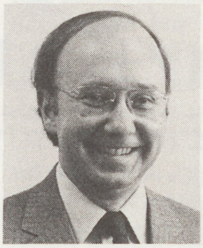

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Capital forbearance for commercial banks

by John C. Rasmus

Deterioration in the economies of certain agricultural and oil and gas-producing sections of this country has seriously impacted a number of well-managed commercial banks. These banks have experienced a decline in their capital base that otherwise could cause their regulators to reassess their status as viable institutions.

A capital forbearance program

Under the leadership of ABA and the state banking associations, bankers concerned about this situation have mobilized to seek some breathing room for the industry. They have urged the regulators to provide these banks with the opportunity to manage themselves out of this difficult situation. Responding to these banker initiatives, the federal financial regulators have developed a capital forbearance program to give banks the needed time to weather economic problems they did not create.

The ABA's Agricultural Bankers Division, through its Executive Committee and President Mark Olson's Task Force on Agricultural Credit, has helped spearhead the effort to bring this problem to the attention of the regulators. During frequent meetings with the regulators, bankers emphasized the need for a formal, capital-forbearance program to give banks time to rebuild their capital.

In March 1986, the Comptroller of the Currency, the Federal Deposit Insurance Corp. and the Federal Reserve Board announced a uniform capital forbearance policy for banks with specific concentrations in agricultural, oil and gas loans.

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This program allowed banks with primary capital between 4 percent and 5.5 percent to request time to rebuild their depleted capital to their regulatory minimum with the approval of the appropriate bank regulator.

A necessary ingredient

In order to qualify, the depleted capital would have had to result primarily from losses on agricultural, oil and gas loans, and not from other factors such as poor management. These agricultural, oil and gas loans would have to equal at least 25 percent of the bank's total loans and leases. Since the program was designed to be temporary, banks would have had to make application to participate no later than Dec. 31, 1987. If approved, they would have until Jan. 1, 1993, to rebuild their capital to acceptable levels. A necessary ingredient in the approval process was a business plan established by the bank and designed to achieve the acceptable regulatory minimum-capital level prior to 1993.

Because of the impact this forbearance program would have on national bank-lending limits, the Comptroller of the Currency issued a temporary rule increasing the loan-to-borrower lending limits to reflect the charged-off agricultural, oil and gas loans. This new lending limit of 20 percent of unimpaired capital and unimpaired surplus would apply to banks whose capital had declined as a result of the special loans charged-off during the window period of Jan. 1, 1986, to Dec. 31, 1987. The regulation was originally scheduled to expire Dec. 1, 1993.

Bankers wanted more guidance

Even though the regulators had stretched the application requirements on a case-by-case basis to include commercial banks with capital as low as 3 percent, bankers believed that regulators needed to do more to improve the program. Bankers were concerned with what was perceived as a lack of guidance from the regulators regarding the details of the application process. They believed that the program was unnecessarily restricted to the agricultural, oil and gas sectors of the United States when the economies of other regions of the country were suffering because of comparable problems. Bankers were concerned that the capital forbearance program would terminate before the underlying economic problems were resolved and banks were given the chance to return to good health.

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Bankers also believed that capital forbearance could benefit more banks than were participating in the program. According to bank regulators, of the approximately 220 applications completed for the first quarter of 1987, only 87 have been approved. Bankers believe that this demonstrates the need for more knowledge throughout the industry of the program's availability and modification of terms in order to attract greater participation.

In response to detailed suggestions from bankers, and following meetings with the regulators and the ABA Agricultural Credit Task Force, the Comptroller of the Currency, the FDIC and the Federal Reserve, in July 1987, adopted significant amendments to their programs. The capital forbearance program was extended two additional years until Jan. 1, 1995. The application period was extended two years until Dec. 31, 1989. The new guidelines also extended the program beyond the agricultural, oil and gas sectors to include "any well-run bank experiencing financial difficulties due to underlying economic problems beyond the control of the bank's management." The 4 percent eligibility level has been eliminated, opening the program to all banks operating with positive capital levels.

These changes should make the program even more attractive to commercial banks and provide needed time. They will allow distressed banks to rebuild their capital to acceptable levels so they can continue to serve their communities and ultimately provide a fair return on their stockholders' investments.

In the future the ABA Agricultural Bankers Division will continue to closely monitor the regulators' capital forbearance programs and urge modifications where appropriate.

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