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AMID ECONOMIC CHALLENGES, BANK REGULATORS ISSUE FINAL POLICY STATEMENT ADDRESSING DISTRESSED COMMERCIAL LOAN WORKOUTS

On June 29, 2023, the Office of the Comptroller of Currency, Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration, in consultation with state bank and credit union regulators, issued their Final Policy Statement on Prudent Commercial Loan Accommodations and Workouts (Policy Statement), updating and reaffirming principles from the Oct. 30, 2009 Policy Statement on Prudent Commercial Real Estate Loan Workouts (2009 Statement). In general, the Policy Statement provides "a broad set of risk management principles relevant to CRE loan accommodations and workouts in all business cycles, particularly in challenging economic environments." The Policy Statement is a particularly helpful resource for financial institutions and their legal counsel seeking to understand "the approach examiners will use to review CRE loan accommodation and workout arrangements."

The Policy Statement is largely consistent with the 2009 Statement and reiterates two fundamental principles: (1) financial institutions that implement prudent commercial real estate (CRE) loan accommodation and workout arrangements after performing a comprehensive review of a borrower's financial condition will not be subject to criticism for engaging in these efforts, even if these arrangements result in modified loans with weaknesses that result in adverse classification; and (2) modified loans to borrowers who have the ability to repay their debts according to reasonable terms will not be subject to adverse classification solely as a result of a decline in the value of the underlying collateral to an amount that is less than the outstanding loan balance.

Turning to the substance of best practices, the Policy Statement endorses the

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use of short-term, less complex loan accommodations as a prudent means for financial institutions to work with and mitigate adverse circumstances affecting borrowers experiencing an onset of financial stress. Such short-term accommodations are "often in the best interest of financial institutions and their borrowers" but must be consistent with applicable laws, regulations and prudent risk management practices.

The Policy Statement also addresses circumstances in which such short-term accommodations are insufficient. Formal loan workout programs should be carefully crafted to bolster financial institutions' risk management practices as they relate to longer-term or more complex loan arrangements. Examiners' reviews of the effectiveness of such practices will focus on, among other things: whether the financial institutions' workout policy establishes appropriate loan terms that permit reasonable adjustments to the workout plan if the plan proves to be unsustainable; the effectiveness of management infrastructures that monitor the performance, volume and complexity of loan workout activities; and loan documentation standards that promote institutions' ability to verify borrowers' creditworthiness.

The Policy Statement makes clear that the primary focus of an examiner's review of a CRE loan, including binding commitments, "is an assessment of the borrower's ability to repay the loan. The major factors that influence this analysis are the borrower's willingness and ability to repay the loan under reasonable terms and the cash flow potential of the underlying collateral or business."

In addition to detailing certain changes in accounting principles since 2009, including those in connection with current expected credit losses methodology from 2016 (which replaced the Allowance for Loan and Lease Losses accounting standard), the Policy Statement contains updated CRE loan workout examples. Such examples are specific to income-producing properties; hotel, acquisition, development and construction loans; and residential and multifamily property financings, which "are intended to illustrate the application of existing rules, regulatory reporting instructions, and supervisory guidance on credit classifications and the determination of nonaccrual status."

Click here for a copy of the final Policy Statement.

Armstrong Teasdale's Debt Finance and Restructuring, Insolvency and Bankruptcy teams are composed of multidisciplinary lawyers who regularly advise financial institutions on the documentation and structuring of loan facilities and the restructuring of debt in distressed situations. For additional guidance specific to your institution, please contact one of the authors listed below or your regular Armstrong Teasdale lawyer.

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