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Guidance Relative to Residential Mortgage Loan Modifications for Non-Delinquent Borrowers and Troubled Debt Restructuring (TDR)

Purpose

The Division of Banks (Division) is issuing this guidance in response to industry inquiries relative to the classification of the modification of a residential mortgage loan as a troubled debt restructuring (TDR) when the value of the collateral has declined, resulting in a high loan-to-value ratio. Specifically, the Division is clarifying that, in cases where both the borrower and his or her current lender wish to modify the terms of a mortgage loan that is current and performing (i.e. non-delinquent), and the only concern is that the collateral value has fallen below the outstanding loan amount (typically referred to as being "underwater"), that credit may not necessarily have to be classified as a TDR.

Background

As a result of the economic downturn, financial institutions are receiving an increased volume of requests from residential mortgage borrowers to revise the terms of their existing mortgage loans to more closely align with current market conditions. This trend is consistent with national policy towards minimizing foreclosures and keeping residential borrowers in their homes. However, it is not uncommon given current market conditions for property market values to have fallen below the outstanding loan amounts, resulting in high loan-to-value ratios. Many requests for modifications are from responsible homeowners who remain current on their underwater mortgages despite the challenges in the housing market. The determination of when a modification constitutes a TDR can be particularly challenging in light of these economic conditions. The relevant guidance is contained in the Accounting Standards Codification (ASC) Subtopic 310-40: *Receivables – Troubled Debt Restructurings by Creditors*. The guidance was updated by the Financial Accounting Standards Board (FASB) in April 2011 with the

Accounting Standards Update ASU 2011-02: *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*[1].

A TDR is one in which the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Therefore, two conditions must be present: the debtor is experiencing financial difficulties and, as a result, the creditor grants a concession relative to the loan terms.

Existing TDR guidance provides possible indicators of when either condition exists, but emphasizes that all facts and circumstances must be considered when making such a determination. Such guidance should be referenced as needed.

Guidance

If a residential mortgage borrower and his or her lender wish to modify the terms of a mortgage, the singular fact that the loan is underwater does not necessarily constitute a TDR provided that the borrower is (a) performing satisfactorily under his or her mortgage loan, and (b) is not experiencing financial difficulties. A lender must consider all facts and circumstances in determining whether the borrower is experiencing financial difficulty and whether the lender is granting a concession. In each case, the lender must perform and document its own analysis in making such a determination. Nevertheless, the fact that a residential borrower is underwater does not, in and of itself, necessitate the classification of the loan as a TDR.

A lender may choose to modify a residential loan under the revision in mortgage terms statute (Massachusetts General Laws chapter 183, section 63A). As with any loan modification program, lenders should have policies and procedures in place to address and document all modification requests in a consistent manner.

[1] ASU No. 2011-02 is effective for public entities for the first interim or annual period beginning on or after June 15, 2011. For nonpublic entities, the amendments are effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods.