Quarterly Journal

Appeals Process

Appeals Process

Appeal 1—Appeal of a Shared National Credit

Background

A bank appealed to the ombudsman a decision rendered by the Shared National Credit (SNC) Interagency Appeals Panel in July 2004. Initially, the SNC review team rated as substandard and nonaccrual two priority lien credit facilities secured by an assignment in an equity interest in the assets of two bankrupt commercial projects. Additionally, there was a guaranty from the parent company for an equity commitment to complete construction of the projects. The bank appealed the nonaccrual designation on both facilities to the SNC appeals panel. The SNC appeals panel determined that the bankrupt projects, including the priority lien credit facilities should be classified as "other assets," and the remaining unsecured portions of debt classified as loss.

The bank agreed with the classification of the affected credits as "other assets," however, it disagreed with the loss classification, and submitted an appeal to the ombudsman. According to the appeal, the bankruptcy documents supported that there were assets available to provide some relief to the unsecured creditors. The bank further cited inconsistent treatment among the SNC review teams in the classification of these credit facilities at other banks. Specifically, there were two other agent banks designated as unsecured creditors by the bankruptcy court, yet the SNC review teams at those banks gave value to varying degrees the underlying assets supporting the bankruptcy claims.

Management's view was that since the unsecured facilities would be treated equally in bankruptcy, they should be treated similarly in the SNC evaluation process. The fair value of the underlying assets should include value given to the bankruptcy claim on the underlying assets.

Discussion

In December 2002, the lender groups assumed effective control of the two projects by replacing management, obtaining the rights to sell the projects, and actively marketing the plants for sale. (The guarantor for equity to finish these projects had previously experienced severe financial difficulties, abandoned support of the projects, and filed for bankruptcy protection.) Consequently, both the primary and secondary repayment sources were in jeopardy.

The appeal states that the bankruptcy court has recognized the obligations of the guarantor, and they are subject to claim by the unsecured creditors. The appeal also states that there is a secondary market for these bankruptcy claims that precludes a full loss classification.

The ombudsman reviewed the information submitted by the bank and held discussions with the bank's senior management team, the SNC review team, the SNC appeals panel and OCC accountants. While sufficient information was provided for the ombudsman to render a decision as to the fair value to be assigned to the underlying assets of the bankrupt guarantor, doing so would not resolve the issue of inconsistent treatment among the banks holding similar bankruptcy claims. Therefore, the ombudsman determined that the best course of action was to convene a new SNC review team consisting of a representative from each of the primary federal agencies to make a classification decision applicable to the banking groups.

Conclusion

The new SNC interagency review team was convened in November 2004. In the time period between the initial SNC review and the review by the new SNC interagency review team, the guarantor emerged from bankruptcy and the lending group signed contracts for the disposition of assets. Consequently, the credits were reviewed in November 2004, based on this later information rather than the bankruptcy status at the time of the initial review, which would be the traditional approach employed in the appellate arena.

The SNC interagency review team concluded that credit factors were substantively unchanged from when the guarantor originally filed for bankruptcy, and insufficient to maintain carrying the exposed portions of the facilities dependent on its guaranty in the active loan portfolio.

Critical to this evaluation is the determination of whether the obligation under this guaranty was, and should remain, a "bankable asset" (as referred to in the interagency definition of loss[1]). This does not mean the obligation has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may result in the future. In this assessment, credit factors should be present that provide assurances that the obligation is reasonably well secured and if not, at least in process for full collection with imminent closure expected. These are necessarily high standards because the obligor is in default and under the control of the bankruptcy court. The claim is unsecured, and the lenders were not entitled to adequate protection payments or any other regular distribution from the bankruptcy estate that might be considered interest income. The total unsecured claims against the bankruptcy estate, of which the bank group was a part of, substantially exceed estimated recoverable amounts from a potential sale of the operating assets of the guarantor. These factors do not

[1] Interagency definition of loss: "Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future."

provide adequate support for the bank group's portion of these claims to remain indefinitely in the active portfolio, even when charged down to estimated recoverable amounts. The foreseeable events, since the guarantor filed for bankruptcy, held considerable uncertainties for those estimated recoverable amounts, and their unfolding in recent months does not obscure the fact that collection efforts were best characterized as recovery.

Thus, the classifications of the assignment of the equity interest in the commercial properties as "other assets" were upheld. Any remaining balance was deemed a recovery matter and directed to be charged off. However, since collection efforts were already in process, the banks were allowed to charge-off the losses consistent with the closing of the sales contracts scheduled for the upcoming quarter following this review. This decision was confirmed by the ombudsman and applied unilaterally to all banking groups.

Appeal 2—Appeal of Partial Assessment Fee

Background

A bank appealed to the ombudsman for a partial refund of its semi-annual assessment fee. The bank originally appealed to its supervisory office and was denied.

Discussion

The bank converted to a federal savings bank three months after paying its semi-annual assessment fee. According to the appeal, since the bank was no longer under the supervision of the OCC, it was entitled to a refund of the remaining assessment. The appeal included documentation to support the amount of payment made by the bank to the OCC for the six-month period.

Conclusion

The ombudsman reviewed the documentation submitted by the bank and OCC policies and procedures regarding payment of semi-annual assessment fees. According to paragraph (5) under section (a) of 12 CFR 8 Assessment of Fees, "Each bank subject to the jurisdiction of the Comptroller of the Currency on the date of the second or fourth quarterly Call Report required by the Office under 12 USC 161 is subject to the full assessment for the next six-month period." The OCC assessment is levied against all institutions that are in the national banking system as of December 31 and June 30. Therefore any bank that is a national bank on the assessment date is required to pay the full semi-annual assessment. Additionally, the Notice of Fees issued to all national banks on December 1, 2000, provided notification that the OCC planned to discontinue prorated refunds for institutions that leave the national banking system part way through an assessment period. This policy became effective as of January 1, 2001. Since the bank was a national bank on the date that the assessment was levied, the ombudsman opined that no partial refund was warranted.