

Module: Compliance

Section: Borrower Rights - Restructuring

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Authority and Purpose

Section 4.14A of the Farm Credit Act of 1971 (Act) requires qualified lenders to consider restructuring a loan before initiating foreclosure. As a result, qualified lenders must notify a borrower with a distressed loan of the opportunity to apply for restructuring.

Distressed status is not specifically driven by adverse classification or delinquency. Distressed status should be determined independently, relying primarily on the borrower's lack of financial capacity to repay debt according to terms. The determination of lack of capacity should include a borrower's total financial situation. Therefore, even though the qualified lender's loan is current, a borrower's inability to repay other debts could indicate a distressed status. Conversely, borrowers who maintain the capacity to repay but who choose not to do so do not fit the definition of distressed. In such a situation, institutions should have sufficient documentation supporting the nondistressed determination. The objective of distressed loan restructuring action is to return the borrower's operation to viability; therefore, the loan file must contain documentation that the probability of viability was considered.

The Act and FCA Regulations also provide guidelines for the decision process to be used by qualified lenders when considering a loan for restructuring. If the borrower's restructuring plan is not acceptable, the qualified lender must notify the borrower expeditiously and allow the borrower to request a review of the decision. Examiners should refer to the notification requirements of Federal Reserve Board Regulation 12 CFR § 202.9, which are described in the Consumer Protection - Equal Credit Opportunity section of this module, when assessing institution timeliness for providing notification of denials of restructuring applications.

An institution may not make a loan on the condition that the borrower waive any right provided under the agricultural loan mediation program of any State. In addition, waivers of future restructuring or first refusal rights may not be required of applicants as part of a restructuring negotiation. Such waivers would imply that the applicant was gaining some advantage in the current negotiations not otherwise available when the right to a distressed restructuring is provided by statutory language.

Applicability and Exemptions

Distressed restructuring is only afforded to certain loans made by Farm Credit System (System) lenders. Specifically, the loan must be made to a farmer, rancher, or producer or harvester of aquatic products (regardless of full-time versus part-time status), must be for an agricultural or aquatic purpose or other credit needs of the borrower, and must be made by a qualified lender. These criteria would eliminate from applicability all loans made by Banks for Cooperatives. The criteria would also usually eliminate farm-related business loans and rural housing loans. However, restructuring rights do apply to farm-related business loans and rural housing loans (as defined in FCA Regulations 12 CFR § 613.3050 and § 614.4222, respectively) made to a bona fide farmer, rancher or producer or harvester of aquatic products.

Credit extensions made in connection with an institution's incidental powers to dispose of other property owned (sales contracts, purchase money mortgages, etc.) are not considered "loans" for purposes of an institution's lending authorities, and thus do not meet the applicability criteria. Such credit extensions do not have the normal eligibility requirements applicable to credit extended

under an institution's loan-making authority. However, institution's may opt to grant borrower rights, including restructuring rights on sales contracts and purchase money mortgages, particularly if there are other credit extensions in the form of loans outstanding to the same obligor.

Loans on which distressed restructuring servicing actions (actions which made probable a return to viability) have been initiated can become distressed again at a later date. Another distressed restructuring opportunity is required for such loans. Although unlikely, the same loan or same borrower could have several distressed restructurings over a period of years, all of which complied with regulatory requirements.

Monthly payment installment loans present a special problem. As noted in the Borrower Rights -Protection of Borrowers section of this module, the lender is obligated to accept late payments and halt foreclosure actions if the payment covers all past due amounts, including penalties. When such loans involve repeated delinquencies, several distressed restructuring notifications may be required. System institutions cannot limit the number of distressed restructuring opportunities that are provided to an individual borrower.

Restructuring Process, § 614.4516 and § 614.4519

Notification--When a loan is determined to be distressed, the qualified lender must notify the borrower in writing in a timely manner that the loan may be suitable for restructuring. In addition, FCA Regulation 12 CFR § 614.4519(a) requires lenders to notify borrowers not later than 45 days before commencing foreclosure proceedings that the alternative to restructuring may be foreclosure. If the loan has more than one primary obligor, notification can be provided to any one of the primary obligors. The following materials must accompany either the distressed loan notification or the 45-day letter:

- A copy of the institution's restructuring policy (requirements of the policy are contained under § 4.14A(g) of the Act); and
- All materials necessary for the borrower to submit an application for restructuring.

Restructure Plan--The qualified lender must provide borrowers who have received a notice for restructuring a reasonable opportunity to meet in person with the lender to review the status of the loan, the financial condition of the borrower, and the suitability of the loan for restructuring.

Voluntary Restructuring--A qualified lender may propose a restructuring plan in the absence of an application from the borrower to restructure.

Foreclosure Restriction--No qualified lender may foreclose or continue foreclosure proceedings prior to considering the loan for restructuring and, if applicable, the Credit Review Committee's decision on the appeal. However, a lender may take any action necessary to avoid the dissipation of assets or the destruction, diversion, or deterioration of collateral if the lender has reasonable grounds to believe it has occurred or may occur.

When a lender has reasonable grounds to believe collateral dissipation, diversion, or destruction is occurring even though the loan is paid current, the lender may request additional principal payments or may make other requests of the borrower. These types of borrower actions may also result in a criminal referral.

If the borrower is unwilling or unable to make such payments or to comply with the requested action, the loan would no longer be considered current and FCA Regulation 12 CFR § 614.4514 would no longer prevent foreclosure. Having complied with these steps, the lender may proceed directly to foreclosure without providing a restructuring opportunity.

If the borrower is in default and the lender chooses to retire the borrower's equities, the lender must make additional disclosures in the notice. (Refer to the Borrower Rights - Retirement of

Equities section of this module for further discussion.)

Restructuring Decision, § 614.4517

When a qualified lender receives an application for restructuring, the lender must expeditiously determine whether to restructure the loan. The following must be taken into consideration in making the determination:

- Whether the cost to the lender of restructuring the loan is equal to or less than the cost to foreclose. Relevant factors include:
 - The present value of interest and principal foregone by the lender in carrying out the restructuring plan;
 - Administrative expenses involved in working with the borrower to develop and implement the restructuring plan;
 - Whether the borrower has presented a restructuring plan and cash-flow analysis that take into account income from all sources to be applied to the debt and all assets to be pledged as collateral, showing a reasonable probability that an orderly retirement of debt will occur as a result of the restructuring plan; and
 - Whether the borrower has furnished or is willing to furnish complete and current financial statements as required by the lender.
- Whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations.
- Whether the borrower has the financial capacity and the management skills to protect the collateral from diversion, dissipation, or deterioration.
- Whether the borrower is capable of working out existing financial difficulties, taking into consideration any prior restructurings on the loan, returning the operation to viability, and repaying the loan under the terms of the restructuring.
- Whether restructuring consistent with sound lending practices will reasonably ensure that a distressed loan that is not delinquent will not become a nonaccrual loan.

Least-cost analyses completed by lenders should be representative of the economic and financial circumstances of the institution and the locale. Examiners should evaluate such least-cost analyses for reasonableness and consistency, and should challenge those which are unreasonable, inconsistent, or lack adequate documentation. See the following section for a discussion of the critical assumptions and relevant information that should be evaluated.

Documentation of least-cost analyses is usually less extensive on loans that are restructured since the congressional intent of keeping farm owners on their farms has been met. Nonetheless, prudent lending practices should include completion of the documentation. A lender who repeatedly approves restructuring proposals which are more costly than foreclosure might be jeopardizing the financial health of the institution and could be subject to safety and soundness criticisms. Least-cost analyses **must always** be completed on restructuring applications which are denied on the basis that foreclosure is less costly to the lender.

If the qualified lender determines the potential cost of restructuring is less than or equal to the potential cost of foreclosure, the lender must restructure the loan in accordance with the plan. If more than one restructuring alternative is available, the lender must restructure the loan with the alternative that makes it probable the borrower's operations will become financially viable at the least cost to the lender.

When loans are restructured and principal is charged off, stock is canceled to the same extent up to the value of the stock. **Borrowers, however, are entitled to retain one share to maintain voting privileges.** (Refer to the Borrower Rights-Retirement of Equities section of this module for further discussion.)

Notice of Decision and Right to Review, § 614.4518

The qualified lender shall make a decision on an application to restructure in as expeditious a manner as practicable. Upon reaching a decision, the lender must notify the borrower of its decision in writing by certified mail, or other means that acknowledges receipt of the lender's decision. If the loan has more than one obligor, the notice can be provided to any one of the primary obligors. If an application for restructuring is denied, the notice must include:

- The reason(s) for the denial and any critical assumptions and relevant information upon which the reasons were based, except that any confidential information shall not be disclosed;
- Notification that the borrower may request a review of the decision on either the original restructuring application or a revised version (Such notification would be provided after the lender determines negotiations are complete.);
- Notification that any request for a review must be made in writing within 7 days after receiving the notice; and
- A description of the review process, including the appraisal process and the right to appear before the Credit Review Committee accompanied by counsel or by anyone else the borrower chooses. (Refer to the Borrower Rights - Notice of Action and Review section of this module for a more detailed discussion of the review process.)

The purpose of the denial notice is to provide the applicant with information needed to fully understand the lender's decision. The notice must contain application-specific information, such as cash flows, discount rates, property holding periods, and/or collateral values, so that the applicant can understand why the request was denied or reduced. For example, denials of restructuring applications based on least-cost analyses must inform the borrower of the key assumptions involved in the decision. Such assumptions include, when applicable: (a) appraised value of collateral; (b) estimated holding period required to liquidate the collateral; (c) any assumed income during the holding period; (d) any estimated deficiency judgment (and assumed time period within which it will be collected); and (e) the discount rate used to determine present value of cash flows. If the denial is based on insufficient borrower cash flow, the borrower must be informed of the cash flows necessary as well as any assumptions used to estimate the cash flows. Denials of restructure applications due to nonviability must include any assumptions used by the institution to conclude on nonviability.

The requirement for application-specific information in the denial letter does not include confidential information, such as the identity of comparable properties used in the appraisal or other information that might reveal their identities.

An applicant should be given the opportunity to appeal any denied restructuring proposal as long as it meets the requirements for a completed application as defined in FCA Regulation 12 CFR § 614.4512(a). A restructuring application which proposes a deed-in-lieu of foreclosure or total liquidation plan may, when denied, require Credit Review Committee hearing rights. Normally, the restructuring plan appealed to the Credit Review Committee will be the preliminary restructuring plan included in the original application. However, if the preliminary restructuring plan has been updated through negotiation or counter proposals from the applicant, the applicant may choose to appeal the updated proposal, provided it meets the regulatory definition for an application.

Mediation Programs, § 614.4521

If initiated by a borrower, System institutions must participate and cooperate in good faith in a State mediation program to present and explore debt restructuring proposals. A System institution cannot make a loan on the condition that the borrower waive any right under the agricultural loan mediation program of any State.

Examination Objectives

Determine whether adequate policies, procedures, and internal controls have been established to provide reasonable assurance of compliance with loan restructuring regulations.

Obtain corrective action when violations are identified or when deficiencies in policies, procedures, and internal controls are noted.

Examination Procedures

The following procedures are provided to facilitate an evaluation of an institution's loan restructuring process. Consistent with risk-based examination principles, examiners should add, delete, or modify the procedures as needed based on the particular circumstances of the institution.

1. Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasis should be on identifying violations of law and regulation in other areas (e.g., eligibility, scope of financing, lending limits, etc.); integrating those findings with the examination of consumer protection, borrower rights, and financial reporting; and concluding on management's compliance with laws and regulations.
2. Review and evaluate the adequacy of policies, procedures, and internal controls that are in place to ensure compliance with the disclosure requirements of FCA Regulations 12 CFR §§ 614.4515, 614.4516, 614.4517, 614.4518, and 614.4519.
3. Review a sample of adversely classified and delinquent loans to determine if the qualified lender has properly identified distressed loans per FCA Regulation 12 CFR § 614.4512(d).
4. Review a sample of distressed loans to ensure notifications of possible restructuring were sent and the notifications were complete and timely.
5. Through discussions with institution personnel and a review of distressed loans, determine if:
 - a. The qualified lender has provided an opportunity for the borrower to meet with the lender to discuss restructuring.
 - b. The institution participates and cooperates in good faith with State mediation programs at the request of a borrower.
 - c. The institution requires borrowers to waive their rights for any reason, including participation in State mediation programs, as a condition of granting a loan.
6. Review loans in foreclosure to ensure restructuring was fully considered.
7. Review loans in foreclosure and restructured loans to determine if:
 - a. All the factors required were considered in making the decision to restructure or foreclose and the costs were reasonable and documented.

- b. The decision on a restructuring application was made in an expeditious manner.
- 8. Review loans denied restructuring and loans in foreclosure to ensure notification of the decision was timely.
- 9. Complete workpapers FCA 6060, FCA 6075, and FCA 6080, if necessary, in conjunction with evaluating the requirements of the restructuring regulations.
- 10. Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution personnel to ensure compliance with laws and regulations.
- 11. Conclude whether the institution is adequately complying with FCA Regulations 12 CFR §§ 614.4515, 614.4516, 614.4517, 614.4518, and 614.4519. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.
- 12. Consider the possibility of issuing a borrower rights directive or imposing civil money penalties if significant, repeated, and uncorrected violations are surfaced.
- 13. Discuss tentative conclusions and examination findings with the examiner(s) responsible for evaluating management.
- 14. Discuss items of concern, scope of work performed, and conclusions with the EIC and with the appropriate institution manager. Obtain a response regarding the cause(s) of deficiencies or weaknesses and anticipated corrective actions.
- 15. Organize and compile, if necessary, violations of law and regulation into an appendix for the Report of Examination.
- 16. Prepare a leadsheet or other summary document to provide workpaper support for the work performed and the conclusions reached.