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National Association of Federally-Insured Credit Unions

February 1, 2021

Ms. Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Capitalization of Interest in Connection with Loan Workouts and Modifications (RIN 3133-AF30)

Dear Ms. Conyers-Ausbrooks:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the National Credit Union Administration's (NCUA) proposed rule to remove the prohibition on the capitalization of interest under Appendix B to Part 741. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve nearly 123 million consumers with personal and small business financial service products. NAFCU supports the proposed changes and thanks the NCUA for moving forward with this rulemaking as it will provide relief for both credit unions and their members while the impacts of the COVID-19 pandemic endure. The benefits of this new rule would far outweigh any risks to credit union members as the documentation and consumer protection guardrails currently in Appendix B and those that would be added by this rule are sufficient to ensure any efforts to capitalize interest are mutually beneficial for the borrower and the credit union. With respect to federal credit unions (FCUs), the NCUA should reconcile the proposed rule's requirement to comply with state consumer protection laws with the agency's federal preemption regulations.

General Comments

As NAFCU has outlined in several letters, including a letter dated March 26, 2020 and another letter dated September 1, 2020, credit unions support removing the prohibition on the capitalization of interest in Appendix B to Part 741 for several reasons. Above all else, credit unions are eager to provide their members with options if the members are unable to meet their loan payment obligations due to the effects of the COVID-19 pandemic, but the current prohibition on the capitalization of interest limits those options. The prohibition on capitalizing interest also does not align with Generally Accepted Accounting Principles (GAAP), the practices of government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, and the rules for banks issued by the other banking regulators.

Moreover, as credit union members continue to struggle with the economic challenges posed by the pandemic and are unable to resume normal payments on their loans, credit unions will likely see an increase in the number of loan modifications and troubled debt restructurings (TDRs). This

remains true even though the *Consolidated Appropriations Act, 2021* extended the provision in the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) allowing for the suspension of GAAP on loan modifications that would otherwise be categorized as TDRs. To best assist members, credit unions should have more available tools to offer a streamlined modification option that protects the member and provides benefits to the credit union.

As NAFCU has noted previously, the current loan modification options that do not capitalize interest are often unworkable and can cause unnecessary hardship and confusion for borrowers and pose operational challenges for credit unions. A credit union may (1) attempt to capture the deferred interest first as a borrower resumes making payments; (2) require the borrower to pay deferred interest up front or on a shortened term (such as over the course of 12, 24, or 36 months); (3) create a balloon payment at maturity of the loan; (4) extend the loan by roughly the number of payments deferred by the borrower; (5) bifurcate the loan to create a separate non-interest-bearing loan for the deferred interest with the same term as the original or modified loan; and (6) forgive the interest owed by the borrower. These options are often not appropriate for all borrowers, creating confusion, leading to an unfavorable member experience, increasing the total required payoff amount, potentially necessitating an additional modification for the borrower, and adding operational burdens on the credit union.

For many members, a far simpler solution is to permit credit unions to capitalize the interest accrued during the forbearance period, adding it to the principal loan amount, and re-amortizing the loan once the borrower exits forbearance and resumes regular payments. The payment differential between the current options and the capitalization of interest option is generally going to be small when amortized over the remaining life of the average mortgage loan. NAFCU appreciates that the NCUA Board recognized the difficulties and impracticality of the options outlined above for many members and is adopting a more flexible approach by modifying its May 2012 final rule on loan workout policies and monitoring requirements for all federally-insured credit unions (FICUs) to remove the prohibition on capitalizing interest. NAFCU generally supports the proposed guardrails and urges the NCUA to quickly finalize this rule to offer relief in the form of a streamlined modification option for both borrowers and credit unions.

In ultimately implementing this rule, NCUA examiners should not retroactively apply the current prohibitions on the capitalization of interest when evaluating loans modified before finalization of this rule. In the interest of fairness, if a credit union had been capitalizing interest on its mortgage loans or commercial or business loans without receiving a finding or document of resolution from its examiners, examiners should not take such corrective action for these practices once the rule is finalized. Exam consistency and the lack of transparency about the processes and procedures deployed during examinations continue to be points of frustration for NAFCU's members and the implementation of this rule should not add to those issues.

Additional Documentation and Policy Requirements for Appendix B

NAFCU's member credit unions generally agree that the NCUA is appropriately pursuing this rulemaking. The additional requirements for credit union loan modification policies that permit the capitalization of interest are reasonable as they outline important written policies and good

practices that explain how and why the credit union is capitalizing interest on a loan. However, as credit unions are working to assist members in need, NCUA examiners should be careful not to substitute their own standards for the required documentation of a borrower's ability to repay, source(s) of repayment, and other information. Instead, examiners should only evaluate whether the credit union is obtaining the necessary information from its member-borrowers in a consistent and coherent fashion. Examiners should defer to the credit union's evaluation of a borrower's creditworthiness for a loan modification with capitalization of interest so long as they are meeting the requirements of their internal written policy, in accordance with the additions to proposed Appendix B, Federal law, and state law, if applicable.

NAFCU's member credit unions report that it is often a difficult guessing game to ascertain which loan modifications will lead to positive results and which will ultimately become uncollectible. Nonetheless, the credit union knows its members best and those members may have unique circumstances depending on the credit union's field of membership. Credit unions are all working to provide their members with the individualized attention and service they require; for example, a member may have an emergency pop up and be unable to make payments on their mortgage loan because it is their largest single expense, then they get behind on payments and have a difficult time getting caught up. Other members may have used Federal forbearance options to cover short-term income lapses due to job loss in the leisure and hospitality industry, which has been particularly impacted by the COVID-19 pandemic. Each member's situation is different, and the credit union and the borrower should have the flexibility to determine the best loan workout option and terms. The NCUA should defer to the credit union's judgment on a modification based on the specific circumstances of the borrower. If a modification with capitalization of interest is in the long-term best interest of the member and the credit union, then NCUA examiners should not second guess that decision.

The guiding principle for a loan modification with capitalization of interest should be that the credit union has a reasonable belief, based on available information, that it will be able to ultimately collect all of the principal and interest due on the loan. The documentation is important but should not be standardized in a way that impedes a credit union's ability to provide a prudent workout option for its members. For example, imposing standards for how to determine ability to repay in the context of the loan modification, with a specific threshold such as a debt-to-income ratio, is inappropriate as it would only hinder credit unions' ability to work with its members to offer the best loan modification option.

A certain degree of flexibility is appropriate in how credit unions meet their own written loan workout policies and how they conduct monitoring and controls of loan workouts. If a credit union is unable to offer a particular loan modification option to a borrower because the standards are difficult to meet, the alternative for that borrower may be foreclosure—a lose-lose situation for the borrower and the credit union. Accordingly, the NCUA and its examiners should refrain from establishing bright line requirements for documentation beyond those in the proposed rule and instead defer to the judgment of the credit union and its understanding of a member-borrower's ability to repay the loan, absent a broader, significant threat to the safety and soundness of the institution.

Additional Advances to Finance Credit Union Fees and Commissions

The proposed rule would continue to prohibit additional advances to finance credit union fees and commissions although certain advances, such as those to cover third party fees to protect loan collateral like force-placed insurance or property taxes, are permitted. Should the NCUA decide to authorize additional advances to finance credit union fees and commissions, appropriate limitations should be put in place to provide consumer protections. NAFCU and its member credit unions do not disagree that this prohibition is an important consumer protection feature because advances for fees and commissions may be perceived as going beyond the scope of attempting to get the member back on track with repaying the loan based on the original terms of the loan agreement. The potential for predatory behavior and risk to the member-borrower may be heightened if the NCUA chooses to permit such advances; however, appropriate limitations and disclosures could neutralize that risk and protect consumers.

Credit unions agree that not just any fee and not just any amount should be eligible to be advanced. The NCUA should adopt a reasonable cap on the percentage of total fees and commissions that may be advanced and consider requiring credit unions who choose to advance such fees to provide a justification as to why the fees and commissions are necessary. Providing such flexibility for additional advances along with limits on the total percentage of fees advanced plus adequate disclosure to the borrower appropriately balances the best interests of the FICU and the member-borrower. To ensure adequate consumer protections, credit unions should be required to provide members with disclosures detailing the amount any fees or commissions in addition to the amount of capitalized interest.

Ultimately, modifications will be judged on whether they are successful, much like the loan at origination, so if it is helpful for the credit union to advance certain fees and/or commissions during the modification, at little to no risk to the borrower, then the NCUA should permit this practice in the final rule. The NCUA should also recognize that state law may permit the advancement of certain fees or commissions during the loan workout or modification and not penalize those state-chartered credit unions who choose to advance those amounts according to their state law. NAFCU supports permitting additional advances to finance credit union fees and commissions only if limitations are put in place to protect consumers and prevent unrestricted advances.

Reconciling Federal Preemption with State Law Requirements

NAFCU requests the NCUA further clarify the proposed rule's broad requirement that all FICUs follow applicable state consumer protection laws that may be more stringent than Federal law regarding the capitalization of interest. FCUs enjoy Federal preemption of many state consumer lending laws under section 701.21(b), promulgated pursuant to section 107(5) of the *Federal Credit Union Act* (FCU Act), which outlines the NCUA's authority to regulate the rates, terms of repayment and other conditions for FCUs loans and lines of credit to members. Section 701.21(b)(1)(ii)(B) states that the terms of repayment includes "the amount, uniformity, and frequency of payments, including the accrual of unpaid interest if payments are insufficient to pay all interest due." Furthermore, section 701.21(b)(3) outlines that the NCUA Board does not intend to preempt certain state laws affecting aspects of credit transactions primarily regulated by other

Federal law, including state laws regarding credit cost disclosure requirements, credit discrimination, credit reporting practices, unfair credit practices, and debt collection practices.

Capitalization of interest fits squarely within the “terms of repayment” category in section 701.21(b)(1)(ii)(B) and, as such, state laws regulating the topic should continue to be preempted for FCUs. Presumably, the proposed rule is referring to compliance with Federal consumer protection laws and regulations and their corresponding state laws and regulations under section 701.21(b)(3). As the capitalization of interest is not regulated by any Federal consumer protection laws, any state laws prohibiting the charging of interest on interest should be preempted for FCUs because they are not an aspect of “credit transactions that are primarily regulated by Federal law other than the [FCU Act].” With the exception of perhaps the terms and requirements for credit cost disclosures to member-borrowers detailing the terms of the loan modification, the amount of capitalized interest, and any fees and commissions (if the prohibition on such fees and commissions is removed), this rule should not interrupt existing Federal preemption of state laws as this could result in significant compliance cost, create operational disruption, and unexpectedly expose FCUs to additional litigation and compliance risk. NAFCU urges the NCUA to reconcile the language in the proposed rule with its federal preemption regulation under section 701.21(b).

Conclusion

Thank you for your attention to this important issue and decision to propose revising Appendix B to Part 741 to permit the capitalization of interest in loan workouts and modifications. NAFCU appreciates the opportunity to comment on this proposed rule and encourages the NCUA to swiftly finalize the rule to provide relief to credit unions and their member-borrowers. If you have any questions, please do not hesitate to contact me at akossachev@nafcu.org or (703) 842-2212.

Sincerely,



Ann C. Kossachev
Director of Regulatory Affairs