Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

RESCINDED

March 30, 1993

This rescission applies to the transmitting document only and not the attached interagency guidance. Refer to (BB 1993-18) for the status of the attached interagency guidance.

MEMORANDUM FOR CHIEF EXECUTIVE OFFICERS

FROM: Jonathan L. Fiechter
Acting Director

SUBJECT: Interagency Policy Statement on Documentation for Loans to Small and Medium-Sized Businesses and Farms

On March 30, 1993, the four Federal bank and thrift regulatory agencies (Office of Thrift Supervision, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Federal Reserve Board) issued an Interagency Policy Statement on Documentation for Loans to Small and Medium-Sized Businesses and Farms.

Problems with the availability of credit over the past several years have been particularly significant in the area of small and medium-sized business and farm lending. While this may be due to a variety of factors, the four Federal regulatory agencies do not want misperceptions about the documentation required for such loans to be an impediment to lending. As a result, we have issued the attached Interagency Policy Statement. The purpose of this Statement is two-fold. First, we want to make clear the general standards we use in our evaluation of institutions' loan documentation policies.

Second, the Interagency Policy Statement also establishes a new policy, under which well-run, adequately-capitalized banks and thrifts can make small and medium-sized business loans without fear of examiner criticism of loan documentation. These institutions are, by definition, those that have demonstrated sound judgment and good underwriting skills. Moreover, their strong capital position insulates the deposit insurance funds from potential losses.

These institutions will be permitted to identify a portion of their small and medium-sized business loan portfolio that will be evaluated solely on performance and will be exempt from examiner criticism of documentation. While management will continue to be responsible for the credit quality assessment and loan loss allowance for these loans, the lending institution will not be subject to criticism for the documentation of these loans. To qualify for the exemption, each loan may not exceed the lesser of $[illegible] or three percent of total capital and the aggregate value of the loans may not exceed 20 percent of total capital. In addition, loans selected for this exemption by an institution must not be delinquent as of the selection date, nor may they be to an insider."

To implement this new Policy Statement, OTS will issue an interim final regulation to waive the current loan documentation requirements at 12 C.F.R. 563.170(c).

The agencies will monitor how qualifying institutions implement this authority and how these institutions and the loans they designate for inclusion perform. The agencies may revise the policy statement based on this experience. Please contact your Regional office if you have any questions about the *Policy Statement.*

Attachment

Joint Release

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

Interagency Policy Statement on Documentation of Loans

March 30, 1993

The four federal regulators of banks and thrifts — the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision — today announced further details on the implementation of their March 10 program to increase credit availability. Today's policy statement outlines changes in the area of loan documentation.

The strongest banks and thrifts, those with regulatory ratings of 1 or 2 and with adequate capital, will now be able to make and carry some loans to small- and medium-sized businesses and farms with only minimal documentation. The total of such loans at an institution will be limited to an amount equal to 20 percent of its total capital. Eligible banks and thrifts will be encouraged to make these based on their own best judgment as to the creditworthiness of the loans and the necessary documentation. These loans will be evaluated solely on the basis of performance and will be exempt from examiner criticism of documentation.

Each minimal documentation loan is subject to a maximum loan size of $900,000 or 3 percent of the lending institution's total capital, whichever is less. If a borrower has multiple loans in the exempt portion of the portfolio, those loans must be aggregated before the maximum is applied. Loans to institution insiders — executive officers, directors, and principal shareholders — are ineligible for inclusion, as are loans that are already delinquent.

The package also offers some relief for banks that do not qualify for the program, and for loans that are not in the exempt portion of a bank's portfolio. The policy statement also includes guidelines which provide institutions some additional flexibility in applying their documentation policies for small- and medium-sized business and farm loans without examiner criticism.

Today's initiatives are directed at eliminating unnecessary documentation and reducing costs to lending institutions and the time it takes to respond to credit applications. OTS will soon issue a regulation to amend its current loan documentation requirements to comply with the statement. For banks, the program requires no change in existing regulations and is effective with today's release.

The complete program is being mailed to all regulated institutions and all examiners, and additional copies are available from the agencies.

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

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

March 30, 1993

Introduction

Problems with the availability of credit over the last few years have been especially significant in the area of small- and medium-sized business and farm lending. This reluctance to lend may be attributed to many factors, including general trends in the economy; a desire by both borrowing and lending institutions to improve their balance sheets; the adoption of more rigorous underwriting standards after the losses associated with some laxities in the 1980s; the relative attractiveness of other types of investments; the impact of higher capital requirements, supervisory policies, and examination practices; and the increase in regulation mandated by recent legislation — specifically, the Financial Institutions Reform, Recovery, and Enforcement Act and the Federal Deposit Insurance Corporation Improvement Act.

The four federal banking agencies — the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision — expect small- and medium-sized business and farm loans, like all credits, to be made consistent with sound underwriting policies and loan administration procedures. The agencies are concerned, however, that institutions may perceive that the agencies are requiring a level of documentation to support sound small- and medium-sized business and farm loans that is in excess of what is necessary to making a sound credit decision. Unnecessary documentation raises the cost of lending to small- and medium-sized businesses and farms, results in delays in bank lending decisions, and may discourage good borrowers from applying. The agencies believe that the elimination of unnecessary documentation for loans to small- and medium-sized businesses and farms will reduce costs to the institution and the time it takes to respond to credit applications from small- and medium-sized businesses and farms without adversely affecting the institution's safety and soundness.

The federal banking agencies expect financial institutions to maintain documentation standards that are consistent with prudent banking policies. However, the maintenance of documentation beyond that necessary for a credit officer to make a sound credit decision and to justify that decision to the institution's management adds to loan administration costs without improving the credit quality of the institution. Unnecessary documentation impedes the institution from responding in a timely and prudent manner to the legitimate credit needs of small- and medium-sized businesses and farms in its community. Accordingly, the agencies are taking steps to correct any misunderstanding of regulatory requirements and to reduce regulatory impediments to lending to creditworthy small- and medium-sized businesses and farms.

Documentation Exemption for Small- and Medium-sized Business and Farm Loans

Well- or adequately capitalized institutions with a satisfactory supervisory rating will be permitted to identify a portion of their portfolio of small- and medium-sized business and farm loans that will be evaluated solely on performance and will be exempt from examiner criticism of documentation. While bank and thrift management will retain responsibility for the credit quality assessment and loan loss allowance for these loans, the lending institution will not be subject to criticism for the documentation of these loans.

This exemption will be available only to institutions that are well- or adequately capitalized institutions under each agency's regulations implementing section 38 of the Federal Deposit Insurance Act and that are rated CAMEL or MACRO 1 or 2. These institutions are by definition those that have demonstrated sound judgment and good underwriting skills; moreover, their strong capital position insulates the deposit insurance funds from potential losses that may be incurred through small- and medium-sized business and farm lending.

To qualify for the exemption, each loan may not exceed the lesser of $900,000 or three percent of the institution's total capital, and the aggregate value of the loans may not exceed 20 percent of its total capital. In addition, loans selected for this exemption by an institution must not be delinquent as of the selection date, and each institution must comply with applicable lending limits and other laws and regulations in making these loans. Furthermore, such loans may not be made to an insider.

Small- and medium-sized business and farm loans that do not meet the criteria for exemption set forth in this policy statement would continue to be reviewed and classified in accordance with the agencies' existing policies.

The details of the exemption are as follows:

- **Documentation exemption.** Each institution eligible for the exemption provided in this policy statement may assign eligible loans, subject to the aggregate limit on such eligible loans, to an exempt portion of the portfolio. Loans assigned to this exempt portion will not be reviewed for the completeness of their documentation during the examination of the institution. Assignments of loans to the exempt portion shall be made in writing, and an aggregate list or accounting segregation of the assigned loans shall be maintained, including the performance status of each loan.

- **Restrictions on loans in the exempted portion of the portfolio.** The institution must fully evaluate the collectibility of these loans in determining the adequacy of its allowance for loan and lease losses (ALLL) or general valuation allowance (GVA) attributable to such loans and include this evaluation in its internal records of its assessment of the adequacy of its ALLL or GVA. Once a loan in the exempt portion of the portfolio becomes more than 60 days past due, the loan may be reviewed and classified by an examiner; however, any decision to classify would be based on credit quality and not on the level of documentation.

- **Eligible institutions.** An institution is eligible for the documentation exemption if (1) pursuant to the regulations adopted by the appropriate federal banking agency under section 38 of the FDI Act, the institution qualifies as well- or adequately capitalized, and (2) during its most recent report of examination, the institution was assigned a composite CAMEL or MACRO rating of 1 or 2.

- **Ineligible loans.** Loans to any executive officer, director, or principal shareholder of the institution, or any related interest of that person, may not be included in the basket of loans.

- **Aggregate limit on loans.** The aggregate value of all loans assigned to the basket of loans provided for in the exemption may not exceed 20 percent of the institution's total capital (as defined in the capital adequacy standards of the appropriate agency).

- **Limit on value of individual loan.** A loan, or group of loans to one borrower, assigned to the basket of loans provided for in the exemption may not exceed $900,000 or 3 percent of the institution's total capital (as defined in the capital adequacy standards of the appropriate agency), whichever is the smaller amount.

- **Transition from eligibility to ineligibility.** An institution that has properly assigned loans to the exempt portion of its portfolio pursuant to this statement but subsequently fails to qualify as an eligible institution may not add new loans (including renewals) to this category.

Treatment of Small- and Medium-sized Business and Farm Loans Not Qualifying for Exemption

The agencies will continue current examination practices with regard to documentation of small- and medium-sized business and farm loans at institutions not qualifying for the exemption and loans at qualifying institutions that are not assigned to the exempt basket. The guiding principle of agency review will continue to be that each insured depository institution should maintain documentation that provides its management with the ability to:

(a) make an informed lending decision and to assess risk as necessary on an ongoing basis;

(b) identify the purpose of the loan and the source of repayment;

(c) assess the ability of the borrower to repay the indebtedness in a timely manner;

(d) ensure that a claim against the borrower is legally enforceable; and

(e) demonstrate appropriate administration and monitoring of a loan.

In prescribing the documentation necessary to support a loan, an institution's policies should take into account the size and complexity of the loan, legal requirements, and the needs of management and other relevant parties (such as loan guarantors).

In applying these standards, the agencies will continue to recognize the difficulty and cost of obtaining some documents from small- and medium-sized businesses and farms. These difficulties and costs could result in some deviations from an institution's own loan documentation policy for small- and medium-sized business and farm lending. Such deviations are frequently based on past experience with the customer. In such cases, the loan will not be criticized if the examiner concurs that sufficient information exists to serve as a basis for an informed credit decision.

Implementation

This policy statement will take effect immediately upon issuance. However, the agencies will monitor how qualifying institutions implement its provisions and how those institutions and the loans they designate for inclusion in the exempt basket perform. Changes to this policy statement may be made based on the agencies' experience.