Credit Union National Association
CUNA

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January 26, 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 America's credit unions, I am writing to the National Credit Union Administration (NCUA) in support of the proposed rulemaking on Capitalization of Interest in Connection with Loan Workouts and Modifications. The Credit Union National Association (CUNA) represents America's credit unions and their 120 million members.

Summary of Proposed Rulemaking

In May 2012, the NCUA adopted a rule requiring credit unions to have written policies that address loan workouts and nonaccrual practices.[1] The rule specified in Appendix B to Part 741 that such policies must prohibit a credit union from capitalizing interest.

The NCUA is proposing to remove the prohibition on the capitalization of interest in connection with loan workouts and modifications.[2] The agency has determined that the current prohibition on authorizing additional advances to finance unpaid interest (capitalization of interest) may be overly burdensome and, in some cases, hamper a credit union's good-faith efforts to engage in loan workouts with borrowers facing difficulty because of the economic disruption caused by the COVID-19 pandemic. Advancing interest may avert the need for alternative actions that would be more harmful to borrowers.

The proposed rule would establish documentation requirements to help ensure that the addition of unpaid interest to the principal balance of a mortgage loan does not hinder

[1] 77 Fed. Reg. 31,993 (May 31, 2012).
[2] 85 Fed. Reg. 78,269 (Dec. 4, 2020).

the borrower's ability to become current on the loan. The proposed change would apply to workouts of all types of member loans, including commercial and business loans.

For the reasons discussed below, CUNA supports the proposal to allow for the capitalization of interest. We expect credit unions will likely utilize this tool as a way to help struggling borrowers.

Proposed Rule

As stated in letters submitted last year to the NCUA on September 16,[3] June 29,[4] and April 8,[5] we see a real need for the agency to permit credit unions to capitalize interest in connection with loan workouts and modifications.

Under the existing regulation prohibiting capitalization of interest, there are essentially no good options for modifying a loan for a member facing financial distress. Existing options are basically limited to:

1) *Collecting interest current at the time of the modification:* This causes additional hardship for members, especially as many members have become unemployed.
2) *Forgiving the interest:* This harms the credit union, making it difficult to loan to other members and creates potential tax ramifications for the members.
3) *Deferring the interest until the end of the loan term:* This creates balloon payments for the members and could cause additional hardship.
4) *Adjusting the amortization on the loan and bifurcating it to create a modified rate component and a zero-interest component:* This is confusing for members and poses operational challenges for the credit union, as systems are not designed to easily incorporate such an adjustment.

It is clear another, more consumer-friendly option is needed. Thus, we urge the NCUA to adopt the proposed rule permitting credit unions to capitalize in connection with loan workouts and modifications. This is especially critical as it may take many months for consumers to become financially healthy given the ongoing COVID-19 crisis.

The proposal would continue to provide that a credit union may, in no event, authorize additional advances to finance credit union fees and commissions. Credit unions will be permitted to continue to make advances to cover third party fees to protect loan collateral, such as force-placed insurance or property taxes. The NCUA believes that maintaining the prohibition on the capitalization of credit union fees is an important consumer

[3] CUNA Letter to NCUA Chairman Rodney Hood (Sept. 16, 2020), *available at* https://www.cuna.org/uploadedFiles/Letter%20from%20CUNA%20CEO%20Jim%20Nussle%20to%20NCUA%20Chairman%20Hood%209.16.2020.pdf.

[4] CUNA Letter to NCUA Chairman Rodney Hood (June 29, 2020), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2020/Comment_Letters/Letter%20to%20NCUA%20Chairman%20Hood%20from%20Jim%20Nussle%206.29.2020.pdf.

[5] CUNA Letter to NCUA Chairman Rodney Hood (Apr. 8, 2020), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2020/Comment_Letters/Letter%20from%20CUNA%20CEO%20to%20NCUA%20Chairman%20Hood.pdf.

protection feature of the rule for member borrowers. We agree with this proposed provision, as it makes sense from a consumer protection perspective.

Further, the proposal would establish that, at a minimum, if a credit union's loan modification policy permits capitalization of unpaid interest, the policy must require each of the following:

1) Compliance with all applicable consumer protection laws and regulations, such as the Equal Credit Opportunity Act, the Fair Housing Act, and the Truth In Lending Act.
2) Documentation that reflects a borrower's ability to repay, a borrower's source(s) of repayment, and when appropriate, compliance with the credit union's valuation policies at the time the modification is approved.
3) Providing borrowers with documentation that is accurate, clear and conspicuous, and consistent with federal and state consumer protection laws.
4) Appropriate reporting of loan status for modified loans in accordance with applicable law and accounting practices. The credit union shall not report a modified loan as past due if the loan was current prior to modification and the borrower is complying with the terms of the modification.
5) Prudent policies and procedures to help borrowers resume affordable and sustainable repayments that are appropriately structured, while at the same time minimizing losses to the credit union. The prudent policies and procedures must consider:
    i) Whether the loan modifications are well-designed, consistently applied, and provide a favorable outcome for borrowers.
    ii) The available options for borrowers to repay any missed payments at the end of their modifications to avoid delinquencies or other adverse consequences.
6) Appropriate safety and soundness safeguards to prevent the following:
    i) Masking deteriorations in loan portfolio quality and understating charge-off levels;
    ii) Delaying loss recognition resulting in an understated allowance for loan and lease losses account or inaccurate loan valuations;
    iii) Overstating net income and net worth (regulatory capital) levels; and
    iv) Circumventing internal controls.

We agree with the NCUA that capitalization of interest is not an appropriate solution in all cases, and a credit union should consider and balance its best interests with that of the borrower. Further, we agree that modifications of loans that result in capitalization of unpaid interest are appropriate only when the borrower can repay the debt in accordance with the modification. Thus, we support establishing these six consumer protection guardrails.

Consistency with Bank Regulations

Banks are not subject to the same prohibition on capitalizing interest (the banking agencies have not adopted an absolute standard equivalent to that adopted in the NCUA's

May 2012 rule). The banking agencies examine these practices for safety and soundness during the course of their supervision. As a result, credit unions have fewer options when working with their member borrowers, as compared to banks.

In addition to the reasons noted above, the NCUA should adopt the proposed rule in order to provide parity between credit unions and banks with regard to capitalization of interest. We expect credit unions may provide borrowers with the option to capitalize interest along with other loan modification options, such as lowering loan payments or the interest rate, extending the maturity date, and partial principal or interest forgiveness.

Consistency with GSEs

The government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, have had a long-standing policy supporting the ability of servicers to capitalize interest and fees as part of a prudent modification program. When credit unions originate certain loans, they often do so with the intent of selling to the secondary market, but many credit unions may retain servicing rights after the sale of the loan. The GSEs are frequent investors in credit union-originated loans. After such a sale, if a member with a loan sold by a credit union begins experiencing financial difficulty and needs assistance in the form of a modification, capitalization of interest is permitted within a loan workout by the GSE that now holds the loan. However, for loans retained by the credit union, the borrower would not get the benefit of interest capitalization upon a loan workout due to the prohibition currently in the Appendix.

This inconsistency is another reason the NCUA should permit the capitalization of interest in connection with loan workouts and modifications. We agree with the agency that the current contrast with the GSEs' policy results in inequitable treatment of members within the same credit union, which jeopardizes the integrity of the cooperative membership base.

Conclusion

On behalf of America's credit unions and their 120 million members, thank you for considering our comments in response to the proposal to allow for capitalization of interest in connection with loan workouts and modifications. If you have questions about our comments, please do not hesitate to contact me at (202) 508-6743 or LMartone@cuna.coop.

Sincerely,

Luke Martone
Senior Director of Advocacy & Counsel