Via E-Mail (*comments@fdic.gov*)

October 3, 2022

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments RIN 3064–ZA33
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Mr. Sheesley:

Thank you for the opportunity to comment on the proposed updated Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts, which was published for comment in the *Federal Register* by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency, and the National Credit Union Administration (collectively, the agencies) on August 2, 2022. If finalized, the proposed updated policy statement would supersede the Policy Statement on Prudent Commercial Real Estate Loan Workouts, which was issued by the Federal Financial Institutions Examination Council in 2009 and adopted by the FDIC and each of the other financial regulators.

My comments are focused on the discussion of multiple note (A/B Note) restructurings in Section V.D, Classification and Accrual Treatment of Restructured Loans With a Partial Charge-Off, and Appendix 1, Example B, Scenario 3, of the proposed updated policy statement. My understanding is that some banks have not in the past properly structured their multiple note restructurings of collateral-dependent commercial real estate loans, which resulted in A Notes being written in amounts far less than the fair value of the real estate collateral. This also resulted in B Notes being written (and then charged off) in amounts much greater than both the collateral shortfall on the loan being restructured and the impairment amount measured under then applicable U.S. generally accepted accounting principles. In this regard, I would note that the discussion of multiple note restructurings in the "Restoration to accrual status" section of the Glossary entry for "Nonaccrual Status" in the instructions for the Consolidated Reports of Condition and Income (Call Report)[1] includes the following sentence addressing the size of an A Note: "For a troubled debt restructuring of a collateral-dependent loan involving a multiple note structure, the amount of the 'A' note should be determined using the fair value of the collateral."

Appendix 1, Example B, Scenario 3

Example B of Appendix 1 of the proposed updated policy statement addresses a loan for the construction of a shopping mall. In Scenario 3, the size of the A Note matches the "as is" market

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[1] See page A-95 of the instructions for the FFIEC 031-FFIEC 041 Call Reports (most recent update June 2022) and page A-78 of the instructions for the FFIEC 051 Call Report (most recent updated June 2022).

value of the real estate collateral based on a recent appraisal and the size of the B Note represents the excess of the loan balance over the market value of the collateral (which, presumably, also was its fair value, which is relevant for accounting purposes). This is an appropriate clarification of the version of Scenario 3 included in the 2009 policy statement, the wording of which may have contributed to some improperly structured multiple note restructurings.

Nevertheless, in my opinion, the order in which the sentences in the second paragraph of Scenario 3 are written in the proposed updated policy statement is awkward and, as a consequence, the sentences do not flow properly. More specifically, the fourth sentence of this paragraph says, “The lender then charged off the $3 million note due to the project’s lack of repayment capacity and to provide reasonable collateral protection for the remaining on-book loan of $7 million.” However, the creation and existence of the $3 million note, which is the B Note in this scenario, has not been mentioned in the three preceding sentences of the second paragraph (or in the first paragraph). In addition, it would be helpful to readers of Scenario 3 to explicitly indicate that the original $10 million debt is collateral dependent because that helps support the reason for the $3 million charge-off of the B Note. I would recommend that the agencies revise the second paragraph of Scenario 3 to read as follows:

> At the original loan’s maturity, the lender restructured the $10 million debt, which is a collateral-dependent loan, into two notes. The lender placed the first note … based on the shopping mall’s projected net operating income. For the second note (*i.e.*, the Note B), the lender placed the remaining $3 million, which represents the excess of the $10 million debt over the $7 million market value of the shopping mall, into a 2 percent interest-only loan that resets in five years into an amortizing payment. The lender then charged off the $3 million note due to the project’s lack of repayment capacity and to provide reasonable collateral protection for the remaining on-book loan of $7 million. Since the restructuring, the borrower … under the new terms.

The final sentence of the first paragraph of Scenario 3 refers to a “recent appraisal on the shopping mall.” The third paragraph of Section IV.C, Supervisory Assessment of Collateral Values, of the proposed updated policy statement states, in part:

> CRE loans in workout arrangements consider current project plans and market conditions in a new or updated appraisal or evaluation, as appropriate. In determining whether to obtain a new appraisal or evaluation, a prudent financial institution considers whether there has been material deterioration in the following factors: … A new appraisal may not be necessary when an evaluation prepared by the financial institution appropriately updates the original appraisal assumptions to reflect current market conditions and provides a reasonable estimate of the collateral’s fair value.

However, it is not clear from Scenario 3 what the age of the “recent appraisal” is, whether the appraisal assumptions underlying this appraisal continue to reflect current market conditions at the restructuring date, and whether the lender considered the need to obtain a new appraisal or evaluation. To clarify the appropriateness of the lender’s use of the recent appraisal in

determining the proper amounts for the A and B Notes in this scenario's multiple note restructuring, I would recommend the addition of a new final sentence at the end of the first paragraph of Scenario 3 that would align with the language from Section IV.C. and would read as follows: "The lender determined at the maturity of the $10 million loan that the appraisal assumptions in the recent appraisal continue to reflect current market conditions and that the $7 million market value reasonably estimates the fair value of the shopping mall."

Section V.D, Classification and Accrual Treatment of Restructured Loans With a Partial Charge-Off

The second paragraph of Section V.D. of the proposed updated policy statement, which discusses multiple note restructurings, states in the final sentence, "The portion of the debt that is not reasonably assured of repayment (*i.e.*, Note B) must be adversely classified and charged-off." The "not reasonably assured of repayment" phrase was also included in the corresponding paragraph of the 2009 policy statement. This phrase may have been meant to complement the paragraph's statement that Note A "is reasonably assured of repayment." However, the June 1993 Revised Interagency Guidance on Returning Certain Nonaccrual Loans to Accrual Status,[2] which was the original source of guidance on A/B Note restructurings, and the "Restoration to accrual status" section of the Call Report Glossary entry for "Nonaccrual Status," both describe the B Note by saying instead it "is unlikely to be collected." With its use of the word "unlikely," I would consider this phrase to be a stronger statement about the note's lack of collectability than "not reasonably assured of repayment." Because the B Note must be charged off, the phrase "unlikely to be collected" also better aligns with the phrase "Assets classified loss are considered uncollectible" in the definition of a Loss classification cited in Appendix 4 of the proposed updated policy statement and Attachment 4 of the 2009 policy statement than the phrase "not reasonably assured of repayment." Furthermore, the final sentence of the second paragraph does not state which adverse classification should be applied to the B Note even though the sentence goes on to require that the B Note be charged off.

Therefore, I would recommend that the agencies strengthen the final sentence of the second paragraph of Section V.D. of the proposed updated policy statement by revising it to state the following: "The portion of the debt that is unlikely to be collected and therefore is deemed uncollectible (*i.e.*, Note B) should be adversely classified 'loss' and must be charged off."

In addition, for greater clarity and the avoidance of any doubt regarding the appropriate size of the A Note, I would further recommend that the agencies add a new sentence after the second sentence in the second paragraph of Section V.D. that would align with the sentence cited above from the "Restoration to accrual status" section of the Call Report Glossary entry for "Nonaccrual Status." This recommended new sentence should state the following: "When restructuring a troubled collateral-dependent loan using a multiple note structure, the amount of Note A should be determined using the fair value of the collateral."

[2] The June 1993 revised interagency guidance, which was issued jointly by the FDIC and other federal financial regulators, is available at https://fraser.stlouisfed.org/files/docs/historical/frbdal/circulars/frbdallas_circ_19930709_no93-071.pdf .

Conclusion

Your consideration of my comments and recommendations would be appreciated. Please feel free to contact me if you would like to further discuss my comments and recommendations. Thank you.

Sincerely,

Robert F. Storch