AVOIDING TROUBLE - TDRS

by Steve Brown

Bankers everywhere are looking for ways to restructure loans to limit credit losses. It isn't any wonder when you consider how unstable things are in the economy and the industry. For our discussion today, we want to highlight troubled debt restructurings ("TDRs").

TDRs first entered banker vocabulary with FAS 15, which was then refined further under FAS 114. A TDR occurs when a loan is restructured and the bank "grants a concession to the debtor that would not otherwise be considered." That is a pretty broad (one of the reasons trouble often follows TDRs) definition, so we tighten it up by indicating TDRs are concessions a bank makes in order to reduce losses or improve collectibility of a given loan.

TDRs most often crop up when banks take specific action to protect a loan, usually because of deterioration in a borrower's ability to repay. Bankers consider such factors as whether the borrower is in default, has filed (or will file) for bankruptcy, is able to continue as a going concern and has projected cashflows that are insufficient to satisfy the debt (among other factors). Restructuring a loan to help any or all of these can trigger a TDR, but how do we know for sure?

To begin, let's define things a bit more. Basic loan restructuring activities that would qualify as a TDR under accounting rules would include: modification of loan terms (including reducing the interest rate for a period of time, reducing the interest rate to below current market or extending the maturity date); reducing or eliminating accrued interest owed; substituting (or adding) a new borrower/guarantor; adding contingent provisions based on potential events in the future; reducing the amount of the loan below its original contracted amount; transferring assets resulting from foreclosure (such as cash, inventory, accounts receivable, etc.) and allowing equity interests to be granted (includes stock and warrants).

Remember that not all restructured loans are considered TDRs. Basic loan renewals or extensions at market interest rates are not TDRs, but loans that have borrowers that are unable to refinance debt at another bank at a current market rate (or pay off the loan at all) would be considered TDRs.

TDRs are fine for banks to do (and happen more these days), but to do them correctly, banks must also make sure they perform certain duties along the way. First, make sure you have good policies and procedures that address how these loans will be handled. Policies should cover identification, monitoring and any additional credit management controls the bank will have in place. Any concessions should be approved in writing and files should be kept current. Next, restructured loans should be easily identified on systems and regular detailed reporting should be provided to management, while summary reports are provided to the board. Reports should include repayment action plans that also track level and trend. Third, bankers should be sure all TDRs get an annual once-over by third party review teams. This will ensure the loans are being handled properly and help quickly raise awareness in the event other issues begin to occur.

Remember TDRs are not "bad," but that doesn't mean they aren't tricky to handle. The key to good TDR management is honestly assessing whether providing the borrower with additional time improves chances of collection. Modifying loans by reducing cash outflows and by lowering future debt service can sometimes be the difference between helping an existing (albeit strained) borrower work through tough times and the bank avoiding having to face more trouble.

CONFERENCE UPDATE

Our annual conference kicks off with a pre-conference on May 3rd that includes a bank simulation. The conference then runs the next 3 days, focusing on issues community bankers are dealing with in 2009. If you know any bankers who have attended our conference in the past (one of the largest on the West Coast with more than 300 attendees), then you also know it is filled with plenty of immediately usable information you can take back to the bank and apply. Every year we line up topics, issues, presentations and presenters that consistently knock the lights out and this year is no exception. This conference is no-nonsense, focused on learning and is aimed squarely at the key issues bankers are facing right now. To help community banker's budgets, we are extending the early bird registration until March 15th. Click here to view the agenda and register http://www.pcbb.com/2009Conf_Summary.asp, but get moving, because you only have 11 days to get the lower registration rate.

BANK NEWS

FDIC Special Assessment

After getting a huge response on additional insurance premiums, we remind bankers that the rule remains open for comment. Information can be found at http://edocket.access.gpo.gov/2009/pdf/E9-4585.pdf. We are still researching whether the one time assessment is all due in Sep. or will be pro-rated over 4 qtrs.

TALF

The official launch of the Term Asset Backed Liquidity Facility program that will support credit card, student, auto and small business loans is now set for March 25th.

Savings

The US personal savings rate rose to 5% (the highest in 14Y). That's $545.5B at an annualized rate. Just last year, personal savings was only 0.1%.