

E&P Companies Poised to Fare Better Under OCC's Leverage Test

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As a sign of the improved financial health of the oil and gas industry, exploration and production companies appear to be in a better position to comply with strict lending guidelines released by the Office of the Comptroller of the Currency (OCC) in 2016, according to a [recent analysis](#) by Haynes Boone.

The OCC in 2016 published revised guidelines to assist banks in assessing the risk of their oil and gas loans. The revised guidelines resulted in a large majority of E&P borrowers being categorized as “classified” or otherwise as non-passing credits, which requires the banks to increase the amount of reserves held against these investments. In August 2016, Haynes Boone released a report that analyzed 58 E&P companies and determined that 53 of them (more than 91 percent) would fail the OCC’s leverage test in 2016. “The data suggests,” Haynes Boone concluded, “that the OCC has deemed the vast majority of the oil and gas industry as non-bankable.”

But the picture is improving, according to an updated analysis by Haynes Boone Counsel Laura Martone and Partner [Jeff Nichols](#). In October 2017, Martone and Nichols, with the assistance of The Mitchell Group, analyzed publicly available data for 55 E&P companies and estimated that about 62 percent of the companies would fail the OCC’s leverage test in 2017 – down from 91 percent in 2016. The companies’ “fail” rate, moreover, should decline to about 42 percent in 2018 and 26 percent in 2019, according to the updated Haynes Boone report.

Nichols says E&P companies are faring better because they have raised capital through means other than the banks, including from a robust capital market last year and from private equity firms that refinanced debt or used non-debt ways to finance these companies, such as farmouts or joint ventures. In addition, the price of oil has risen modestly in the past year, which helps with collateral values.

Martone notes that it will be interesting to see whether banks that left or took a step back from the E&P lending market will reengage as more companies cross over into “passing” territory and banks get more familiar with the OCC’s implementation of the revised guidelines.

To read the full report, click [here](#).

The report generated news coverage in [Oil & Gas 360](#) (Subscription required).