QUESTIONS AND ANSWERS

"Interagency Policy Statement on Documentation for Loans to Small- and Medium-sized Businesses and Farms"

1. -- Q. What procedures must an examiner perform during an examination with regard to the "exempt portion" of the loan portfolio?

A. The "exempt portion" of the loan portfolio is available only to banks that have CAMEL ratings of 1 or 2 and that are well or adequately capitalized. These banks can be expected to use the "exempt portion" prudently and within the spirit of the policy statement. Examiners are not required to perform any review of the "exempt portion." Examiners who decide to check the bank's compliance with the policy, should obtain and review the bank's listing of loans comprising the "exempt portion" of the portfolio. In their review of the bank's listing they should determine that ineligible loans are not included in the "exempt portion" and that it does not exceed the capital limitation.

During an examination of an eligible bank, examiners should take the opportunity to explain when it may be appropriate for the bank to use the "exempt portion" of the loan portfolio. Examiners can discuss situations in which banks may find the "exempt portion" a good way to book loans the bank thinks can be made with less than complete documentation.

Finally, the OCC is developing a way for examiners to report information on banks using the exemption through its bank information systems. Until that is accomplished, examiners will be expected to document whether a bank is using the "exempt portion" and is complying with the policy statement in examination working papers.

2. -- Q. May the "exempt portion" of the loan portfolio contain only loans made subsequent to the effective date of the policy?

A. No. The "exempt portion" may contain any loan that meets the criteria outlined in the policy, including loans already on the bank's books. The policy is intended to encourage new small business lending, but it should also be used to eliminate unnecessary documentation, reduce costs to lending institutions, and reduce the time it takes to respond to credit applications on new and refinanced loans.

3. -- Q. When may an examiner actually review a loan that has been assigned to the "exempt portion" of the loan portfolio?

A. An examiner's review of an eligible bank's loan portfolio should focus on the non-exempt portion. That review, along with other examination activities, should allow the examiner to properly assess management/board performance, asset quality, compliance with laws and regulations, and the bank's overall condition. An examiner should review an "exempt portion" loan only when he or she has a good reason to review it. The four examples that follow should help examiners understand what constitutes a "good reason" to review an "exempt portion" loan.

Example 1 -- In reviewing loans of a borrower for compliance with the bank's legal lending limit, 12 U.S.C. 84, that are not in the "exempt portion," the examiner notices that the borrower is listed as having a loan or loans in the "exempt portion." The examiner can review those loans in the "exempt portion" to determine whether they should be included when testing compliance with the legal lending limit. The loans should not, however, be criticized for any lack of loan documentation.

Example 2 -- The examiner identifies a clear and consistent pattern where real estate loans in the non-exempt portion are not in compliance with the appraisal requirements of 12 CFR 34. The examiner, to determine the extent of this practice, may want to review "exempt portion" loans for compliance with the appraisal regulation. This would be rare because, in most cases, review of the non-exempt portion of the portfolio should provide a good basis for determining whether or not the bank is complying with the appraisal regulation without a review of "exempt portion" loans.

Example 3 -- The examiner classifies part of a relationship outside of the "exempt portion" and the relationship also includes a loan or loans in the "exempt portion." The non-exempt debt is classified doubtful or loss and the examiner has reason to believe, from discussion with management, that the "exempt portion" loan(s) require similar classification. The examiner may review those "exempt portion" loans for classification. Remember, however, that even if "exempt portion" loans are reviewed, they may not be criticized for documentation.

Example 4 -- The examiner identifies several "exempt portion" loans(s) that are 60 days or more delinquent. Based on other examination activities, the examiner has some concerns that the bank's internal loan review system hasn't properly classified these loans. These loans may be reviewed to determine if classification is appropriate. However, any decision to classify must be based solely on credit quality and not the level of documentation.

4. -- Q. What performance criteria will an examiner use to determine if a loan is eligible for inclusion in the "exempt portion?"

A. A loan may not be assigned to the "exempt portion" if it is delinquent. The call report definition of a past due loan should be used to determine if a loan is delinquent.

5. -- Q. What kinds of loans are covered by the term "business loan" in the policy? For example, could it include loans to an individual for investment purposes, including personal investments, if "investments" is that person's business?

A. The policy does not define "business loan." The agencies are relying on the size limitation to determine what loans can be placed in the "exempt portion." The bank should consider the spirit of the policy statement when assigning a loan to the "exempt portion."

6. -- Q. What if the OCC or the bank classifies an "exempt portion" loan? What happens? Is it taken out of the exempt portion?

A. A loan does not need to be removed from the "exempt portion" simply because it has been classified either by the OCC or by the bank, internally. Further, a loan that has been removed from the "exempt portion" may be placed back into exempt status at any time, providing it meets the criteria for inclusion. Assignment of loans to the "exempt portion" is the bank's decision.

7. -- Q. Loans have to be current when put into the "exempt portion." What happens to a loan that becomes more than 60 days past due while in the "exempt portion?" What if the loan is one that goes in and out of past due status? When an "exempt portion" loan that had been classified for being past due is paid current, must the loan automatically be upgraded?

A. An examiner may review an "exempt portion" loan that becomes 60 days past due for classification. The bank does not have to remove the loan from the "exempt portion." The loan may not be reviewed or criticized for documentation, unless the bank has removed the loan from exempt status.

There is no requirement for any loan to be removed from the "exempt portion" based on performance. Only the bank can decide to whether or not to change a loan's exempt status. There is no automatic upgrade of a classified "exempt portion" loan simply because it becomes current. Such a loan is upgraded only when the reasons for classification have been remedied.

8. -- Q. What happens when a bank that is maintaining an "exempt portion" loses eligibility? Does the "exempt portion" remain intact? Do "exempt portion" loans retain their "exempt status" even if the bank's CAMEL rating goes to 4 or 5?

A. The loans assigned to the "exempt portion" remain in exempt status even if a CAMEL rating declines. No new loans or renewals of loans previously exempted may be included in the "exempt portion." Remember, the exemption means examiners will not criticize the loan for lack of documentation. However, as the bank's condition deteriorates, it is more likely that the examiner will have specific reasons to review "exempt portion" loans, as illustrated in question 3.

9. -- Q. What capital figure is used to make the 20 percent limitation computation? Total risk-based capital, equity capital, or some other definition of capital?

A. The limitation is computed using total risk-based capital. This is Tier 1 capital plus qualifying supplementary Tier 2 capital, net of deductions as outlined in 12 CFR 3, Appendix A, Section 2.

10. -- Q. When a bank's capital structure declines, does the bank have to remove loans from the "exempt portion" to maintain the 20 percent maximum limitation on exempt loans?

A. No. The bank does not have to remove loans to maintain the 20 percent maximum limitation; however, it may not add any new loans until it is below the 20 percent figure.

11. -- Q. How should loans in an "exempt portion" be analyzed for ALLL adequacy?

A. Banks that are eligible to participate under the policy statement are the most highly rated banks and, therefore, are likely to have acceptable ALLL methodologies. It is, therefore, reasonable to assume that allocations made to loans assigned to the "exempt portion" are sufficient to cover any inherent loss. Examiners should not need to review these loans for ALLL adequacy. When examiners have more experience with "exempt portion" loans, their reserve analyses will be based more on performance. When reviewing a loan that becomes more than 60 days past due for classification, the examiner will also review it for reserve adequacy.

12. -- Q. Can participations purchased, consortium loans, or loans purchased as a pool be placed in the "exempt portion?" Can the retained portion of a loan sold go into the "exempt portion?"

A. There is no prohibition against inclusion of participations purchased, consortium loans, loans purchased, or retained portions of sold loans in the "exempt portion." Banks, however, are encouraged to comply with the spirit of the policy statement and only assign those loans to small- and medium-sized businesses and farms.

Also the retained portion of a loan sold can be assigned exempt status only if the gross loan amount was within the bank's 3 percent limit or $900,000, whichever is less.