

# RESCINDED AL 2004-1

## OCC ADVISORY LETTER

Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

Subject: Legal Lending Limits

Description:

Non-conforming Loans Due to Collateral Shortfalls

**TO:** Chief Executive Officers of All National Banks, Federal Branches and Agencies, Department and Division Heads, and All Examining Personnel

### INTRODUCTION AND PURPOSE

On December 23, 2003, federal officials announced the first case of suspected Bovine Spongiform Encephalopathy (BSE), also known as Mad Cow disease, in a dairy cow located in the state of Washington. Due to public perception of the issue, along with the almost immediate ban on imports of U.S. beef by other countries, live cattle prices and futures prices for cattle dropped in the range of 20 to 30 percent. Market reports since January 2, 2004, however, indicate the decline in market value resulting from the BSE announcement may be a temporary market impairment because domestic demand appears to be holding, and supply is relatively low. In addition, there is some expectation that export markets will reopen, should the disease prove isolated and controlled.

The Office of the Comptroller of the Currency (OCC) has received inquiries from bankers requesting guidance on legal lending limit compliance for loans where a decline in the collateral value of cattle that secures those loans has led to temporary collateral shortfalls for purposes of the legal lending limit calculations and whether such shortfalls may fall within the scope of the “extraordinary circumstances” provision of 12 CFR 32.6(c).

### GUIDANCE

Under 12 CFR 32.6(c), banks must bring a loan that is nonconforming as a result of a fall in collateral value into conformity with the lending limit within 30 calendar days, except, among other things, when extraordinary circumstances beyond the bank’s control prevent the bank from taking action. The decline in market value of live cattle has been a systemic phenomenon and is not the result of action by a particular bank or borrower. Given this, the OCC is advising its examiners to treat collateral shortfalls that arise from the BSE announcement as an “extraordinary circumstance” beyond the bank’s control for purposes of the nonconforming loan provisions of 12 CFR 32.6(c) for the next 180 days, until July 21, 2004.

This interpretation applies *only* to monies already advanced on existing loans and does not apply to any new advances under existing facilities or new loans. As with other loans, the OCC expects

bankers to address, through, each individual borrower's commodity risk management practices and encourage banks to take appropriate steps to mitigate or prevent loan losses.

The OCC will continue to monitor this situation to assess whether additional supervisory measures may be needed. Its supervisory offices in areas that may be affected by this event are contacting affected banks to evaluate the potential impact of the market drop in cattle prices and the controls that banks may have in place, such as hedging and out of money options, to mitigate this risk.

For further information on this matter and the application of the legal lending limits, please contact your supervisory office, the Credit Risk Division at (202) 874-5170, or the Bank Activities & Structure Division at (202) 874-3000.

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