NCUA LETTER TO CREDIT UNIONS

NCUA LETTER NO. 119

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TO THE BOARD OF DIRECTORS OF THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

The Accounting Manual for Federal Credit Unions outlines the use of three methods of delinquency calculation, methods A, B, and C. Prior to September 1981, the Accounting Manual contained an additional delinquency calculation method known as Method D. Many credit unions continue to calculate loan delinquency using Method D. This method does not consider the "time value of money", and as a result, often understates loan delinquency.

Under Method D, a member can miss several payments on a loan and then make a lump sum "catch-up" payment that totals the sum of the missed payments and not be considered delinquent. Under other delinquency calculation methods that consider the "time value of money", the member would be considered delinquent until a catch-up payment was made that included the related accrued interest.

The distinction between delinquency calculation methods becomes especially important when we consider the growing real estate lending activities of credit unions. Substantial differences in delinquency classifications between the methods of delinquency calculation can result when longer term, larger mortgage loans are involved.

Although there are no available statistics, it appears that Method D is commonly used in the credit union system for two reasons: (1) it is easy to calculate, and (2) it is easy to administer and explain to credit union members. On the other hand, while it may be functional, it is not technically accurate. While not technically correct, it nonetheless appears sufficiently accurate in reliably identifying collection problem and loss loans in shorter term maturity loans.

Due to the widespread use of Method D for loan delinquency calculations, and in consideration of the significant costs it would take to reprogram automated systems, last year the National Credit Union Administration adopted the following position:

- Method D may be used on loans with maturities of 15 years or less.

- Acceptable delinquency computations method (Method A, B, or C per the Accounting Manual for Federal Credit Unions) must be in place by August 1, 1991, for closed-end loans with maturities that exceed 15 years.

- All other loan delinquency calculations should comply fully with contract terms.

I would like to stress that results are more important than the method of delinquency computation. If a credit union has effective lending and delinquency programs, the method of delinquency computation will be of secondary importance. We will continue to evaluate delinquent loan calculation methods and encourage credit unions and their data processors to do the same.

For the National Credit Union Administration Board,

Roger W. Jepsen

Chairman