



COVID-19 Loan Modifications - Risk Rating

lending pandemic business

Summary: Many lenders have completed loan modifications for their borrowers due to the coronavirus. Determining the loan risk rating and next steps after 90 days.

Because of the issues around COVID-19, the REAL ID deadline is pushed out to October 2021, according to Homeland Security. This is one of many changes due to COVID-19. Loan modifications have also changed.

Many lenders have already completed COVID-19-related loan modifications to help their borrowers. These are short-term accommodations granted to borrowers who had been performing previously, but are now experiencing hardship. Normally, these modifications would likely be labeled a Troubled Debt Restructure (TDR); but, temporary regulatory guidelines are suspending that requirement.

Many bankers are finding that there is a complex web of inter-related issues when considering these modifications including (but not limited to): a loan's individual risk rating, loan loss reserves, accrual vs. non-accrual status, etc.

Today, we tackle how to ascertain the risk rating for a COVID-19-related loan modification and next steps after 90 days. For our example, we will use a 3-month payment deferral with no extension of maturity scenario.

Review all guidance. First, we highly encourage everyone to review the CARES 4013 and the [Interagency Statement](#) on this topic, as there are nuances to understand specific for the current crisis. There was also a highly informative [Ask the Regulators webinar](#) presented recently on this topic, which you may want to listen to as well.

Use existing risk rating policies. Under the new guidance, regulators are asking lenders to continue applying existing risk rating policies to these loans. For instance, if the 3-month payment deferral allows your borrower to maintain positive cash flow, then it may not be necessary to downgrade the loan below a "Pass" risk rating, depending on your loan policy.

If the borrower's cash flow is negative despite the payment deferral, you may consider a downgrade of the risk rating. But remember, there are other factors to consider as well, such as the depth of the cash flow shortfall, impending expense reductions, guarantor support, a plan for recovery, etc.

Determine next steps. If the risk rating determination allows for it, at the end of the initial 3-month payment deferral period, even if the borrower is unable to generate positive cash flow, lenders can offer a second 3-month payment deferral, according to the guidance. Lenders may view a combined "3 months + 3 months" as adhering to the "6 months" guidance; however, prudence is still required. Keep in mind that the purpose of these modifications is to provide borrowers with temporary relief from COVID-19 conditions.

While financial institutions don't need to report these modified loans as TDRs, they must maintain records of these loans. It is likely that starting with Q2 2020 reporting, there will be some requirements to report on these modified loans. Plan accordingly.

We hope we have helped you better understand how to determine the risk rating of a modified loan and steps to take after the first 90 days. If you need further assistance, we are here.

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