

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 80-34  
February 25, 1980

PROPOSED UNIFORM EXAMINATION POLICY FOR  
CLASSIFICATION OF CONSUMER INSTALLMENT CREDIT

TO ALL STATE MEMBER BANKS IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:

The Federal Financial Institutions Examination Council has recommended to the three Federal bank regulators a uniform examination policy for the classification of consumer installment loans held by commercial banks. The proposed policy will be effective June 30, 1980.

Printed on the following pages are copies of the press release and the text of the proposed policy statement from the Council. Any questions concerning this policy should be directed to Uzziah Anderson or Marvin C. McCoy of our Bank Supervision and Regulations Department, Ext. 6274.

Sincerely yours,

Robert H. Boykin

First Vice President



## Press Release

For immediate release

February 14, 1980

The Federal Financial Institutions Examination Council today announced that it has recommended to the three Federal bank regulators a uniform examination policy for the classification of delinquent consumer instalment loans held by commercial banks.

The Council suggested that the three agencies -- the Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Federal Reserve Board -- take action to make the proposed policy effective June 30, 1980.

The Council said that the uniform policy for classifying delinquent consumer loans at commercial banks would replace policies that vary among the agencies with standardized examination practices and would provide consistent statistical data. The proposed policy is a revision of previous proposals made by the agencies.

Classification of loans is used by bank examiners in evaluating the overall quality of a bank's loan portfolio and identifying poorly performing loans and loans with more than normal risk of loss.

The policy recommended by the Examination Council, would, for the purposes of bank examination, establish the following standard classifications for delinquent consumer instalment loans:

1. Loans that would be classified as losses to the bank:

--Open end credit (such as credit obtained by use of a credit card) that is overdue by 180 days or more;

--Closed end credit (such as a car loan) overdue by 120 days or more.

2. Loans that would be classified as substandard:

--Open end credit that is overdue by 90 to 179 days;

--Closed end credit that is overdue by 90 to 119 days.

The proposed policy would recognize that some flexibility in such classifications may be appropriate provided that bank management can clearly demonstrate that exceptions are warranted.

The policy as proposed differs from earlier proposals -- on which hundreds of comments were received -- in classifying as losses open end delinquent consumer instalment loans after 180 days, rather than 120 days. It also makes a number of clarifying definitions for consumer loans, delinquencies and statutory bad debts and clarifies the circumstances in which partial payments may be considered by examiners as full payments.

The Council did not at this time direct its recommendation for a new uniform policy for classifying delinquent consumer instalment loans to the Federal regulation of thrift institutions by the Federal Home Loan Bank Board, the National Credit Union Administration and the Federal Deposit Insurance Corporation. The Council noted that the FHLBB and the NCUA were not parties to the Uniform Agreement on Classification of Assets and Appraisal of Securities Held by Banks adopted by the bank regulators in 1938 and most recently revised by them in 1979. Consequently, these two thrift institution regulators have over the years developed independent regulations and policies for treating delinquent loans that would require substantial modification to conform to the new policy proposed for commercial banks. This is also true to a lesser extent of the FDIC's supervision of mutual savings banks.

The Council recommended that the FHLBB, NCUA and FDIC seek comment on the application to the thrift institutions they supervise of the uniform delinquent consumer loan classification policy, and advise the Council of their findings.

The examination policy proposed by the Council to the Federal bank regulators is attached.

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Recommendation Of The  
FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

To The

Board of Governors of the Federal Reserve System  
Federal Deposit Insurance Corporation  
Office of the Comptroller of the Currency

UNIFORM POLICY FOR CLASSIFICATION OF CONSUMER INSTALMENT CREDIT  
BASED ON DELINQUENCY STATUS

The Policy

INTRODUCTION

This examination policy establishes uniform guidelines for the classification of instalment credit based on delinquency status. This use of a formula approach in determining consumer loan classifications parallels, in principle, current industry practices and recognizes the statistical validity of measuring losses predicated on past due status. The policy covers both open- and closed-end credit. Although the three Federal banking agencies have historically relied on delinquency status as a major determinant in classifying consumer instalment credit, no interagency standard has been employed. The policy seeks to provide that standard and should result in more uniform treatment of all classes of insured banks and in more consistent statistical data being developed from bank examination reports.

The general classification policy recognizes that evaluating the quality of a consumer credit portfolio on a loan-by-loan basis is inefficient and unnecessary. For this reason, examiners are expected to adhere closely to the policy in their analysis of consumer credit. Nevertheless, it is recognized that there are instances, particularly

where significant amounts are involved, that may warrant exceptions to the formula in order to recognize individual situations where the bank being examined can clearly demonstrate that repayment will occur irrespective of delinquency status. Examples of such situations might include: loans well secured by collateral and in the process of collection; loans where the claims have been filed against solvent estates and loans supported by valid guarantees or insurance.

### General Classification Policy

Examiners will adhere to the following general classification policy during examinations of commercial banks.

(1) Closed-end consumer instalment credit delinquent 120 days or more (5 monthly payments) will be classified loss. Loans delinquent 90 to 119 days (4 monthly payments) will be classified substandard.

(2) Open-end consumer instalment credit delinquent 180 days or more (7 zero billing cycles) will be classified loss. Loans delinquent 90 to 179 days (4 to 6 zero billing cycles) will be classified substandard.

### Definitions

The following definitions are intended to provide guidance in application of the general classification policy.

Consumer Instalment Loans - Includes open- and closed-end credit extended to individuals for household, family and other personal expenditures as defined in the instructions for preparation of call reports. Refer to such instructions for information on any loan where there is doubt as to whether it is covered by the general classification policy.

Delinquency - Closed-end instalment credit is considered delinquent when the borrower is in arrears two monthly payments. Loans in arrears two monthly payments are considered 30 days delinquent.

Banks generally treat open-end credit differently than closed-end credit in computing delinquency. A bank credit card customer generally has 25 days in which to pay billings before the loan is considered delinquent. If no payment is made between two billing cycles, the balance is considered 5 days delinquent. If no payment is received before issuance of still another statement, the balance is 35 days delinquent technically; however, current practice is to define accounts with two zero billings as 30 days delinquent.

See attached charts which illustrate delinquency computation.

Statutory Bad Debts - Section 5204, USRS (12 U.S.C. 56), contains the definition for Federal Reserve System member banks of what constitutes bad debts. Accordingly, loans delinquent seven monthly payments, or seven billing cycles, are considered 180 days, or six months, past due and will be considered statutory bad debts, unless they are well secured and in the process of collection.

Partial Payments - A payment equivalent to 90 per cent or more of the contractual payment may be considered a full payment in computing delinquency.

#### Consumer Instalment Loan Examination Scope

The general classification policy provides that performance is the principal criterion in application of the uniform policy during examinations of banks. In addition to loan classification, examination emphasis should focus on the bank's written consumer lending policy, adherence to stated policy and a review of operating procedures. It is expected that a bank will have written policies suitable for its specific objectives and that they are consistent with prudent banking practices. Procedures for supervising delinquent accounts, including the procedure for renewing and extending past due loans, and automatic charge-off policy should be fully described. Internal controls should be in place to assure that the bank's written policy

is being followed. Banks lacking written policies or failing to implement or follow established policies effectively should be criticized by examiners in reports of examination.

**Effective Date**

This policy will be effective June 30, 1980.

### CLOSED END CREDIT

<u>Due Date</u>	<u>Period</u>	<u>Delinquency Status</u>	<u>Classification</u>
3/10	3/11-04/09	Not delinquent	-
4/10	4/10-05/09	30 days or 2 payments	-
5/10	5/10-06/09	60 days or 3 payments	-
6/10	6/10-07/09	90 days or 4 payments	Substandard
7/10 *	7/10-08/09	120 days or 5 payments	Loss
8/10	8/10-09/09	150 days or 6 payments	Loss
9/10	9/10	180 days or 7 payments	Loss

### OPEN END CREDIT

<u>Statement</u>	<u>Day</u>	<u>Zero Billing Cycle</u>	<u>Payment Record</u>	<u>Days Delinquent</u>	<u>Classification</u>
Statement 1 Due 25th	1 25				
Statement 2	30	1	No payment	5	-
Statement 3	60	2	No payment	30	-
Statement 4	90	3	No payment	60	-
Statement 5	120	4	No payment	90	Substandard
Statement 6	150	5	No payment	120	Substandard
Statement 7	180	6	No payment	150	Substandard
Statement 8**	210	7	No payment	180	Loss

\* Charge-off occurs after borrower is five payments delinquent.

\*\* Charge-off occurs on seventh zero billing.