restructuring and is in compliance with its modified terms need not continue to be reported as a TDR in Schedule RC-C, part I, Memorandum item 1, in calendar years after the year in which the restructuring took place. To be considered in compliance with its modified terms, a loan that is a TDR must not be in nonaccrual status and must be current or less than 30 days past due on its contractual principal and interest payments under the modified repayment terms.

For further information, see the Glossary entry for "Troubled Debt Restructurings" pages A-85 to A-86(9-10) and the instructions for Schedules RC-C, part I, and RC-N.

Illustration of Modification of terms (not collateral dependent) borrower is experiencing financial difficulty and a concession (that would not otherwise be considered) is agreed: The recorded investment in the loan is \$10,500 (\$10,000 principal and \$500 accrued interest assuming no net deferred fees or costs, or unamortized premium or discount). The parties agree on a restructuring in which total future cash payments, principal and interest, total \$8,000. The present value of these payments is \$7,500. Under GAAP, the creditor recognizes a \$3,000 loss (\$10,500 - \$7,500). (Miller 2011 GAAP Guide, page 46.07)

ADD A SLIDE FOR ORE OR ADDRESS AS Q&A?

ORE

Accounting for ORE, see "Foreclosed Assets" in the Call Report Instructions Glossary, is set forth in ASC Subtopic 310-40 "Receivables – Troubled Debt Restructurings by Creditors" (formerly FAS 15 "Accounting by Debtors and Creditors for Troubled Debt Restructurings") and ASC Topic 360, "Property, Plant, and Equipment" (formerly FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets").

ORE would be recorded at fair value, “as-is”, less cost to sell.

Generally, any amounts (insurance, legal fees, maintenance, taxes, etc.) would be expensed in “other noninterest expense.”

In unusual cases, where it is reasonably justified by documented analysis, increases in fair value construction costs may be capitalized if they reasonably add to the ORE fair value. However, I think the capitalization amount would not be dollar-for-dollar increase to the ORE carrying value, but would be factored as a reduction in the completion costs when calculating the DCF of the net expected proceeds on the property.

Closing Remarks

That concludes our presentation for today. We wish to thank all of you for your participation.