CORRECTION OF APPARENT LEGAL LENDING LIMIT VIOLATIONS
OFI Advisory Opinion No. 5
November 13, 2008

Purpose

The purpose of this advisory opinion is to clarify the acceptable methods that state-chartered banks and thrifts may use for the correction of apparent legal lending limit violations under the Louisiana Banking Law (LBL) [banks-LSA—R.S. 6:415; savings and loan associations-LSA—R.S. 6:822; savings banks-LSA—R.S. 6:1235]. This interpretation was previously outlined in OFI Policy No. B/T-01-00 entitled Correction of Legal Lending Limit Violations dated December 29, 2000, which will be repealed as of the effective date of this advisory opinion.

Analysis

On occasion, an institution may inadvertently fund or commit to fund a loan or legally binding line of credit that is in apparent violation of the applicable legal lending limit section of the LBL. Once an apparent violation is corrected, it will be considered corrected from that point forward. Therefore, an apparent violation will be cited in the first examination report after the apparent violation occurred. If corrective action is taken or promised before an examination is complete, it will be noted in the writeup of the apparent violation under Management Response, but the apparent violation will be cited nonetheless.

Historically, this office has allowed any of the following methods to serve as **CORRECTION** for such apparent violations:

1. The institution may reduce the loan through the sale of the loan (or the nonconforming portion, at a minimum) in a nonrecourse participation agreement. A formal, binding commitment for the sale or nonrecourse participation that is consummated before or immediately upon funding the loan in excess of the legal lending limit is acceptable. A reduction resulting from the transfer of a portion of the outstanding credit to another borrower, considered a "nominee" relationship, is **NOT** acceptable.

2. The institution may reduce the loan through the receipt of payments. Charging off a portion of the loan to a level within the applicable legal lending limit does **NOT** correct the apparent violation.

3. For a legally binding line of credit in which the maximum amount to be funded when combined with the borrower's other loans exceeds the institution's legal

lending limit, the institution may be able to renegotiate the maximum amount of the line of credit or provide in its line of credit agreements that the institution is not obligated to fund the line of credit if this would cause the institution to exceed applicable statutory maximum lending limits.

4. On a case-by-case basis, the Commissioner may approve other acceptable methods for correcting an apparent violation of the legal lending limit as deemed appropriate under the circumstances.

An additional remedy available to a bank or savings bank includes the following:

5. The institution may assign additional collateral that qualifies for a higher legal lending limit pursuant to the appropriate lending limit of the institution. Bank examples include (a) an unsecured loan that is subject to a limit of 20 percent of the institution's unimpaired capital stock and unimpaired surplus could be increased to a 50 percent limit if fully secured, (b) a real estate secured loan subject to a 50 percent limit may reach 100 percent of the bank's unimpaired capital stock and unimpaired surplus by obtaining the pledge of an obligation of the U.S., State of Louisiana, or any subdivision or municipality thereof, or readily marketable staples, or (c) the portion of a loan fully secured by the pledge of a deposit in subject bank is not subject to any legal lending limit. An example available to a savings bank includes (d) an unsecured loan that is subject to a limit of 10 percent of the savings bank's net worth could be increased to a 25 percent limit if secured.

An additional remedy available to a bank includes the following:

6. The bank may increase its legal lending limit by increasing its capital stock or surplus accounts through transfers from its undivided profits or retained earnings account. Regulatory approval is not necessary for this transaction but is required when transferring an amount from capital stock or surplus accounts to undivided profits or retained earnings.

Apparent Violation Caused by a Merger

If an institution merges with another in the same trade area, both institutions may have direct or indirect debt to the same borrower(s). Consequently, the merged or surviving institution may have combined debt which exceeds its legal lending limit even though the borrower(s) was within the legal lending limit at both institutions individually.

Following a merger, the surviving institution will be expected to use reasonable judgment in determining how to bring the combined debt into compliance with its legal lending limit **consistent with sound banking practices**. The institution should consider using one of the methods noted above in addressing the situation. The institution would also be expected to document its efforts to address the situation for review by the examination staff at future examinations. As long as the institution is able to provide proper documentation of its

efforts, no apparent violation of the institution's legal lending limit under the LBL is considered to have occurred. **However, no additional loans or legally binding lines of credit may be extended to the borrowers(s) while the overline situation exists.**

Conclusion

While these actions are meant to resolve inadvertent apparent legal lending limit violations under the LBL caused by an oversight or with the merger of two institutions, management and the Board of Directors are ultimately responsible for ensuring compliance with all applicable state and federal laws, rules, and regulations.

John Ducrest, Commissioner
Office of Financial Institutions

| = Changes made when this opinion was updated from an OFI policy.