



BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Premiums on U.S. Government
Guaranteed Loans

To: Chief Executive Officers of All National Banks, Deputy Comptrollers (District) and All
Examining Personnel

PURPOSE

The Comptroller of the Currency has approved a uniform policy for supervising national banks that participate in U.S. government guaranteed loan secondary market programs. The policy was recently endorsed by the Federal Financial Institutions Examination Council. The uniform supervisory policy is a reemphasis of a previously announced OCC policy on U.S. government guaranteed loans as described in Banking Bulletin 8342, dated September 27, 1983. Banking Bulletin 83-42 is superseded by this issuance.

SUMMARY

The policy covers U.S. government loan guarantee programs which provide lenders a partial guarantee of principal and interest and allow for the sale of guaranteed portions of the loans to third parties. Guarantees of principal and accrued interest are as high as 90 percent of the total dollar amount of the loan. Sales of the guaranteed portions of these loans to third parties usually are in the form of 100 percent guaranteed certificates of participation. Such programs are currently being administered by the Small Business Administration and the Farmers Home Administration. Participating national banks may be originators, sellers and services or they may be the purchasers of guaranteed loans.

The statement of the uniform supervisory policy as endorsed by the Comptroller of the Currency is attached.

ORIGINATING OFFICE

If questions arise regarding this circular, please contact the Investment Securities Division, (202) 874-4660, Washington, D.C. 20219.

H. Joe Selby
Acting Comptroller of the Currency

Attachment



Federal Financial Institutions Examination Council

Supervisory Policy

THE SALE OF U.S. GOVERNMENT GUARANTEED LOANS AND SALE PREMIUMS

Recommendations for Originating and Selling Institutions

Examiners should review the extent and nature of activities in connection with the sale of government guaranteed loans. Lax or improper management of the selling institution's servicing responsibilities should be criticized. Out-of-trade area lending for the purpose of resale of any portion of U.S. government guaranteed loans should be carefully reviewed to ensure that the practice is conducted in a safe and sound manner.

All income, including servicing fees and premiums charged in lieu of servicing fees, associated with the sale of U.S. government guaranteed loans, should be recognized only as earned and amortized to appropriate income accounts over the life of the loan.

Recommendations for Purchasing Institutions

Purchasers of U.S. government guaranteed loans should be aware that the purchase premiums are not guaranteed and are not paid by the guaranteeing Federal agency when the loans are prepaid. Because payment of premiums which do not reasonably relate to the yield on the loan can distort published financial reports by overstating the value of a financial institution's assets, it will generally be viewed as an unsafe and unsound banking practice for a financial institution to pay purchase premiums which result in a significant overstatement in the value of bank assets.

Many government guaranteed loans currently being originated and sold are variable rate. These variable rate loans normally should not trade at anything more than a modest premium or discount from par. Examiners will be directed to carefully review any loans being sold or purchased at significant premiums and will criticize any involvement with excessive premiums as an unsafe and unsound business practice. Excessive purchase premiums will be classified loss. The loans will be required to be revalued to the market value at the time of the acquisition and the excessive premiums will be charged against current earnings.

In addition, any unamortized loan premium on a government guaranteed loan must be immediately charged against income if the loan is prepaid, regardless of whether payment is received from the borrower or the guaranteeing agency.

Institutions, supervised by the above agencies are advised that guaranteed portions of U.S. government guaranteed loans should not be recorded or carried as U.S. government or federal agency securities. They should be carried and reported as U.S. government guaranteed loans.

Additional Information

Questions concerning this supervisory policy should be addressed to the appropriate regulatory agency.