

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 80-41
March 11, 1980

EXAMINATION POLICY FOR CLASSIFICATION OF
CONSUMER INSTALLMENT CREDIT

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

The Federal Reserve Board has adopted an examination policy for the classification of delinquent consumer installment loans held by state member banks.

The Board acted on a recommendation made February 14, 1980, by the Federal Financial Institutions Examination Council to the three Federal bank regulators for a uniform examination policy. The Federal Deposit Insurance Corporation and the Comptroller of the Currency are expected to act on the recommendation shortly.

The new policy, which becomes effective June 30, 1980, is enclosed. Any questions concerning the policy should be directed to Uzziah Anderson or Marvin McCoy of our Bank Supervision and Regulations Department, Ext. 6274.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

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.