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BC - 215

EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Guidelines for Collateral Evaluation and Classification of Troubled Energy Loans

Replaced - See OCC Bulletin 2014-15.

TO: Chief Executive Officers of all National Banks

The Office of the Comptroller of the Currency has recently issued a supplement to examiners on the treatment of troubled oil and gas production loans. This circular is attached for your information. Questions or comments may be directed to the Deputy Comptroller for the District in which the bank is located or the Deputy Comptroller for Multinational Banking, Washington, D.C. 20219.

Robert J. Herrmann
Deputy Comptroller of the Currency

EC - 223
Supplement #1

EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Examining Circular

Subject: Guidelines for Collateral Evaluation and Classification of Troubled Energy Loans

TO: All Examining Personnel

On August 24, 1984, OCC issued EC-223 containing guidance regarding the evaluation and classification of troubled loans where collection was solely dependent on collateral consisting of oil and gas reserves. The guidelines have generally led to greater examination consistency in an area where previously there had been no formal direction. We are concerned, however, that their use in some cases has evolved into a non-discretionary process supplanting examiner judgement and diminishing the flexibility needed to assess each loan based on all pertinent credit factors.

The suggested approach to classifications contained in the guidelines was not intended for rigid application. As the guidelines indicate, there is no substitute for a specific, case-by-case analysis of applicable credit and collateral factors pertaining to each individual loan.

With specific regard to the percentages contained on pages 2 and 3, the guidelines state: "A lesser percentage or less severe criticism may be appropriate in cases where a reliable means of repayment exists for a portion of the debt. For example, the entire outstanding balance of an oil or gas production loan does not necessarily become "troubled" or shrunk, especially if there exists sufficient dedicated cash flow to service all or part of the loan. In other cases, a more severe criticism than that suggested by the guidelines may be appropriate.

Concerns have also been expressed with respect to the prices being used in estimating the value of oil and gas reserves. Obviously, the simplest approach is to observe spot or posted prices, or the prices being received at the wellhead. However, this approach carries with it the potential for distorting quarterly financial results by requiring frequent re-evaluations of collateral and adjustment of the ALLL during periods of

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interim swings in longer term price cycles. For this reason, banks may rely on the advice of in-house or independent petroleum experts to project longer term pricing scenarios on which to base estimates of collateral values. As there can be considerable differences of opinion on how prices will perform, examiners must analyze closely any pricing assumptions that are inadequately documented or incongruous with the general body of information available from recognized industry sources.

As with other types of credit, the determination of an adequate ALLL for energy loans depends on a thorough analysis of the true risk of loss in each loan or group of loans, regardless of ratings or classifications. Banks and examiners should refer to Banking Circular #201, dated May 2[illegible], 1985, when assessing adequacy of the ALLL.

Examiners should continue to review closely the systems and procedures each bank has implemented to monitor internally the quality of its energy loan portfolio. Weaknesses in a bank's approach to recognizing and providing for problem oil and gas production loans that might result in significant charge-offs and/or provisions should be communicated to the appropriate supervisory office.

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