BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 00-8 (SUP)
June 12, 2000

TO THE OFFICER IN CHARGE OF SUPERVISION AND APPROPRIATE SUPERVISORY AND EXAMINATION STAFF AT EACH FEDERAL RESERVE BANK AND TO EACH DOMESTIC AND FOREIGN BANKING ORGANIZATION SUPERVISED BY THE FEDERAL RESERVE

SUBJECT: Revised Uniform Retail Credit Classification and Account Management Policy

The Federal Financial Institutions Examination Council has issued a revised Uniform Retail Credit Classification and Account Management Policy (revised policy) that supersedes the policy issued on February 10, 1999 (February 1999 policy). The February 1999 policy updated and expanded the classification policy for retail credit loans that was issued in 1980.[1] The revised policy contains several noteworthy changes and clarifications to the February 1999 policy, including the following:

- The explicit limitation on the number and frequency of extensions, deferrals, rewrites, and renewals of closed-end loans is replaced with language that stresses the need for institutions to adopt and adhere to prudential internal standards regarding these practices. In addition, institutions should establish and maintain comprehensive and effective risk management, reporting, and internal controls to support the collection process and ensure the timely recognition of losses. The once-in-twelve-months/twice-in-five years limitations on re-ages of open-end loans is retained.[2]

- Open-end accounts that enter a debt counseling/workout program may be re-aged after receipt of at least three consecutive minimum monthly payments, or the equivalent cumulative amount. This re-aging is limited to once in a five-year period, and is in addition to the once-in-twelve-months/twice-in-five-years limitation for other open-end loans.

- For loans that are secured by residential real estate, a current assessment of value should be made no later than 180 days past the contractual due date. Any outstanding loan balance in excess of the value of the property, less cost to sell, should be classified Loss and charged off.

- Clarification that loans with collateral that are due to be charged off under the policy may be written down to the value of the collateral, less cost to sell, rather than being charged off in their entirety.

- Clarification that payments received after the applicable charge-off threshold, but before the end of the month in which the charge-off threshold is triggered, may be considered in determining whether a charge off remains appropriate.

While the revised policy, by its terms, applies only to depository institutions, the Federal Reserve believes the guidance it contains is broadly applicable to bank holding companies. Accordingly, examiners should apply the policy, as appropriate, in the inspection of consumer finance subsidiaries of bank holding companies.

In reviewing consumer finance subsidiaries of banking organizations, examiners should consider the methodology used for aging retail loans. In accordance with the Call Report instructions, banks and their consumer finance subsidiaries are required to use the contractual method, which ages loans based on the status of contractual payments. Bank holding companies, in preparing their financial statements, are permitted to use the range of options available under GAAP. This, in effect, allows uninsured, nonbank financial affiliates of holding companies to employ the recency method, which ages loans according to the date of the most recent payment, regardless of the contractual terms of the loan. In general, the contractual method provides a more accurate reflection of loan performance and, therefore, is the preferred methodology, especially from the standpoint of financial statement transparency and public disclosure.

Accordingly, examiners should encourage bank holding companies and their consumer finance subsidiaries to use the contractual method. Bank holding companies should not change their aging methodology from contractual to recency without the prior concurrence of the Federal Reserve. A bank holding company will not be permitted to change its methodology if the intent or effect of such a change is to mask asset quality or financial weaknesses, and, in the event that consumer receivables are transferred from the bank to the holding company, the holding company should continue to age the receivables according to the contractual method. In those cases where a bank holding company uses the recency method, it should have adequate controls in place to accurately track the performance of loans within the retail portfolio and demonstrate sound and compelling business reasons for the use of this method. Examiners should also refer to the Bank Holding Company Supervision Manual (Section 3100) for further guidance on the review of consumer finance operations.

Questions pertaining to this letter should be directed to Dave Adkins, Supervisory Financial Analyst, (202) 452-5259 or Anna Lee Hewko, Financial Analyst, (202) 530-6260.

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Director

Attachment (36K PDF)

Supersedes: SR letter 99-5

Notes:

1. The February 1999 policy was to be effective as of June 30, 1999, for manual adjustments to an institution's policies and procedures, and December 31, 2000, for changes involving programming resources. However, on November 23, 1999, the FFIEC extended the implementation date for manual changes to December 31, 2000. Return to text

2. Re-agings of open-end loans that occur prior to the December 31, 2000, implementation date do not count toward the once-in-twelve-months/twice-in-five-years limitation. However, examiners should review an institution's record of re-agings to ensure that the use of this practice was not excessive prior to the implementation date. Return to text