

Loan Forbearance and Loan Modification

Frequently Asked Questions

The FHLB realizes there may be confusion around the concepts of “forbearance” versus “loan modification”. We would like to offer the following clarifications on our intended use of these terms regarding both loan eligibility and the *COVID Loan Forbearance Survey* we recently rolled out.

What is the FHLB’s definition of “forbearance?”

A dictionary definition of forbearance is: “an agreement between a lender and a borrower to temporarily suspend debt payments.” Forbearance may be evidenced in a formal loan modification document but is sometimes simply a less formal form of flexibility that does not contain all of the characteristics of a formal modification, such as a rescheduling or re-amortization of missed payments. All instances of forbearance should be included on the Survey response. Only loans that are in forbearance that have not been formally modified need to either be deducted from loan eligibility or listed and market valued.

What distinguishes “loan modification” from “loan forbearance” for purposes of FHLB collateral reporting (Certifications and Listings) and the *COVID Loan Forbearance Survey*?

In the context as used by your FHLB, a loan modification is a formal document that references the note being modified, which includes revisions to the original note’s terms and/or conditions, and is executed by an authorized individual at the lending institution and all borrowers on the original note. Such a modification may also require a modification to the original mortgage or deed of trust as well.

A forbearance arrangement *may* be evidenced by a loan modification, but if beneficial to the borrower, could also simply be a communication to the borrower(s) in some fashion, whether electronic, in writing, or verbally, that required payments have been suspended. As noted by the FDIC guidance on forbearance and delinquency reporting, forbearance may be offered to customers across the board without additional documentation. In this type of approach, which may be just a suspension of collections activities and bureau reporting, pledged loans would become ineligible if the borrower takes advantage of this forbearance and the length of time in forbearance exceeds FHLB eligibility criteria for a delinquent loan. However, this form of forbearance along with formal loan modifications that include forbearance should be included in loan numbers and balances in the Survey response.

If a borrower’s required payments have been suspended by way of a forbearance arrangement, why does the FHLB differentiate eligibility based on whether that forbearance is in a formal loan modification?

Modified loans have always been eligible collateral as long as payments have been made in accordance with the modified terms and all other eligibility criteria have been met. We view unmodified loans whereby a lender informally agrees not to pursue collection of payments as higher risk. If payments are not made in these situations, the borrower is contractually delinquent or may be viewed as contractually delinquent by a potential purchaser.

Are formal loan modifications that include payment forbearance to be included in the number and balance of loans reported on the survey?

Yes. The objective of the survey is to establish the extent to which the COVID related lockdown has impacted the ability of borrowers to make timely loan payments. The potential credit risk being evaluated involves the question of whether borrowers will be unable to make normal payments if the economic rebound is insufficiently robust.

If a forbearance arrangement is in place but the borrower continues to make scheduled payments, should these loans be included in reported balances on the survey and are these loans eligible collateral?

These loans should be included on the survey in that although they may have made payments to date, the borrower has the opportunity to skip payments at any point during the forbearance period.

These loans are eligible as collateral even if they have not been formally modified as long as they meet the FHLB's loan delinquency eligibility criteria. That is, they are less than 60 days contractually delinquent if a 1-4 family loans, or less than 30 days delinquent if any other form of collateral. Otherwise, would also be eligible if the member "lists" loan level data on its portfolio such that the FHLB can market value the loans. Members should contact CollateralOperations@fhlbcin.com if they wish to submit such listings. See the question below on the June 4 NewsLine regarding a future opportunity to include loans under forbearance as eligible on collateral certifications.

Does the FHLB want us to report loans in forbearance on the survey for loan types not being pledged?

Yes. The objective is to gather information on the full extent of forbearance activities, not just on loan collateral.

The FHLB NewsLine of June 4 mentioned the potential for including loans under forbearance arrangements as eligible collateral on collateral certifications at some point in the future. How would that work? Why the delay?

Loans that *have not been* formally modified can be included as eligible beginning in August (end of July "as of" date) by identifying the otherwise ineligible loans on a separate line item on collateral certification forms. These loans will be subject to an additional haircut or discount (thus generating reduced borrowing capacity). It will take until August for the FHLB to best determine the appropriate discount because it in part depends on third party modeling of the impact of forbearance related delinquencies on loan values. This will take some time to develop. Also, the end of July is an estimated timeframe and the process may take an additional month.

The FDIC and NCUA do not at present require banks, thrifts or credit unions to report loans in forbearance as being delinquent. Given this, why does the FHLB require its members to exclude such loans from eligibility on collateral reporting due to delinquency?

The FHLB only requires exclusion of such loans from eligibility if a member does not provide loan level information such that they can be market valued or if the loan has been formally modified. Also, as noted in the previous question, they may be included as eligible collateral subject to an incremental haircut if a member chooses to provide monthly collateral certifications beginning as of July 31, 2020. Aside from these caveats, the FHLB views loans under forbearance arrangements that have not been formally modified with a determination made as to the borrower's ability to repay under modified terms as bearing elevated credit risk. Forbearance was

requested presumably due to the borrower being unable to make scheduled payments. Although there is the hope that this situation will only persist over the forbearance period, there is no assurance of this. The FHLB expects that for a material number of borrowers, the inability to repay will be more long term. If a loan has been formally modified, we grant the benefit of the doubt that an ability to repay under modified terms has been determined.

Didn't the FHLB previously make special allowance for loan modification documentation?

Yes. The special allowances are that COVID-related modifications could be executed electronically as long as there is compliance with the ESIGN Act (as relayed in the March 26, 2020 NewsLine, available on the COVID Resources page on our public website and in the Inbox in Members Only). Additionally, the borrower could execute the agreement up to 60 days after its effective date. Normally the FHLB would require a hard-copy, wet-signed modification agreement in order for a loan to be deemed eligible.

Your NewsLine states that members not responding to the survey may be subject to the FHLB having to make some conservative assumptions about the existence of forbearance loans and related delinquencies and losses, which may impact FHLB borrowing capacity. How might this impact a member's borrowing capacity?

The FHLB performs "stress tests" of the credit ratings it assigns to its members. In the current environment, one of the stressed variables is the volume of loans its members have approved for forbearance. The expectation is that a certain portion of these loans will continue to be unable to make loan payments subsequent to the end of the forbearance period. The assumption is also made that loans that will have negative long term effects from the economic downturn are likely in the population of loans granted forbearance, although this may not always be the case. Members are likely to experience losses to some extent from these credits. The FHLB has not yet determined the other stress factors such as nonaccrual rates and net loan losses that may result from forbearance, but a required data point is the volume of loans in this category, and perhaps the average length of forbearance periods. Gathering this information is the objective of the survey. If we are unable to make this determination due to the lack of response, we will have to make an assumption based on national levels or some other proxy. If the stressed result indicates the potential for a rating downgrade, members will be placed under additional scrutiny based on this result in light of other facts and circumstances. If a downgrade results, an increased collateral haircut may be triggered resulting in reduced collateral based borrowing capacity.

When are survey results due?

The FHLB asks that members complete this survey monthly, beginning in June (with data as of the prior month-end). We ask that you complete your survey response by the 10th calendar day of each month. Currently, we expect to ask for this data five times (from June through October).