July 3, 2012

TO: CHIEF EXECUTIVE OFFICER
ALL STATE CHARTERED BANKS

FROM: BRET AFDAHL
DIRECTOR OF BANKING

RE: GUIDANCE AND APPLICATION FORM TO IMPLEMENT LENDING LIMIT EXCEPTION

The South Dakota Legislature recently passed Senate Bill 158 (SB 158) which became law on July 1, 2012. The bill amends SDCL chapter 51A-12 by adding two new sections to allow exceptions to the loan or credit limitation imposed on state chartered banks under certain circumstances. The new laws, 51A-12-2.1 and 51A-12-2.2, provide state chartered banks the flexibility to extend agricultural operating credits beyond the limitation defined in 51A-12-2, subject to certain requirements and limitations detailed below. 51A-12-2.1 will allow a state chartered bank in satisfactory condition (composite rating of “1” or “2”), with the consent of its Governing Board, to request an exception to the loan or credit limitation from the Director of Banking (Director). This guidance is intended to explain this new exception, its impact on our state chartered banks, and what will be required in each application. Management must ensure that any credit relationship contemplated as a candidate for an exception meets the following requirements prior to submitting an application to the Director. To qualify the credit must:

- Not be on the bank’s internal watch list or problem loan report;
- Not be adversely classified at the most recent regulatory examination;
- Be fully secured by the fair market value of the collateral and may not exceed one hundred percent of the discounted value assigned by the bank to the collateral;
- Be an agricultural operating loan in the bank’s normal trade area; and
- Be originated by the requesting bank.

No credit approved under this section may exceed 25 percent of the sum of capital stock, surplus and undivided profits. Furthermore, management may not exceed, in aggregate, 100 percent of the bank’s Tier One Leverage Capital, for loans or extensions of credit made pursuant to this section. This aggregate limitation is to be calculated using the total amount of each loan made pursuant to this exception process and NOT the difference between the exception based lending limit and the traditional lending limit. The exception based lending limit shall be determined based on the bank's most recently filed Report of Condition (Call Report), and will remain in effect until the approval expires. As provided in 51A-12-2.2, any exception to the lending limit granted by the Director shall expire when the applicable loan matures or twelve months after the exception is granted, whichever occurs first. An example is attached to aid in this calculation.

SB 158 was introduced to allow banks to exceed the traditional legal lending limit on a limited number of very high quality agricultural loans. As a result, 51A-12-2.1 and 51A-12-2.2 should aid state chartered banks in retaining large high-quality borrowers, increasing loan volume, and enhancing earnings with minimal additional risk. However, if a borrower's credit balance at maturity exceeds the traditional lending limit and the loan has since migrated to the watch list or has been adversely classified at a recent examination, the bank will need to either; participate a portion of the credit, or reduce the balance of the credit to prevent a violation of 51A-12-2 from occurring.

An application titled Exception to Loan or Credit Limitations is available online at our website, http://dlr.sd.gov/banking/. Simply select the "Forms" link from the left-hand navigation, and then the link to "Banking Forms" (Banking Information for Banking Professionals). A copy of the application form is enclosed for your convenience. For any questions regarding this guidance, please call your contact examiner; their business card is enclosed with this letter for your convenience. Please plan in advance for these requests, as the South Dakota Division of Banking will need up to two weeks to process your application(s).

EXAMPLE:

Bank A

Common Stock:	$500M
Surplus:	$2,500M
Undivided Profits:	$7,000M
Tier One Leverage Capital	$10,000M
Traditional Legal Lending Limit:	$1,300M (20% Capital Stock + 20% Surplus + 10% Undivided Profits)
Exception to the Legal Lending Limit:	$2,500M (25% Capital Stock + 25% Surplus + 25% Undivided Profits)

Bank A has identified six very high quality agricultural borrowers whose current needs are in excess of the bank's traditional legal lending limit. Each lending limit exception will require the Director's approval. None of the notes identified below are on Bank A's watch list or classified for regulatory purposes.

Borrower 1: The first borrower has three notes at the Bank. A real estate loan for $600M, an equipment note for $400M, and an operating line for $1,500M. In this instance, the bank would be able to apply for an exception for the agricultural borrower. Total loan commitment is $2,500M and the aggregate balance of $2,500M represents 25 percent of Tier One Leverage Capital. However, the exception for this agricultural customer would only apply to credit extended on the operating note, as the other loan types are not eligible for the exception. The real estate and equipment notes would need to comply with the traditional lending limit.

Borrower 2: The second borrower has two notes at the Bank. A real estate loan for $1,000M and an operating line for $1,500M. Again, in this instance, the bank would be able to apply for an exception. Total loan commitment for Borrowers 1 and 2 is $5,000M and the aggregate balance represents 50 percent of Tier One Leverage Capital. Once again, in this instance, the real estate note would need to comply with the traditional lending limit, with the operating note being eligible for an exception.

Borrower 3: The third borrower has four notes at the Bank including two real estate notes totaling $900M, one equipment note totaling $300M, and an operating line of credit for $1,000M. This customer relationship would also qualify for an exception for the agricultural borrower. Total loan commitments for Borrowers 1, 2, and 3 is $7,200M and the aggregate balance represents 72 percent of Tier One Leverage Capital. Consistent with Borrowers 1 and 2, this relationship would only be eligible for an exception on the operating note, and all other loan types must comply with the traditional lending limit.

Borrower 4: The fourth borrower has one operating note at the bank for $2,000M. This customer relationship would also qualify for an exception for the agricultural borrower. Total loan commitment for Borrowers 1, 2, 3, and 4 is $9,200M and the aggregate balance represents 92 percent of Tier One Leverage Capital.

Borrower 5: The fifth borrower has one real estate note at the bank for $1,200M and one equipment note for $600M. This customer would not qualify as an exception to the traditional lending limit since neither loan type is eligible. This customer relationship must comply with the traditional legal lending limit statute.

Borrower 6: The sixth borrower has one operating note at the bank for $1,500M. This customer relationship would not qualify for the exception because any amount exceeding the traditional lending limit amount of $1,300M would cause the aggregate balance of all eligible borrowers' loan balances ($9,200M + $1,300 M = $10, 500M) to exceed 100 percent of the bank's Tier One Leverage Capital which is the maximum allowable under the process established in 51A-12-2.1 and 51A-12-2.2.