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## DEPARTMENT OF THE TREASURY

### Office of the Comptroller of the Currency

12 CFR Parts 32, 159 and 160

Docket ID OCC-2012-0007

RIN 1557-AD59

### Lending Limits

**AGENCY:** Office of the Comptroller of the Currency, Treasury.

**ACTION:** Interim final rule and request for comments.

**SUMMARY:** The Office of the Comptroller of the Currency (OCC) is amending its regulation governing lending limits for national banks to consolidate the lending limit rules applicable to national banks and savings associations and remove its separate regulation governing lending limits for savings associations. The OCC also is amending its rules to implement section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amends the statutory definition of “loans and extensions of credit” to include credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreements, securities lending transactions and securities borrowing transactions. Pursuant to the OCC’s authority in section 5200(d) of the Revised Statutes, the OCC is amending the lending limit rules to provide a temporary exception for the transactions covered by section 610 until January 1, 2013, in order to allow institutions a sufficient period to make adjustments to assure compliance with the new requirements.

**DATES:** This interim final rule is effective on July 21, 2012, except that amendatory instruction 3a amending § 32.2 is effective January 1, 2013. Comments must be received by [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title “Lending Limits” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal—“regulations.gov”:** Go to <http://www.regulations.gov>. Click “Advanced Search”. Select “Document Type” of "Interim Final Rule", and in “By Keyword or ID” box, enter Docket ID "OCC-2012-0007", and click "Search". If rules for more than one agency are listed, in the “Agency” column, locate the interim final rule for the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen. In the “Actions” column, click on “Submit a Comment” or "Open Docket Folder" to submit or view public comments and to view supporting and related materials for this rulemaking action.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- **E-mail:** [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov).
- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.
- **Fax:** (202) 874-5274.
- **Hand Delivery/Courier:** 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

**Instructions:** You must include “OCC” as the agency name and “Docket ID OCC-2012-0007” in your comment. In general, OCC will enter all comments received into the docket and

publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this interim final rule by any of the following methods:

- **Viewing Comments Electronically:** Go to <http://www.regulations.gov>. Click “Advanced Search”. Select “Document Type” of "Public Submission", and in “By Keyword or ID” box enter Docket ID "OCC-2012-0007", and click "Search". If comments from more than one agency are listed, the “Agency” column will indicate which comments were received by the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen.
- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.
- **Docket:** You may also view or request available background documents and project summaries using the methods described above.

**FOR FURTHER INFORMATION CONTACT:** Jonathan Fink, Assistant Director, Bank Activities and Structure Division, (202) 874-5300; Heidi M. Thomas, Special Counsel, Legislative and Regulatory Activities Division, (202) 874-5090; or Kurt Wilhelm, Director for Financial Markets, (202) 874-4479.

**SUPPLEMENTARY INFORMATION:**

**I. Background**

Section 5200 of the Revised Statutes, 12 U.S.C. 84, provides that the total loans and extensions of credit by a national bank to a person outstanding at one time shall not exceed 15 percent of the unimpaired capital and unimpaired surplus of the bank if the loan is not fully secured, plus an additional 10 percent of unimpaired capital and unimpaired surplus if the loan is fully secured. Section 5(u)(1) of the Home Owners' Loan Act (HOLA), 12 U.S.C. 1464(u)(1), provides that section 5200 of the Revised Statutes "shall apply to savings associations in the same manner and to the same extent as it applies to national banks." In addition, section 5(u)(2) of HOLA, 12 U.S.C. 1464(u)(2), includes exceptions to the lending limits for certain loans made by savings associations. These HOLA provisions apply to both Federal and state-chartered savings associations.

OCC regulations at 12 CFR parts 32 and 160.93 implement these statutes for national banks and state and Federal savings associations,<sup>1</sup> respectively. Section 160.93 specifically applies 12 U.S.C. 84 and the lending limit regulations and interpretations promulgated by the OCC for national banks to Federal and state savings associations. Section 160.93 also implements specific statutory lending limit exceptions unique to Federal and state savings associations.

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<sup>1</sup> The OCC has rulemaking authority for lending limit regulations applicable to national banks and to all savings associations, both state- and Federally-chartered. However, the FDIC, not the OCC, is the appropriate Federal banking agency for state savings associations and enforces these rules as to state savings associations.

Section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act), amends section 5200 of the Revised Statutes<sup>2</sup> to provide that the definition of “loans and extensions of credit” includes any credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between a national bank and that person. This amendment is effective July 21, 2012. By virtue of section 5(u)(1) of the HOLA, this new definition of “loans and extensions of credit” applies to all savings associations as well as to national banks.

## **II. Description of the Interim Final Rule**

### **A. Integration of Savings Associations.**

This interim final rule amends part 32 to consolidate the lending limit rules applicable to national banks and savings associations. Specifically, the interim final rule amends the authority section, § 32.1(a), to include relevant statutory citations for savings associations; amends the scope section, § 32.1(c), to include savings associations; inserts the term “savings association” elsewhere throughout the rule where necessary; and replaces “OCC” or “Comptroller” with “appropriate Federal banking agency,” as appropriate. The rule defines “appropriate Federal banking agency” as having the same meaning as in 12 U.S.C. 1813(q). For purposes of part 32, therefore, “appropriate Federal banking agency” means the OCC in the case of a national bank or Federal savings association, and the Federal Deposit Insurance Corporation (FDIC) in the case of a state savings association. The OCC also is removing 12 CFR 160.93 as no longer necessary in light of this consolidation. These changes will eliminate duplication and create efficiencies by establishing a single set of lending limit rules for national banks and savings associations, without substantially changing the requirements.

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<sup>2</sup> 12 U.S.C. 84.

Certain statutory provisions apply only to savings associations, and the interim final rule amends part 32 by adding § 32.3(d) to account for these statutory exceptions, which are included in current § 160.93. First, 12 U.S.C. 1464(u)(2)(A)(i) permits a savings association to make loans to one borrower in an amount not to exceed \$500,000, even if its limit as calculated under section 84 would be lower. Second, 12 U.S.C. 1464(u)(2)(A)(ii) prescribes a specific lending limit to develop domestic residential housing units provided certain conditions are met. This latter exception as included in the interim final rule differs from the provision in § 160.93 in that it incorporates a change made by section 404 of the Financial Services Regulatory Relief Act of 2006, which removed from 12 U.S.C. 1464(u)(2)(A)(ii) the requirement that the final purchase price of each single family dwelling unit not exceed \$500,000.

To complement the inclusion of these exception, the interim final rule adds an appendix to part 32 that is substantively identical to the current appendix to § 160.93 and that provides further interpretation of the domestic residential housing unit development exception. The interim final rule also adds to § 32.2 the definition of “residential housing units,” a term used in this exception and included in § 160.93(b).

In addition, the interim final rule carries over in new § 32.3(d)(3) the provision now contained in § 160.93(d)(5),<sup>3</sup> which provides that notwithstanding the lending limit, a Federal savings association may invest up to 10 percent of unimpaired capital and unimpaired surplus in obligations of one issuer evidenced by commercial paper or corporate debt securities that are, as of the date of purchase, investment grade.<sup>4</sup>

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<sup>3</sup> As part of the integration of bank and savings association rules, the OCC is considering whether to revise part 1 to include savings associations, in which case we will move this provision for savings associations from part 32 to part 1.

<sup>4</sup> The OCC recently revised § 160.93 in its rulemaking to implement section 939A of the Dodd-Frank Act by adopting alternatives to the use of external credit ratings. See 77 FR 35253 (June 13, 2012).

The interim final rule also deletes the current provision at § 160.93(h), which states that the OCC may impose more stringent restrictions on a Federal savings association's loans to one borrower if the agency determines that such restrictions are necessary to protect the safety and soundness of the savings association, since this provision simply repeats section 5(u)(3) of HOLA, 12 U.S.C. 1464(u)(3). The OCC also has authority to take action to prevent any type of unsafe or unsound lending practice by a savings association (or a national bank) on a case-by-case basis, and the OCC's broad authority under 12 U.S.C. 84(d)(1) to establish lending limits applicable to particular categories or classes of loans or extensions of credit broadly authorizes adjustments to the lending limits across types of loans and types of institutions. Furthermore, § 32.1(c)(4), as revised, provides that loans and extensions of credit made by national banks, savings associations, and their domestic operating subsidiaries must be consistent with safe and sound banking practices.

The treatment of financed sales of bank assets in part 32, § 32.2(k)(2)(iii), and the provision now contained in the savings association rule, § 160.93(e), addressing the financed sale of real property acquired in satisfaction of debts previously contracted (DPC property) are comparable. Specifically, current § 32.2(k)(2)(iii) provides that the financed sale of bank assets is not treated as a loan for purposes of the lending limit if the financing does not place the bank in a worse position than when the bank held title to the assets. Section 160.93(e) applies the same treatment to the financed sale of DPC property. The final rule incorporates savings associations into the part 32 provision, renumbered as § 32.2(q)(2)(iii) by this interim final rule. While the scope of the national bank rule is somewhat broader, covering the financed sale of all bank assets and not just DPC property, the financed sale of other bank assets, subject to the existing requirement that the sale not place the bank in a worse position, is consistent with safety and soundness considerations. OCC supervisory experience does not indicate that exempting the

financed sale of all bank assets from the general lending limit, where the sale does not place the bank in a worse position, has been a problem at national banks, and therefore the interim final rule applies such treatment to the financed sale of a savings association's assets. Accordingly, under the interim final rule, financed sales of a savings association's own assets, including Other Real Estate Owned, do not constitute loans or extensions of credit if the financing does not put the institution in a worse position than when it held title to the assets. Financed sales that put the savings association in a worse position than when it held title to the assets are subject to the general combined limit set forth in § 32.3(a). This treatment is consistent with § 160.93(e).

The interim final rule also revises the scope provision in part 32. Current § 32.1(c) excludes loans made to affiliates, operating subsidiaries, or Edge Act or Agreement Corporation subsidiaries. The amendment incorporates the exclusion in § 160.93(a) of loans to certain savings association service corporations. It also broadens in some respects the exclusion for loans to certain subsidiaries of national banks. As amended, the exclusion also will apply to loans to any subsidiary consolidated with the bank under Generally Accepted Accounting Principles (GAAP).

Question 1: Has the OCC appropriately addressed the applicability of the lending limit to loans made to subsidiaries with respect to the amendments made to the scope section?

Under the interim final rule, savings associations are required to calculate their lending limits in accordance with the rules set forth in § 32.4. Although stated differently in § 160.93(f), the calculation rule for a national banks and savings associations lending limit produces the same result. Section 32.4 provides that a national bank shall calculate its lending limit as of (1) the most recent of the last day of the preceding calendar quarter (effective as of the earlier of the date on which the bank's Consolidated Reports of Condition and Income (Call Report) is submitted or the date it is required to be submitted) or (2) the date on which there is a change in the bank's

capital category (effective when the lending limit is to be calculated.) The OCC may require more frequent calculations for safety and soundness reasons. The current rule for savings associations, set forth at § 160.93(f), provides for the savings association to calculate its lending limit as of the most recent periodic report required to be filed prior to the date of the loan unless the savings association knows or has reason to know of a significant change subsequent to filing the report. Under § 160.93(f), the most recent periodic report is the savings association's Call Report, which is filed, as with national banks, for each calendar quarter. A "significant change" would include a change in the savings association's capital category. Therefore, there is no substantive difference in how a savings association will calculate its lending limit under the interim final rule.

Part 32 and § 160.93 differ in certain respects and there are some differences that are not being incorporated into part 32. First, the scope of part 32 is narrower than that of § 160.93. Part 32 applies the lending limit restrictions to loans and extensions of credit made by national banks and their domestic operating subsidiaries. The lending limit restrictions in current § 160.93 apply to loans made by savings associations and all their subsidiaries.

Question 2: Has the OCC appropriately addressed the applicability of the lending limit to loans made by subsidiaries of savings associations by narrowing the scope of the rule to domestic operating subsidiaries?

Second, § 160.93(f) requires savings associations to document their lending limit compliance if the loan is greater than \$500,000 or 5 percent of unimpaired capital and unimpaired surplus. The interim final rule does not include this unique documentation requirement in part 32. Consistent with safe and sound banking practices, institutions should always maintain documentation showing compliance with the lending limit.

The interim final rule also makes a clarifying change to §32.7, Residential real estate loans, small business loans, and small farm loans, by amending the title of this section to reference the “Supplemental Lending Limits Program,” and by replacing the phrase “special lending limits” with “supplemental lending limits” throughout the section. This conforms §32.7 to the terminology currently used by the OCC.

**B. Section 610 of the Dodd-Frank Act**

The interim final rule amends part 32 to implement section 610 of the Dodd-Frank Act. Section 610 amends section 5200(b) of the Revised Statutes<sup>5</sup> to provide that the definition of “loans and extensions of credit” includes any credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between a national bank and the person. Section 610 also amends section 5200(b) by adding a definition of “derivative transaction” to include any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets. These amendments are effective July 21, 2012, two years after enactment of the Dodd-Frank Act.

Section 610 adds to the scope and complexity of the lending limits. To implement these new requirements, the interim final rule amends the definition of “loans and extensions of credit” in § 32.2, to include certain credit exposure arising from a derivative transaction or a securities financing transaction. A securities financing transaction is defined as a repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction. The interim final rule also removes current § 32.2(k)(1)(iii), which excludes repurchase

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<sup>5</sup> 12 U.S.C. 84(b).

agreements for Type I securities from the definition of loan or extension of credit. Instead, it adds a provision, set forth at § 32.3(c)(11) and explained below, that exempts credit exposure arising from securities financing transactions involving Type I securities for all securities financing transactions.<sup>6</sup>

The interim final rule also adds a definition of “derivative transaction” as new paragraph (k) of § 32.2 that mirrors the definition added to section 5200 of the Revised Statutes by section 610. To complement these changes, it amends the definition of “borrower,” redesignated as § 32.2(b), to include a party to whom the bank has credit exposure arising from a derivative transaction or a securities financing transaction. It also amends § 32.2 to add the definitions of “credit derivative,” “qualifying central counterparty,” and “qualifying master netting agreement,” all defined as in current 12 CFR part 3, as well as “effective margining arrangement,” “eligible credit derivative,” and “eligible protection provider.” These terms are used in new § 32.9, as described below.

Question 3: Are these terms adequately defined? Are there other terms we should define in part 32 to help implement section 610 of the Dodd-Frank Act?

Section 610 does not provide guidance on how to measure the fluctuating credit exposure of derivative transactions and securities financing transactions for purposes of the lending limit. In order to reduce the practical burden of such calculations, particularly for smaller and mid-size banks and savings associations, the OCC is providing different options for measuring the appropriate exposures in new § 32.9, as discussed below. The OCC believes these alternatives implement the statutory changes, consistent with safety and soundness and the goals of the statute, in a manner that seeks to reduce unnecessary new regulatory burden..

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<sup>6</sup> We note, however, that the deletion of current § 32.2(k)(1)(iii), renumbered as §32.2(q)(1)(vii) in the interim final rule, is effective as of January 1, 2013, the date new § 32.3(c)(11) takes effect pursuant to new § 32.1(d), discussed below.

1. Derivative transactions.

The “credit exposure” arising from a derivative transaction is commonly viewed as the sum of the current credit exposure on the contract or portfolio plus some measure of potential future exposure (PFE). Under the interim final rule, the “current credit exposure” is determined by the mark-to-market value (MTM) of the derivative contract. The current MTM is generally zero at execution of the contract. Subsequent to the execution of the contract, if the MTM value is positive, then the current credit exposure equals that MTM value. If the MTM value is zero or negative, then the current credit exposure is zero. This current credit exposure determination is the same as that included in the capital rules at 12 CFR part 3, Appendix A, § 3(b)(7)(A).

PFE, on the other hand, recognizes the possibility that the MTM amount may increase over time, based upon changes in market factors. The PFE, when added to the MTM amount, can be viewed as the anticipated ceiling of credit exposure at the execution of a derivative transaction.

The interim final rule provides three methods for calculating credit exposure of derivative transactions other than credit derivatives. Unless required to use a specific method by the appropriate Federal banking agency pursuant to § 32.9(b)(3), a national bank or savings association may choose which of these methods it will use. However, a national bank or savings association must use the same method for calculating credit exposure arising from all derivative transactions. Examples of these three approaches are reflected in the Explanatory Table that appears in section 4 of this preamble.

Question 4: Is the requirement to use the same method when calculating credit exposure for all non-credit derivative transactions appropriate? Should institutions be allowed to use a different method for different types of transactions or for the same transaction type but different parties?

Under the first method, the “Internal Model Method,” national banks and savings associations may model their exposures via an internal model approved by the OCC. Under this method, the counterparty credit exposure of a derivative transaction will be measured by a model that estimates a credit exposure amount, inclusive of the current MTM. A bank or savings association using this approach should calculate its exposure by using the internal model that it considers most appropriate in evaluating the risk associated with derivative transactions. The model must have been approved for purposes of section 53 of the Advanced Approaches Appendices of the appropriate Federal banking agencies’ capital rules, 12 CFR part 3, Appendix C for national banks; 12 CFR part 167, Appendix C for Federal savings associations; and 12 CFR 390, subpart Z, Appendix A for state savings associations, or be another appropriate model approved by the appropriate Federal banking agency. A national bank or savings association that elects to calculate its credit exposure by using the Internal Model Method will be permitted to net credit exposure of derivative transactions arising under the same qualifying master netting agreement, thereby reducing the institution’s exposure to the borrower to the net exposure under the master netting agreement.

Question 5: Would it be more appropriate to require that national banks and savings associations use other models instead of the one included in part 3?

Second, pursuant to § 32.9(b)(1)(ii), a national bank or savings association may choose to measure the credit exposure arising from a derivative transaction under the “Conversion Factor Matrix Method.” Under this method, the credit exposure will equal and remain fixed at the PFE of the derivative transaction, as determined at execution of the transaction by reference to a simple look-up table (Table 1). This table is similar to Table B included in the Risk-Based Capital Guidelines Appendix of 12 CFR part 3, but has been adjusted so that the table adequately reflects the absence of the current MTM component of the credit exposure of these transactions.

This approach will be considerably less burdensome than the Internal Model Method because institutions would not have to establish statistical simulations of future PFE calculations.

Under the third method, the Remaining Maturity Method, as set forth in § 32.9(b)(1)(iii), the measurement of the credit exposure incorporates both the current MTM and the transaction's remaining maturity (measured in years) as well as a fixed add-on for each year of the transaction's remaining life. Specifically, this method measures credit exposure by adding the current MTM value of the transaction to the product of the notional amount of the transaction, the remaining maturity of the transaction, and a fixed multiplicative factor. These multiplicative factors differ based on product type and are determined by a look-up table (Table 2).

The credit exposure calculated under the Remaining Maturity Method accounts for the diminishing maturity of the transaction as well as the current MTM of the transaction. Institutions may find that any additional burden involved with determining the MTM under this optional method is balanced by the fact that, depending on the MTM, as the maturity decreases, the credit exposure also decreases, thereby permitting additional extensions of credit under the lending limit.

In addition, the Remaining Maturity Method incorporates the fact that a negative MTM for a bank offsets the positive contribution to exposure from the remaining life portion of the calculation, though the overall calculation has a floor of zero.

Question 6: Does the calculation under the Remaining Maturity Method adequately measure the credit exposures attributable to derivative transactions? For the Conversion Factor Matrix Method, has the OCC adjusted the numbers in the look-up table (Table 1) in a manner that adequately captures, overstates, or understates the credit exposures of these transactions? Similarly, for the Remaining Maturity Method, has the OCC calibrated the values included in Table 2 correctly so that they appropriately measure the credit risk?

In the case of credit derivatives, in which a national bank or savings association buys or sells credit protection against loss on a third-party reference entity, a special rule applies that is set forth in § 32.9(b)(2) of the interim final rule. Specifically, a national bank or savings association that uses the Conversion Factor Matrix Method or Remaining Maturity Method, or that uses the Internal Model Method without entering an effective margining arrangement with its counterparty as defined in § 32.2(l) of the interim final rule, calculates the counterparty credit exposure arising from credit derivatives by adding the net notional value of all protection purchased from the counterparty on each reference entity. For example, Bank A buys and sells credit protection from and to Bank B on Firms X, Y and Z. No effective margining arrangement exists between the banks. Bank A's net notional protection purchased from Bank B is \$50 for Firm X and \$100 for Firm Y. Bank A's net protection sold to Bank B is \$35 for Firm Z. The lending limit exposure of Bank A to Bank B is \$150.

In addition, a national bank or savings association calculates the credit exposure to a reference entity<sup>7</sup> arising from credit derivatives by adding the notional value of all protection sold on the reference entity. For example, Bank C buys and sells credit protection on Firms 1, 2 and 3. Bank C's notional protection sold is \$100 for Firm 1, \$200 for Firm 2 and \$300 for Firm 3. The lending limit exposure of Bank C to Firm 1 is \$100, to Firm 2 is \$200 and to Firm 3 is \$300.

However, the bank or savings association may reduce its exposure to a reference entity by the amount of any eligible credit derivative, as defined in § 32.2(m), purchased on that reference entity from an eligible protection provider, as defined in § 32.2(o). In the last example,

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<sup>7</sup> Section 610 of the Dodd-Frank Act applies the lending limit to counterparty credit exposures arising from derivative transactions (“credit exposure to a person arising from a . . . transaction between the national banking association and the person”) (emphasis added). Section 610 (a)(1), as codified at 12 U.S.C. 84(b)(1)(C). The OCC's authority to apply the lending limit to exposures to reference entities in credit derivatives derives from 12 U.S.C. § 84(b)(1)(B) (loans subject to the lending limit include “to the extent specified by the Comptroller of the Currency, any liability . . . to advance funds to or on behalf of a person pursuant to a contractual commitment”).

if Bank C purchases protection on Firm 3 from an eligible protection provider in the amount of \$25 via an eligible credit derivative, Bank C can reduce its \$300 lending limit exposure to Firm 3 to \$275.

Question 7: Has the OCC appropriately provided for exposure to both counterparties and reference entities?

Question 8: Should protection purchased from eligible protection providers by way of eligible credit derivatives be allowed to reduce other exposures under the lending limit, for example, loans traditionally covered by the lending limit and counterparty credit exposure arising from financial derivatives, at least where the protection contract maturity is as long as the maturity of the other exposure?

Although both the Internal Model Method, the Remaining Maturity Method, and the Conversion Factor Matrix Method will generally be available to all institutions, the interim final rule provides that the OCC, in the case of national banks and Federal savings associations, and the FDIC, in the case of state savings associations, may require use of a specific method to calculate credit exposure if it finds that such method is necessary to promote the safety and soundness of the bank or savings association.

The OCC is aware that, under the Conversion Factor Matrix Method, the actual MTM value at a given point in the life of a derivative contract may exceed the initially estimated PFE, and that it would be possible for a bank to make a new loan that, combined with the actual exposure (were such exposure based on current MTM value), could exceed the lending limit. The OCC believes that the risks in such case are limited and can be addressed in the supervisory process by examiners appropriately responding to unsafe and unsound concentrations, and that the certainty and simplicity of allowing non-complex banks and savings associations to “lock in” the attributable exposure at the execution of the contract balance the possible risks.

Question 9: Has the OCC properly reflected the different derivative transactions undertaken by community, mid-size, and large institutions for purposes of application of the lending limits? Does the rule adequately capture the actual risks of these transactions?

2. Securities Financing Transactions.

The interim final rule provides national banks and savings associations with two options for determining the credit exposure of securities financing transactions, defined as repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions. These methods recognize that the size of the institution and complexity and volume of the securities financing transactions engaged in by the institution may warrant different approaches. As with derivative transactions, unless required to use a specific method pursuant to §32.9(c)(2), a national bank or savings association may choose which of the two methods it will use and must use this same method for calculating credit exposure arising from all securities financing transactions.

Question 10: Is the requirement to use the same method to calculate credit exposure for all securities financing transactions appropriate? Should institutions be allowed to use a different method for different types of securities financing transactions, or for the same transaction type but different parties?

The first option, the Internal Model Method, provides that an institution may calculate the credit exposure of a securities financing transaction by using an internal model approved by the appropriate Federal banking agency for purposes of § 32(d) of the Internal-Ratings-Based Appendices of the OCC or FDIC's capital rules,<sup>8</sup> as appropriate, or any other appropriate model approved by the appropriate Federal banking agency.

The calculation of the credit exposure under the second option, the Non-Model Method,

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<sup>8</sup> 12 CFR part 3, Appendix C for national banks; 12 CFR part 167, Appendix C for Federal savings associations; and 12 CFR 390, subpart Z, Appendix A for state savings associations.

is based on the type of securities financing transaction at issue. As with derivative transactions, the OCC finds that for non-complex institutions engaged in these transactions, the simpler approach to measuring credit exposure in the Non-Model Method adequately protects the safety and soundness of the institution while mitigating regulatory burden. The specific method for calculating credit exposure under the Non-Model Method for each type of securities financing transaction is set forth below.

Repurchase agreements and securities lending transactions. In a repurchase agreement, also known as a liability repo, an institution that owns securities borrows funds by selling the specified securities to another party under a simultaneous agreement to repurchase the same securities at a specified price and date. In a securities lending transaction, an institution lends securities to a counterparty (who may use them to cover a short sale or satisfy some other obligation). A securities loan is collateralized, usually by cash but sometimes by other securities. The economics of a securities lending transaction are identical to a repurchase agreement when the collateral received by the institution is cash. If the collateral is securities, the economics are slightly different because there is the risk of market price changes on both the securities loaned and the securities received as collateral. For example, the value of the security loaned could increase, and the value of the collateral received could decrease.

The interim final rule provides under the Non-Model Method, in §§ 32.9(c)(1)(ii)(A) and (ii)(B)(1), that for a repurchase agreement or a securities loan where the collateral is cash, exposure under the lending limit will be equal to and remain fixed at the net current exposure, i.e., the market value at execution of the transaction of securities transferred to the other party, less cash received from the other party. For securities lending transactions where the collateral is other securities (i.e., not cash), § 32.9(c)(1)(ii)(B)(2) of the interim final rule provides that the exposure will be equal to and remain fixed at the product of the higher of the two haircuts

associated with the securities, as determined by a look-up table included in the regulation (Table 3), and the higher of the two par values of the securities. The haircuts in Table 3 are consistent with the standard supervisory market price volatility haircuts in 12 CFR part 3, Appendix C.

Reverse repurchase agreements (asset repos) and securities borrowing transactions. In a reverse repurchase agreement, also known as an asset repo, an institution lends money to a counterparty by purchasing a security and agreeing to resell the security to the counterparty at a future date. For example, an institution may enter into an asset repo to invest excess liquidity or to obtain securities to use as collateral in other transactions, or an institution may need securities to cover short positions or to pledge against public funds to obtain a low-cost source of funding.

In a typical securities borrowing transaction, an institution needing to borrow securities obtains the securities from a securities lender and posts collateral in the form of cash and/or marketable securities with the securities lender (or an agent acting on behalf of the securities lender) in an amount that fully covers the value of the securities borrowed plus an additional margin, usually ranging from two to five percent. The economics of a securities borrowing transaction are identical to a reverse repurchase agreement (asset repo) when the collateral posted by the institution is cash.

Under the Non-Model Method, §§ 32.9(c)(1)(ii)(C) and (c)(1)(ii)(D)(1) of the interim final rule provide that the credit exposure arising from a reverse repurchase agreement or a securities borrowing transaction where the collateral is cash will equal and remain fixed at the product of the haircut associated with the collateral received, as determined in Table 3, and the amount of cash transferred to the other party. Section 32.9(c)(1)(ii)(D)(2) provides that the credit exposure arising from a securities borrowed transaction where the collateral is other securities (i.e., not cash) shall equal and remain fixed at the product of the higher of the two haircuts associated with the securities, as determined in Table 3, and the higher of the two par

values of the securities.

Question 11: Are the look-up tables provided in the rule appropriate? Would another look-up table included in 12 CFR part 3 be more appropriate? Do the numbers included in Table 1 adequately capture the credit exposure of the transactions in question?

Provision applicable to all securities financing transactions - Type I securities. New § 32.3(c)(11) of the interim final rule excepts from the lending limit credit exposures arising from securities financing transactions in which the securities being financed are certain government securities, specifically, Type I securities, as defined in 12 CFR 1.2(j), in the case of national banks; or securities listed in section 5(c)(1)(C), (D), (E), and (F) of HOLA and general obligations of a state or subdivision as listed in section 5(c)(1)(H) of HOLA, 12 U.S.C. 1464(c)(1)(C), (D), (E), (F), and (H), in the case of savings associations.<sup>9</sup> This exception is appropriate because these transactions typically involve less risk and involve securities in which national banks and savings associations may invest under 12 U.S.C. 24(Seventh) and section 5(c)(1) of the HOLA, as appropriate, without limit. This treatment follows the treatment of reverse repurchase agreements in current part 32, under which such transactions are treated as

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<sup>9</sup> For national banks, a Type I security means: (1) obligations of the United States; (2) obligations issued, insured, guaranteed by a department or an agency of the United States Government, if the obligation, insurance, or guarantee commits the full faith and credit of the United States for the repayment of the obligation; (3) obligations issued by a department or agency of the United States, or an agency or political subdivision of a state of the United States, that represent an interest in a loan or a pool of loans made to third parties, if the full faith and credit of the United States has been validly pledged for the full and timely payment of interest on, and principal of, the loans in the event of non-payment by the third party obligor(s); (4) general obligations of a state of the United States or any political subdivision thereof; and municipal bonds if the national bank is well capitalized; (5) obligations authorized under 12 U.S.C. 24(Seventh) as permissible for a national bank to deal in, underwrite, purchase, and sell for the bank's own account, including qualified Canadian government obligations; and (6) other securities the OCC determines to be eligible as Type I securities under 12 U.S.C. 24(Seventh). See section 24(Seventh) of the Revised Statutes, 12 U.S.C. 24(Seventh) and 12 CFR 1.2(j). For Federal savings associations, these investments include obligations of, or fully guaranteed as to principal and interest by, the United States; investments in securities of the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Government National Mortgage Association, or any agency of the United States; and investments in obligations issued by any state or political subdivision thereof. See section 5(c)(1) of the HOLA, 12 U.S.C. 1464(c)(1).

loans subject to an exception for transactions relating to Type I securities as defined in 12 CFR part 1. This exception may reduce regulatory burden for community and midsize institutions because it is relatively uncommon for these institutions to engage in a securities financing transaction involving non-type I securities and non-5(c)(1) securities.<sup>10</sup>

(3) Mandatory use of model. Finally, as with derivative transactions, § 32.9(c)(2) provides that the OCC or FDIC, as appropriate, may require a national bank or savings association to use a specific method to calculate the credit exposure of securities financing transactions if the OCC or FDIC finds that this method is necessary to promote the safety and soundness of the bank or savings association.

Question 12: Has the OCC properly accounted for the different securities financing transactions in institutions of different size and complexity? Does the rule adequately capture the actual risks of these transactions?

Question 13: Please comment on the provision that provides the OCC and FDIC with authority to require modeling. Is this discretion appropriately described?

3. Provisions applicable to both derivative transactions and securities financing transactions.

Unless described above, all provisions of part 32 will apply to credit exposures arising from a derivative transaction or a securities financing transaction, including the lending limit calculation rules of § 32.4 and the combination rules of § 32.5. In addition, the interim final rule adds the following provisions to part 32 that apply only to derivative transactions or securities financing transactions.

Exception. The interim final rule amends § 32.3(c) to add intraday credit exposures arising from a derivative transaction or securities financing transaction as an additional exception

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<sup>10</sup>See current § 32.2(k)(1)(iii). As noted above, the interim final rule deletes § 32.2(k)(1)(iii) (renumbered by the interim final rule as (§32.2(q)(1)(vii)) as we have added new § 32.3(c)(11).

to the lending limits for national banks and savings associations. This exception will help minimize the impact of the interim final rule on the payment and settlement of financial transactions and is consistent with the current application of national bank lending limits to certain transactions.<sup>11</sup>

Question 14: Is the intraday exception appropriate? Should the OCC exempt other types of intraday exposures? Should the OCC provide for other exemptions for credit exposures arising from derivative transactions or securities financing transactions? Why?

Nonconforming Loans and Extensions of Credit. The interim final rule adds a new paragraph (a)(3) to § 32.6 to provide that a credit exposure arising from a derivative transaction or securities financing transaction and determined by the Internal Model Method specified in § 32.9(b)(1)(i) or § 32.9 (d)(3), respectively, will not be deemed a violation of the lending limits statute or regulation and will be treated as nonconforming if the extension of credit was within the national bank's or savings association's legal lending limit at execution and is no longer in conformity because the exposure has increased since execution.

Question 15: The interim final rule does not address the applicability of the lending limit rules to a national bank's or savings association's contingent obligation under derivative clearinghouse rules to advance funds to a clearinghouse guaranty fund. Please comment on whether and to what extent part 32 should apply to these obligations and if applicable, how the credit exposure of these obligations should be measured.

Question 16: Should the lending limit calculation rules set forth at § 32.4 or the combination rules set forth at § 32.5 be adjusted or changed in any way given the addition of

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<sup>11</sup> We note that the lending limit rules have long provided that an intraday overdraft and a sale of Federal funds with a maturity of one day or less are not subject to the lending limit. See 12 CFR 32.2(k)(1)(v), (vi) of the current rule.

credit exposures arising from derivative and securities financing transactions to part 32 as new categories of extensions of credit?

4. Explanatory Table

The table below is provided to aid in understanding the interim final rule. It is not a substitute for the interim final rule itself.

Transaction Type	What Happens?	Credit Risk	Transaction Purpose	Credit Exposure	Example
Interest Rate Swap	Banks execute interest rate and other swaps by signing a transaction confirmation, which becomes part of an ISDA Master Agreement.	<p>If the bank receives a fixed rate, it has a mark-to-market (MTM) gain if interest rates fall. That represents a current credit exposure (CCE).</p> <p>If the bank pays a fixed rate, it has a MTM gain if rates rise. A MTM gain is CCE.</p> <p>Beyond current exposure, the bank has a risk of potential future exposure (PFE), i.e., the amount the CCE might become over time.</p>	Banks do interest rate swaps to convert cash flows from fixed to floating, or vice versa.	<p>Banks that have an approved model can choose to use the model to determine the attributable credit exposure.</p> <p>Institutions can lock-in, or fix, attributable credit exposure at the potential future exposure (PFE) on day 1 by simply multiplying notional principal amount by a conversion factor provided in table. No requirement to calculate daily mark-to-market or re-calculate PFE.</p>	<p><u>Non-modeled bank:</u> Bank A without an approved model executes a \$10 million, 5-year, interest rate swap. It receives a fixed rate and pays floating. The PFE factor for this swap is 1.5%. Bank A “locks-in” attributable exposure of \$150,000 (\$10 million x 1.5%), the day-one PFE amount.</p> <p><u>Under remaining maturity method:</u> Bank A enters a 5-year interest rate swap with notional value of \$100,000 and MTM of zero at execution. At execution, Bank A’s exposure is \$7,500 (<math>\\$0 + (\\$100,000 \times 5 \times 1.5\%)</math>). In year 2, Bank A makes loan to counterparty of interest rate swap. At this time, MTM of swap is \$1,000. Bank A’s lending limit exposure is \$5,500 (<math>\\$1,000 + (\\$100,000 \times 3 \times 1.5\%)</math>). If the MTM of the swap in year 2 is negative \$1,000, Bank A’s lending limit exposure for the swap is \$3,500 (<math>-\\$1,000 + (\\$100,000 \times 3 \times 1.5\%)</math>). If the MTM of the swap in year 2 is negative \$10,000. Bank A’s lending limit exposure for the swap is zero (<math>-\\$10,000 + (\\$100,000 \times 3 \times 1.5\%) = \text{negative}</math></p>

Transaction Type	What Happens?	Credit Risk	Transaction Purpose	Credit Exposure	Example
					\$5,500 which is less than zero; zero is the floor for the calculated exposure).
Credit Derivative	Banks buy or sell protection on a reference entity (RE). Protection buyers are hedging risk; protection sellers are taking on risk (e.g., using the CDS exposure as a loan substitute).	<p>The protection seller is exposed to default and/or credit deterioration of the RE. It will make a payment upon default of the RE.</p> <p>The protection buyer is exposed to the counterparty risk of the dealer; the buyer expects payment from the dealer if there is a default.</p>	<p>Transactions such as credit default swaps allow institutions to sell credit protection (i.e., assume credit risk) against loss on a third-party reference entity. Protection sellers often use CDS as loan substitutes.</p> <p>Protection buyers typically use credit derivatives to hedge credit exposures in their loan portfolios.</p>	<p><u>To Counterparty</u> Banks that model derivatives exposures (see above) determine the attributable exposure based on the model provided there is an effective margining arrangement. Banks that use the conversion factor approach (see above) or that model but do not have an effective margining arrangement calculate the attributable exposure as the sum of all net notional protection purchased amounts across reference entities.</p> <p><u>To Reference Entities</u> Banks calculate the exposure as the net notional protection sold amount. The bank may reduce this amount by the amount of any eligible credit derivative purchased on that reference entity from an eligible protection provider.</p>	<p><u>Modeled bank with effective margining arrangement:</u> Bank A buys and sells credit protection from and to Bank B on Firms X, Y and Z. There is an effective margining arrangement between the banks. Banks A and B use their models to determine their counterparty credit exposures.</p> <p><u>Non-modeled bank or bank without effective margining arrangement:</u> Bank A buys and sells credit protection from and to Bank B on Firms X, Y and Z. Bank A's net notional protection purchased from Bank B is \$50 for Firm X and \$100 for Firm Y. Bank A's net protection sold to Bank B is \$35 for Firm Z. The lending limit exposure of Bank A to Bank B is \$150.</p> <p>Bank C buys and sells credit protection on Firms 1, 2, and 3. Bank C's notional protection sold is \$100 for Firm 1, \$200 for Firm 2 and \$300 for Firm 3. The lending limit exposure of Bank C to Firm 1 is \$100, to Firm 2 is \$200 and to Firm 3 is \$300. If Bank C purchases protection on Firm 3 from an eligible protection provider in the amount of \$25 via an eligible credit derivative, Bank C can reduce its \$300 lending limit exposure to Firm 3 to \$275.</p>
Reverse Repo (bank asset)	Lend cash against collateral	Collateral value falls	Provide secured financing; invest	Attributable credit exposure	<u>Non-modeled bank:</u> Lend \$100 secured

Transaction Type	What Happens?	Credit Risk	Transaction Purpose	Credit Exposure	Example
			funds; run a dealer matched book	for lending limit purposes is the product of the haircut associated with the collateral received and the amount of cash transferred	by securities worth \$102 that have haircut of 5%. LLL exposure is \$5 (\$100 x 5%).
Repo (bank liability)	Borrow cash against collateral	Collateral value rises	Finance inventory; run a dealer matched book	Attributable credit exposure for lending limit purposes is the difference between the market value of securities transferred less cash received (i.e., the net current credit exposure).	<u>Non-modeled bank:</u> Bank executes a repo in which it borrows \$100, pledging securities worth \$102. Attributable exposure is \$2, the amount of net current credit exposure.
Securities Borrowed (bank asset)	Lend cash against collateral	Collateral value falls	Obtain collateral to cover a short position	<p>If cash is collateral, treat the same as reverse repo: Attributable credit exposure for lending purposes is the product of the haircut associated with the collateral received and the amount of cash transferred.</p> <p>If collateral is securities: Attributable credit exposure for lending limit purposes is the product of the higher of the two haircuts associated with the two securities and the higher of the two par values of the securities.</p>	<p><u>Non-modeled bank, cash as collateral:</u> Bank borrows a \$100 par value security that has a fair value of \$102. The bank pledges \$100 in cash. The haircut associated with the security is 5%. The attributable exposure is \$5 (\$100 x 5%).</p> <p><u>Non-modeled bank, securities as collateral:</u> Bank borrows a \$100 par value security (with fair value \$101) and pledges a security with a par value of \$100. The fair value of the security pledged is \$102. The haircut on the borrowed security is 2% and the haircut on the pledged security is 5%. The attributable exposure is \$5 (\$100 x 5%), based upon the higher of the two security haircuts and the higher of the two par values (here the par values were the same).</p>
Securities Loaned (bank liability)	Borrow cash against collateral	Collateral value rises	Generate income	If collateral received is cash, treat the same as a repo: The attributable credit exposure for lending limit	<u>Non-modeled bank, cash as collateral:</u> Bank lends a \$102 security (par value of \$100) and receives \$100 in cash collateral.

Transaction Type	What Happens?	Credit Risk	Transaction Purpose	Credit Exposure	Example
				<p>purposes is the net current credit exposure.</p> <p>If the collateral received is other securities: The attributable credit exposure for lending limit purposes is the product of the higher of the two haircuts associated with the two securities and the higher of the two par values of the securities.</p>	<p>Attributable exposure is \$2, the net current credit exposure.</p> <p><u>Non-modeled bank securities as collateral:</u> Bank lends a \$100 par value security (fair value \$101) and receives another security as collateral. The collateral has a \$100 par value (and \$102 fair value). The haircut on the loaned and borrowed securities are 2% and 5% respectively. Attributable exposure is \$5, based upon the higher of the two security haircuts and the higher of the two par values (here the par values were the same).</p>

### III. Effective and Compliance Dates

This interim final rule is effective on July 21, 2012. Pursuant to the Administrative Procedure Act (APA), at 5 U.S.C. 553(b)(B), notice and comment are not required prior to the issuance of a final rule if an agency, for good cause, finds that “notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”

The amendments made by section 610 of the Dodd-Frank Act are effective on July 21, 2012.<sup>12</sup> These amendments are not self-executing, however, in that they do not provide national banks and savings associations with the methodology necessary to comply with the new requirements they impose.

The OCC’s approach to implementation of these standards is related to, and our rulemaking in this respect has been informed by, proposals made by other agencies to implement provisions of the Dodd-Frank Act raising similar issues and the comments received by other

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<sup>12</sup> Dodd-Frank Act, section 610(c).

agencies in connection with such rulemakings.<sup>13</sup> Consideration of this information was appropriate in connection with the OCC's implementation of the amendments made by section 610 of the Dodd-Frank Act.

Based on consideration of the information thereby available, this interim final rule provides clarity regarding the OCC's application of the requirements of section 610. The OCC finds that, under these circumstances, prior notice and comment are impracticable and that the public interest is best served by making the rule effective on the same day as the amendments made by section 610 of the Dodd-Frank Act are effective. Otherwise, national banks and savings associations would be subject to unpredictable assertions of interpretations of the scope and application of the new requirements of section 610 that could result in applications of section 610 contrary to the OCC's interpretation of that section.

For these same reasons, with respect to the amendments implementing section 610 of the Dodd-Frank Act, the OCC finds good cause to dispense with the delayed effective date otherwise required by section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA), 12 U.S.C. 4802.<sup>14</sup>

The OCC recognizes, however, that national banks and savings associations will need time to conform their operations to the amendments implementing section 610 as applied by the OCC. The interim final rule, therefore, includes at § 32.1(d) a temporary exception from the lending limit rules for extensions of credit arising from derivative transactions or securities financing transactions, until January 1, 2013. This exception is issued pursuant to section

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<sup>13</sup> E.g., the Federal Reserve Board's rulemaking implementing section 165(e) of the Dodd Frank Act (single counterparty credit exposures of large bank holding companies and certain nonbank financial companies (covered companies)), 77 Fed. Reg. 594 (Jan. 5, 2012).

<sup>14</sup> The RCDRIA requires that, subject to certain exceptions, regulations imposing additional reporting, disclosure, or other requirements on insured depository institutions take effect on the first day of the calendar quarter after publication of the final rule. This effective date requirement does not apply if the agency finds for good cause that the regulation should become effective before such time.

5200(d)(1) of the Revised Statutes, 12 U.S.C. 84(d)(1), which authorizes the OCC to prescribe rules to administer and carry out the purposes of the lending limit statute, including rules to establish limits or requirements other than those specified in the statute for particular classes or categories of loans or extensions of credit. As a result of this exception, institutions will not be required to comply with amendments in the interim final rule implementing section 610 of the Dodd Frank Act until January 1, 2013. As a practical matter, the temporary exception afforded by the interim final rule fulfills the same objectives as a delayed effective date, that is, providing affected institutions with time to adjust their systems and procedures to come into compliance with new requirements. Notwithstanding this exception to the particular new lending limits provisions, the OCC retains full authority to address credit exposures that present undue concentrations on a case-by-case basis through our existing safety and soundness authorities.

In addition to the amendments required to implement section 610, this rulemaking also contains amendments that are necessary to consolidate the lending limit rules applicable to national banks and savings associations. As indicated previously, the integration amendments included in this interim final rule do not impose any new reporting, disclosure, or other requirements on national banks or savings associations. To the extent that the interim final rule differs from the current lending limit rules, these differences reduce compliance requirements. Accordingly, good cause exists to make these amendments effective without prior notice and comment. For the same reasons, the RCDRIA does not apply to the integration-related amendments made by this interim final rule.

We note that after the 45-day comment period, the OCC may amend this interim final rule based on comments received. If any such amendments are required, we will issue a final rule as expeditiously as possible, and will adjust the compliance date if, and as, necessary.

#### **IV. Solicitation of Comments**

In addition to the specific requests for comment outlined in this **SUPPLEMENTARY INFORMATION** section, the OCC is interested in receiving comments on all aspects of this interim final rule. In particular, we request suggestions on ways to streamline this rule and reduce regulatory burden while still accomplishing the objectives that the rule seeks to achieve.

## **V. Regulatory Analysis**

### **Regulatory Flexibility Act Analysis**

Pursuant to the Regulatory Flexibility Act (RFA),<sup>15</sup> 5 U.S.C. 603, an agency must prepare a regulatory flexibility analysis for all proposed and final rules that describe the impact of the rule on small entities, unless the head of an agency certifies that the rule will not have “a significant economic impact on a substantial number of small entities.” However, the RFA applies only to rules for which an agency publishes a general notice of proposed rulemaking pursuant to 5 U.S.C. 553(b).<sup>16</sup> Pursuant to the APA at 5 U.S.C. 553(b)(B), general notice and an opportunity for public comment are not required prior to the issuance of a final rule when an agency, for good cause, finds that “notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.” As discussed above, the OCC has determined for good cause that the APA does not require general notice and public comment on this interim final rule and, therefore, we are not publishing a general notice of proposed rulemaking. Thus, the RFA does not apply to this interim final rule.

### **Unfunded Mandates Reform Act**

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104–4 (2 U.S.C. 1532) (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating any rule likely to result in a Federal mandate that may result in the

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<sup>15</sup> Pub. L. 96–354, Sept. 19, 1980.

<sup>16</sup> 5 U.S.C. 603(a), 604(a).

expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, § 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC has determined that there is no Federal mandate imposed by this rulemaking that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. Accordingly, final rule is not subject to § 202 of the Unfunded Mandates Act.

### **Paperwork Reduction Act**

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521), the OCC may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. This rule contains information collection requirements under the PRA, which have been previously approved by OMB under OMB Control No. 1557-0221. The requirements under this collection remain unchanged except for the addition of savings associations as respondents. This information collection will be amended through a non-substantive change to include the burden for savings associations.

### **List of Subjects**

12 CFR Part 32

National banks, Reporting and recordkeeping requirements

12 CFR Part 159

Reporting and recordkeeping requirements, Savings associations

12 CFR Part 160

Consumer protection, Investments Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities

For the reasons set forth in the preamble, chapter I of title 12 of the Code of Federal Regulations is amended as follows:

**PART 32—LENDING LIMITS**

1. The authority citation for part 32 is revised to read as follows:

**Authority:** 12 U.S.C. 1 et seq., 84, 93a, 1462a, 1463, 1464(u), and 5412(b)(2)(B).

2. Section 32.1 is amended by:

a. Revising paragraphs (a) and (c)(1) through (c)(3);

b. In paragraph (b), adding the phrase “and savings associations” after the word “banks”;

c. In paragraph (c)(4), adding the phrase “, savings associations,” after the word “banks”;

and

d. Adding new paragraph (d).

The revisions and addition read as follows:

**§ 32.1 Authority, purpose and scope.**

(a) Authority. This part is issued pursuant to 12 U.S.C. 1 et seq., 12 U.S.C. 84, 93a, 1462a, 1463, 1464(u), and 5412(b)(2)(B).

\* \* \* \* \*

(c) Scope. (1) Except as provided by paragraph (d) of this section, this part applies to all loans and extensions of credit made by national banks, savings associations, and their domestic operating subsidiaries. For purposes of this part, the term “savings association” includes Federal savings associations and state savings associations, as those terms are defined in 12 U.S.C. 1813(b). This part does not apply to loans or extensions of credit made by a national bank, a savings association, and their domestic operating subsidiaries to the bank's or savings association's:

(i) Affiliates, as that term is defined in 12 U.S.C. 371c(b)(1) and (e), as implemented by 12 CFR 223.2(a) (Regulation W);

(ii) The bank's or savings association's operating subsidiaries;

(iii) Edge Act or Agreement Corporation subsidiaries; or

(iv) Any other subsidiary consolidated with the bank or savings association under Generally Accepted Accounting Principles (GAAP).

(2) The lending limits in this part are separate and independent from the investment limits prescribed by 12 U.S.C. 24 (Seventh) or 12 U.S.C. 1464(c), as applicable, and 12 CFR parts 1 and 160.30, and a national bank or savings association may make loans or extensions of credit to one borrower up to the full amount permitted by this part and also hold eligible securities of the same obligor up to the full amount permitted under 12 U.S.C. 24 (Seventh) or 12 U.S.C. 1464(c), as applicable, and 12 CFR part 1 and 12 CFR 160.30.

(3) Loans and extensions of credit to executive officers, directors and principal shareholders of national banks, savings associations, and their related interests are subject to limits prescribed by 12 U.S.C. 375a and 375b in addition to the lending limits established by 12 U.S.C. 84 or 12 U.S.C. 1464(u) as applicable, and this part.

\* \* \* \* \*

(d) Temporary exception. The requirements of this part shall not apply to the credit exposure arising from a derivative transaction or securities financing transaction until January 1, 2013.

3. Section 32.2 is amended by:

a. Redesignating paragraphs (a) through (t) as follows:

Old paragraph(s)

New paragraph(s)

(a) through (g)	(b) through (h)
(h)	(j)
(i)	(n)
(j) through (l)	(p) through (r)
(m)	(t)
(n) and (o)	(v) and (w)
(p) and (q)	(y) and (z)
(r) through (t)	(bb) through (dd)

b. Adding new paragraphs (a), (i), (k), (l), (m), (o), (s), (u), (x), and (aa) to read as follows;

c. Revising newly designated paragraphs (b), (c), (n) introductory text, (n)(1), and (q) to read as set forth below;

d. In newly designated paragraphs (d) and (f) removing the word “bank” and adding in its place the phrase “national bank or savings association”;

e. In newly designated paragraph (g):

i. In the introductory text, removing the word “bank’s” and adding in its place the phrase “national bank’s or savings association’s”;

ii. In paragraphs (g)(1)(i) and (g)(2), adding the phrase “or savings association” after the word “bank”; and

iii. In paragraphs (g)(1)(iii) and (g)(1)(iv), removing the phrases “paragraph (m)” and “paragraph (s)” and adding in its place the phrases “paragraph (t)” and “paragraph (cc)”, respectively;

f. In newly designated paragraph (n)(2), removing the word “bank’s” and adding in its place the phrase “national bank’s or savings association’s”;

g. In newly designated paragraph (p), removing the word “banks” and adding in its place the phrase “national banks or savings associations”; and

h. In newly designated paragraph (t):

i. In the introductory text and paragraph (t)(1), remove the phrase “within the bank’s” and adding in its place the phrase “within the national bank’s or savings association’s”, wherever it appears;

ii. In paragraph (t)(1), removing the phrase “made, the bank” and adding in its place the phrase “made, the bank or savings association”;

iii. In paragraphs (t)(1) and (2), adding after the word “bank’s” the phrase “or savings association’s”, wherever it appears;

iv. In paragraph (t)(1), removing the phrase “paragraph (k)(2)(vi)” and adding in its place the phrase “paragraph (q)(2)(vi); and

v. In the first sentence of paragraph (t)(2), removing the word “bank” and adding in its place the phrase “national bank or savings association”.

The additions and revisions read as follows.

### **§ 32.2 Definitions.**

(a) Appropriate Federal banking agency has the same meaning as in 12 U.S.C. 1813(q).

(b) Borrower means a person who is named as a borrower or debtor in a loan or extension of credit; a person to whom a national bank or savings association has credit exposure arising from a derivative transaction or a securities financing transaction, entered by the bank or savings association; or any other person, including a drawer, endorser, or guarantor, who is deemed to be a borrower under the “direct benefit” or the “common enterprise” tests set forth in § 32.5.

(c) Capital and surplus means—

(1) A national bank's or savings association's Tier 1 and Tier 2 capital calculated under the risk-based capital standards applicable to the institution as reported in the bank's or savings association's Consolidated Reports of Condition and Income (Call Report); plus

(2) The balance of a national bank's or savings association's allowance for loan and lease losses not included in the bank's or savings association's Tier 2 capital, for purposes of the calculation of risk-based capital described in paragraph (c)(1) of this section, as reported in the bank's or savings association's Call Report.

\* \* \* \* \*

(i) Credit derivative has the same meaning as this term has in 12 CFR Part 3, Appendix C, Section 2.

\* \* \* \* \*

(k) Derivative transaction includes any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

(l) Effective margining arrangement means a master legal agreement governing derivative transactions between a bank or savings association and a counterparty that requires the counterparty to post, on a daily basis, variation margin to fully collateralize that amount of the bank's net credit exposure to the counterparty that exceeds \$1 million created by the derivative transactions covered by the agreement.

(m) Eligible credit derivative means a single-name credit derivative or a standard, non-tranched index credit derivative provided that:

(1) The derivative contract meets the requirements of an eligible guarantee, as defined in 12 CFR part 3, Appendix C, and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the derivative contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap, the derivative contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) Bankruptcy, insolvency, or inability of the obligor on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due and similar events;

(4) The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract;

(5) If the derivative contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss with respect to the derivative reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the derivative contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provides that any required consent to transfer may not be unreasonably withheld; and

(7) If the credit derivative is a credit default swap, the derivative contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the

protection purchaser the right to notify the protection provider of the occurrence of a credit event.

(n) Eligible national bank or eligible savings association means a national bank or saving association that:

(1) Is well capitalized as defined in the prompt corrective action rules applicable to the institution; and

\* \* \* \* \*

(o) Eligible protection provider means:

(1) A sovereign entity (a central government, including the U.S. government; an agency; department; ministry; or central bank);

(2) The Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, or a multilateral development bank;

(3) A Federal Home Loan Bank;

(4) The Federal Agricultural Mortgage Corporation;

(5) A depository institution, as defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. 1813(c);

(6) A bank holding company, as defined in section 2 of the Bank Holding Company Act, as amended, 12 U.S.C. 1841;

(7) A savings and loan holding company, as defined in section 10 of the Home Owners' Loan Act, 12 U.S.C. 1467a;

(8) A securities broker or dealer registered with the SEC under the Securities Exchange Act of 1934, 15 U.S.C. 78o et seq.;

(9) An insurance company that is subject to the supervision of a State insurance regulator;

(10) A foreign banking organization;

(11) A non-U.S.-based securities firm or a non-U.S.-based insurance company that is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies; and

(12) A qualifying central counterparty;

\* \* \* \* \*

(q) Loans and extensions of credit means a national bank's or savings association's direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds or repayable from specific property pledged by or on behalf of the borrower; and any credit exposure, as determined pursuant to § 32.9, arising from a derivative transaction or a securities financing transaction.

(1) Loans or extensions of credit for purposes of 12 U.S.C. 84 or 12 U.S.C. 1464(u), as applicable, and this part include—

(i) A contractual commitment to advance funds, as defined in paragraph (g) of this section;

(ii) A maker or endorser's obligation arising from a national bank's or savings association's discount of commercial paper;

(iii) A national bank's or savings association's purchase of third-party paper subject to an agreement that the seller will repurchase the paper upon default or at the end of a stated period. The amount of the bank's or savings association's loan is the total unpaid balance of the paper owned by the bank or savings association less any applicable dealer reserves retained by the bank or savings association and held by the bank or savings association as collateral security. Where the seller's obligation to repurchase is limited, the bank's or savings association's loan is measured by the total amount of the paper the seller may ultimately be obligated to repurchase.

A national bank's or savings association's purchase of third party paper without direct or indirect recourse to the seller is not a loan or extension of credit to the seller;

(iv) An overdraft, whether or not prearranged, but not an intra-day overdraft for which payment is received before the close of business of the national bank or savings association that makes the funds available;

(v) The sale of Federal funds with a maturity of more than one business day, but not Federal funds with a maturity of one day or less or Federal funds sold under a continuing contract;

(vi) Loans or extensions of credit that have been charged off on the books of the national bank or savings association in whole or in part, unless the loan or extension of credit—

(A) Is unenforceable by reason of discharge in bankruptcy;

(B) Is no longer legally enforceable because of expiration of the statute of limitations or a judicial decision; or

(C) Is no longer legally enforceable for other reasons, provided that the bank or savings association maintains sufficient records to demonstrate that the loan is unenforceable; and

(vii) A national bank's or savings association's purchase of securities subject to an agreement that the seller will repurchase the securities at the end of a stated period, but not including a national bank's or savings association's purchase of Type I securities, as defined in part 1 of this chapter, subject to a repurchase agreement, where the purchasing bank or savings association has assured control over or has established its rights to the Type I securities as collateral.

(2) The following items do not constitute loans or extensions of credit for purposes of 12 U.S.C. 84 or 12 U.S.C. 1464(u), as applicable, and this part—

(i) Additional funds advanced for the benefit of a borrower by a national bank or savings association for payment of taxes, insurance, utilities, security, and maintenance and operating expenses necessary to preserve the value of real property securing the loan, consistent with safe and sound banking practices, but only if the advance is for the protection of the bank's or savings association's interest in the collateral, and provided that such amounts must be treated as an extension of credit if a new loan or extension of credit is made to the borrower;

(ii) Accrued and discounted interest on an existing loan or extension of credit, including interest that has been capitalized from prior notes and interest that has been advanced under terms and conditions of a loan agreement;

(iii) Financed sales of a national bank's or savings association's own assets, including Other Real Estate Owned, if the financing does not put the bank or savings association in a worse position than when the bank or savings association held title to the assets;

(iv) A renewal or restructuring of a loan as a new "loan or extension of credit," following the exercise by a national bank or savings association of reasonable efforts, consistent with safe and sound banking practices, to bring the loan into conformance with the lending limit, unless new funds are advanced by the national bank or savings association to the borrower (except as permitted by §32.3(b)(5)), or a new borrower replaces the original borrower, or unless the appropriate Federal banking agency determines that a renewal or restructuring was undertaken as a means to evade the bank's or savings association's lending limit;

(v) Amounts paid against uncollected funds in the normal process of collection; and

(vi)(A) That portion of a loan or extension of credit sold as a participation by a national bank or savings association on a nonrecourse basis, provided that the participation results in a pro rata sharing of credit risk proportionate to the respective interests of the originating and participating lenders. Where a participation agreement provides that repayment must be applied

first to the portions sold, a pro rata sharing will be deemed to exist only if the agreement also provides that, in the event of a default or comparable event defined in the agreement, participants must share in all subsequent repayments and collections in proportion to their percentage participation at the time of the occurrence of the event.

(B) When an originating national bank or savings association funds the entire loan, it must receive funding from the participants before the close of business of its next business day. If the participating portions are not received within that period, then the portions funded will be treated as a loan by the originating bank or savings association to the borrower. If the portions so attributed to the borrower exceed the originating bank's or savings association's lending limit, the loan may be treated as nonconforming subject to §32.6, rather than a violation, if:

(1) The originating national bank or savings association had a valid and unconditional participation agreement with a participant or participants that was sufficient to reduce the loan to within the originating bank's or savings association's lending limit;

(2) The participant reconfirmed its participation and the originating national bank or savings association had no knowledge of any information that would permit the participant to withhold its participation; and

(3) The participation was to be funded by close of business of the originating national bank's or savings association's next business day.

\* \* \* \* \*

(s) Qualifying central counterparty has the same meaning as this term has in 12 CFR Part 3, Appendix C, Section 2.

\* \* \* \* \*

(u) Qualifying master netting agreement has the same meaning as this term has in 12 CFR Part 3, Appendix C, Section 2.

\* \* \* \* \*

(x) Residential housing units mean:

(1) Homes (including a dwelling unit in a multi-family residential property such as a condominium or a cooperative);

(2) Combinations of homes and business property (i.e., a home used in part for business);

(3) Other real estate used for primarily residential purposes other than a home (but which may include homes);

(4) Combinations of such real estate and business property involving only minor business use (i.e., where no more than 20 percent of the total appraised value of the real estate is attributable to the business use);

(5) Farm residences and combinations of farm residences and commercial farm real estate;

(6) Property to be improved by the construction of such structures; or

(7) Leasehold interests in the above real estate.

\* \* \* \* \*

(aa) Securities financing transaction means a repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction.

\* \* \* \* \*

3a. Effective January 1, 2013, § 32.2 is amended by removing newly redesignated paragraph (q)(1)(vii), removing the semicolon and the word “and” at the end of newly redesignated paragraph (q)(1)(vi) and adding in its place a period, and adding the word “and” at the end of newly redesignated paragraph (q)(1)(v).

4. Section 32.3 is amended by:

- a. In paragraphs (a) and (b) adding the phrase “or savings association’s” after the word “bank’s”, wherever it appears;
- b. In paragraphs (a) and (b), adding the phrase “or savings association” after the word “bank”, wherever it appears;
- c. In the first sentence of paragraph (a), removing the phrase “in § 32.2(n)” and adding in its place the phrase “in § 32.2(v)”;
- d. In paragraph (b)(1)(i), removing the phrase “in § 32.2(o)” and replacing it with the phrase “in § 32.2(w)”;
- e. In paragraph (b)(2)(i), removing the phrase “at § 32.2(e)” and replacing it with the phrase “at § 32.2(f)”;
- g. In paragraph (b)(5) introductory text, removing the phrase “by § 32.2(m)” and replacing it with the phrase “by § 32.2(t)”;
- h. In paragraph (c) introductory text, adding the phrase “, or 12 U.S.C. 1464(u), as applicable,” after the phrase “12 U.S.C. 84”;
- i. In paragraph (c)(1)(ii), by adding the phrase “or 12 U.S.C. 1464(u), as applicable,” after the phrase “12 U.S.C. 84”;
- j. Revising paragraphs (c)(2) and (c)(3)(ii) to read as set forth below;
- k. In the first sentence of paragraph (c)(4)(ii)(B), paragraphs (c)(5)(i), (c)(6) introductory text, (c)(9)(i), and (c)(10)(i), removing the word “bank”, whenever it appears, and adding in its place with the phrase “national bank or savings association”;
- l. In paragraphs (c)(4)(ii)(B) and (c)(6)(i), adding the phrase “or savings association’s” after the word “bank’s”;
- m. In the second sentence of paragraph (c)(4)(ii)(B), and paragraphs (c)(5)(ii), (c)(6)(i) and (c)(6)(ii)(B), the first sentence of paragraph (c)(7), and paragraphs (c)(9)(iii) and

(iv) and (c)(10)(iii) through (vi), adding the phrase “or savings association” after the word “bank” whenever it appears;

n. In paragraph (c)(7), removing the word “Comptroller”, wherever it appears, and adding in its place the phrase “appropriate Federal banking agency”; and

o. Adding paragraphs (c)(11). (c)(12) and (d).

The addition and revisions read as follows.

### **§ 32.3 Lending limits.**

\* \* \* \* \*

(c) \* \* \*

(2) Bankers' acceptances. A national bank's or savings association's acceptance of drafts eligible for rediscount under 12 U.S.C. 372 and 373 or 12 U.S.C. 1464(c)(1)(M), as applicable, or a national bank's or savings association's purchase of acceptances created by other banks or savings associations that are eligible for rediscount under those sections; but not including—

(i) A national bank's or savings association's acceptance of drafts ineligible for rediscount (which constitutes a loan by the bank or savings association to the customer for whom the acceptance was made, in the amount of the draft);

(ii) A national bank's or savings association's purchase of ineligible acceptances created by other banks or savings associations (which constitutes a loan from the purchasing bank or savings association to the accepting bank or savings association, in the amount of the purchase price); and

(iii) A national bank's or savings association's purchase of its own acceptances (which constitutes a loan to the bank's or savings association's customer for whom the acceptance was made, in the amount of the purchase price).

(3) \* \* \*

(ii) To qualify a loan or extension of credit under paragraph (c)(3)(i) of this section, the national bank or savings association must perfect a security interest in the collateral under applicable law.

\* \* \* \* \*

(11) Credit Exposures arising from transactions financing certain government securities. Credit exposures arising from securities financing transactions in which the securities financed are Type I securities, as defined in 12 CFR 1.2(j), in the case of national banks, or securities listed in section 5(c)(1)(C), (D), (E), and (F) of HOLA and general obligations of a state or subdivision as listed in section 5(c)(1)(H) of HOLA, 12 U.S.C. 1464(c)(1)(C), (D), (E), (F), and (H), in the case of savings associations.

(12) Intraday credit exposures. Intraday credit exposures arising from a derivative transaction or securities financing transaction.

(d) Special lending limits for savings associations. (1) \$500,000 exception for savings associations. If a savings association's aggregate lending limitation calculated under paragraph (a) of this section is less than \$500,000, notwithstanding this limitation in paragraph (a) of this section, such savings association may have total loans and extensions of credit, for any purpose, to one borrower outstanding at one time not to exceed \$500,000.

(2) Loans by savings associations to develop domestic residential housing units. (i) Subject to paragraph (d)(2)(ii) of this section, a savings association may make loans to one borrower to develop domestic residential housing units, not to exceed the lesser of \$30,000,000 or 30 percent of the savings association's unimpaired capital and unimpaired surplus, including all loans and extensions of credit subject to paragraph (a) of this section, provided that:

(A) The savings association is, and continues to be, in compliance with its capital requirements under part 167 of this chapter.

(B) The appropriate Federal banking agency permits, subject to conditions it may impose, the savings association to use the higher limit set forth under this paragraph (d)(2)(i). A savings association that meets the requirements of paragraphs (d)(2)(i)(A),(C), and (D) of this section and that meets the requirements for “expedited treatment” under 12 CFR 116.5 or 12 CFR 390.101 may use the higher limit set forth under paragraph (d)(2)(i) if the savings association has filed a notice with the appropriate Federal banking agency that it intends to use the higher limit at least 30 days prior to the proposed use. A savings association that meets the requirements of paragraphs (d)(2)(i)(A),(C), and (D) of this section and that meets the requirements for “standard treatment” under 12 CFR 116.5 or 12 CFR 390.101 may use the higher limit set forth under this paragraph (d)(2)(i) if the savings association has filed an application with the appropriate Federal banking agency and the agency has approved the use the higher limit;

(C) The loans and extensions of credit made under this paragraph (d)(2)(i) of this section to all borrowers do not, in aggregate, exceed 150 percent of the savings association's unimpaired capital and unimpaired surplus;

(D) The loans and extensions of credit made under paragraph (d)(2)(i) of this section comply with the applicable loan-to-value requirements.

(ii) The authority of a savings association to make a loan or extension of credit under the exception in paragraph (d)(2)(i) of this section ceases immediately upon the association's failure to comply with any one of the requirements set forth in paragraph (d)(2)(i) of this section or any condition(s) set forth in an order issued by the appropriate Federal banking agency under paragraph (d)(2)(i)(B) of this section.

(iii) As used in this section, the term “to develop” includes each of the various phases necessary to produce housing units as an end product, such as acquisition, development and construction; development and construction; construction; rehabilitation; and conversion; and the

term “domestic” includes units within the fifty states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, and the Pacific Islands.

(3) Commercial paper and corporate debt securities. In addition to the amount allowed under the savings association’s combined general limit, a savings association may invest up to 10 percent of unimpaired capital and unimpaired surplus in the obligations of one issuer evidenced by commercial paper or corporate debt securities that are, as of the date of purchase, investment grade.

5. Section 32.4 is amended by:

a. Revising paragraphs (a) introductory text, (a)(2), and (c) to read as set forth below;

b. In paragraphs (b)(1) introductory text and (b)(2), removing the word “bank’s” and adding in its place the phrase “national bank’s or savings association’s”;

c. In paragraphs (b)(1)(i) and (ii), adding the phrase “or savings association’s” after the word “bank’s”.

The revisions read as follows:

**§ 32.4 Calculation of lending limits.**

(a) Calculation date. For purposes of determining compliance with 12 U.S.C. 84, and 12 U.S.C 1464(u), as applicable, and this part, a national bank or savings association shall determine its lending limit as of the most recent of the following dates:

\* \* \* \* \*

(2) The date on which there is a change in the bank’s or savings association’s capital category for purposes of 12 U.S.C. 1831o and 12 CFR 6.3 or 12 CFR 165.3, as applicable.

\* \* \* \* \*

(c) More frequent calculations. If the appropriate Federal banking agency determines for safety and soundness reasons that a national bank or savings association should calculate its

lending limit more frequently than required by paragraph (a) of this section, the appropriate Federal banking agency may provide written notice to the national bank or savings association directing it to calculate its lending limit at a more frequent interval, and the national bank or savings association shall thereafter calculate its lending limit at that interval until further notice.

6. Section 32.5 is amended by:

a. In paragraphs (c)(3), (d)(1), (f)(2) introductory text, and (f)(2)(v), removing the word “bank”, wherever it appears, and adding in its place the phrase “national bank or savings association”;

b. In paragraphs (d)(1) and (f)(3)(iii), adding the phrase “or savings association’s” after the word “bank’s”, wherever it appears;

c. In paragraph (c)(4), removing the word “OCC” and adding in its place the phrase “appropriate Federal banking agency”;

d. In paragraph (f)(2)(iv), removing the phrase “bank’s” and adding in its place the phrase “national bank’s or savings association’s”; and

e. Revising paragraph (f)(3)(ii) introductory text.

The revision reads as follows.

**§ 32.5 Combination rules.**

\* \* \* \* \*

(f) \* \* \*

(3) \* \* \*

(ii) Qualifying restructuring. Loans and other extensions of credit to a foreign government, its agencies, and instrumentalities will qualify for the non-combination process under paragraph (f)(3)(i) of this section only if they are restructured in a sovereign debt restructuring approved by the appropriate Federal banking agency, upon request by a national

bank or savings association for application of the non combination rule. The factors that the appropriate Federal banking agency will use in making this determination include, but are not limited to, the following:

\* \* \* \* \*

7. Section 32.6 is revised to read as follows:

**§ 32.6 Nonconforming loans and extensions of credit.**

(a) A loan or extension of credit, within a national bank's or savings association's legal lending limit when made, will not be deemed a violation but will be treated as nonconforming if the loan or extension of credit is no longer in conformity with the bank's or savings association's lending limit because—

(1) The bank's or savings association's capital has declined, borrowers have subsequently merged or formed a common enterprise, lenders have merged, or the lending limit or capital rules have changed;

(2) Collateral securing the loan to satisfy the requirements of a lending limit exception has declined in value; or

(3) In the case of a credit exposure arising from a transaction identified in § 32.9(a) and measured by the Internal Model Method specified in § 32.9(b)(1)(i) or § 32.9 (c)(1)(i), the credit exposure subject to the lending limits of 12 U.S.C. 84 or 12 U.S.C 1464(u), as applicable, or this part increases after execution of the transaction.

(b) A national bank or savings association must use reasonable efforts to bring a loan or extension of credit that is nonconforming as a result of paragraph (a)(1) or (a)(3) of this section into conformity with the bank's or savings association's lending limit unless to do so would be inconsistent with safe and sound banking practices.

(c) A national bank or savings association must bring a loan that is nonconforming as a result of circumstances described in paragraph (a)(2) of this section into conformity with the bank's or savings association's lending limit within 30 calendar days, except when judicial proceedings, regulatory actions or other extraordinary circumstances beyond the bank's or savings association's control prevent it from taking action.

8. Section 32.7 is amended by:

a. Revising the paragraph heading;

b. Removing the phrase "special lending limits" in paragraphs (a)(5), (b) introductory text, and (e), and adding in its place the phrase "supplemental lending limits".

b. In paragraphs (a)(1), (a)(3), and (e), adding the phrase "or savings association" after the phrases "a national bank", "a bank", and "the national bank", wherever they appear;

c. In paragraphs (a)(1) and (a)(3), add the phrase "or eligible savings association" after the phrase "eligible national bank";

d. Revise paragraphs (a)(2), (b)(1), (c), and (d) to read as follows;

e. In paragraphs (a)(4), (a)(5), and (b)(3), adding the phrase "or savings association's" after the word "bank's", wherever it appears;

f. In paragraph (b) introductory text, add the phrase "or eligible savings association" after the word "bank" in the first sentence.

The revisions read as follows.

### **§ 32.7 Residential real estate loans, small business loans, and small farm loans**

#### **("Supplemental Lending Limits Program").**

(a) \* \* \*

(2) In addition to the amount that a national bank or savings association may lend to one borrower under § 32.3, an eligible national bank or eligible savings association may make small

business loans or extensions of credit to one borrower in the lesser of the following two amounts: 10 percent of its capital and surplus; or the percent of its capital and surplus, in excess of 15 percent, that a state bank is permitted to lend under the state lending limit that is available for small business loans or unsecured loans in the state where the main office of the national bank or home office of the savings association is located.

\* \* \* \* \*

(b) \* \* \*

(1) Certification that the bank or savings association is an “eligible bank” or “eligible savings association”;

\* \* \* \* \*

(c) Duration of approval. Except as provided in paragraph (d) of this section, a bank or savings association that has received appropriate Federal banking agency approval may continue to make loans and extensions of credit under the supplemental lending limits in paragraphs (a)(1), (2), and (3) of this section, provided the bank or savings association remains an “eligible bank” or “eligible savings association.”

(d) Discretionary termination of authority. The appropriate Federal banking agency may rescind a bank's or savings association's authority to use the supplemental lending limits in paragraphs (a)(1), (2), and (3) of this section based upon concerns about credit quality, undue concentrations in the bank's or savings association's portfolio of residential real estate, small business, or small farm loans, or concerns about the bank's or savings association's overall credit risk management systems and controls. The bank or savings association must cease making new loans or extensions of credit in reliance on the supplemental lending limits upon receipt of written notice from the appropriate Federal banking agency that its authority has been rescinded.

\* \* \* \* \*

## **§ 32.8 [Amended]**

9. Section 32.8 is amended by:

a. Adding the phrase “or savings association” after the phrase “national bank” and the phrase “or eligible savings association” after the phrase “eligible bank”; and

b. Removing the word “OCC”, wherever it appears, and adding in its place the phrase “appropriate Federal banking agency”.

10. Section 32.9 is added to read as follows:

## **§ 32.9 Credit exposure arising from derivative and securities financing transactions.**

(a) Scope. This section sets forth the rules for calculating the credit exposure arising from a derivative transaction or a securities financing transaction entered into by a national bank or savings association for purposes of determining the bank’s or savings association’s lending limit pursuant to 12 U.S.C. 84 or 12 U.S.C. 1464(u), as applicable, and this part.

(b) Derivative transactions. (1) Non-credit derivatives. Subject to paragraphs (b)(2) and (b)(3) of this section, a national bank or savings association shall calculate the credit exposure to a counterparty arising from a derivative transaction by one of the following methods. Subject to paragraph (b)(3) of this section, a national bank or savings association shall use the same method for calculating counterparty credit exposure arising from all of its derivative transactions.

(i) Internal Model Method. (A) Credit exposure. The credit exposure of a derivative transaction under the Internal Model Method shall equal the sum of the current credit exposure of the derivative transaction and the potential future credit exposure of the derivative transaction.

(B) Calculation of current credit exposure. A bank or savings association shall determine its current credit exposure by the mark-to-market value of the derivative contract. If the mark-to-market value is positive, then the current credit exposure equals that mark-to-market value. If the mark to market value is zero or negative, than the current credit exposure is zero.

(C) Calculation of potential future credit exposure. A bank or savings association shall calculate its potential future credit exposure by using an internal model that has been approved for purposes of 12 CFR part 3, Appendix C, Section 53, 12 CFR part 167, Appendix C, Section 53, or 12 CFR part 390, subpart Z, Appendix A, Section 53, as appropriate, or any other appropriate model approved by the appropriate Federal banking agency.

(D) Net credit exposure. A bank or savings association that calculates its credit exposure by using the Internal Model Method pursuant to this paragraph (b)(1)(i) may net credit exposures of derivative transactions arising under the same qualifying master netting agreement.

(ii) Conversion Factor Matrix Method. The credit exposure arising from a derivative transaction under the Conversion Factor Matrix Method shall equal and remain fixed at the potential future credit exposure of the derivative transaction as determined at the execution of the transaction by reference to Table 1 of this section.

Table 1—Conversion Factor Matrix for Calculating Potential Future Credit Exposure.<sup>1</sup>

<b>Original maturity<sup>2</sup></b>	<b>Interest Rate</b>	<b>Foreign exchange rate and gold</b>	<b>Equity</b>	<b>Other<sup>3</sup> (includes commodities and precious metals except gold)</b>
1 year or less	.015	.015	.20	.06
Over 1 to 3 years	.03	.03	.20	.18
Over 3 to 5 years	.06	.06	0.20	0.30
Over 5 to 10 years	.12	.12	0.20	.60
Over ten years	.30	.30	.20	1.0

<sup>1</sup>For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

<sup>2</sup>For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

<sup>3</sup> Transactions not explicitly covered by any other column in the Table are to be treated as “Other.”

(iii) Remaining Maturity Method. The credit exposure arising from a derivative transaction under the Remaining Maturity Method shall equal the greater of zero or the sum of the current mark-to-market value of the derivative transaction added to the product of the notional amount of the transaction, the remaining maturity in years of the transaction, and a fixed multiplicative factor determined by reference to Table 2 of this section.

Table 2—Remaining Maturity Factor for Calculating Credit Exposure

	<b>Interest Rate</b>	<b>Foreign exchange rate and gold</b>	<b>Equity</b>	<b>Other<sup>1</sup>(includes commodities and precious metals except gold)</b>
Multiplicative Factor	1.5%	1.5%	6%	6%

<sup>1</sup> Transactions not explicitly covered by any other column in the Table are to be treated as “Other.”

(2) Credit Derivatives. (i) Notwithstanding paragraph (b)(1) of this section, a national bank or savings association that uses the Conversion Factor Matrix Method or Remaining Maturity Method, or that uses the Internal Model Method without entering an effective margining arrangement as defined in § 32.2(l), shall calculate the counterparty credit exposure arising from credit derivatives entered by the bank or savings association by adding the net notional value of all protection purchased from the counterparty on each reference entity.

(ii) A national bank or savings association shall calculate the credit exposure to a reference entity arising from credit derivatives entered by the bank or savings association by adding the notional value of all protection sold on the reference entity. However, the bank or savings association may reduce its exposure to a reference entity by the amount of any eligible

credit derivative purchased on that reference entity from an eligible protection provider.

(3) Mandatory use of Internal Model Method. The appropriate Federal banking agency may require a national bank or savings association to use the Internal Model Method set forth in paragraph (b)(1)(i) of this section, the Conversion Factor Matrix Method set forth in paragraph (b)(1)(ii) of this section, or the Remaining Maturity Method set forth in paragraph (b)(1)(iii) of this section to calculate the credit exposure of derivative transactions if it finds that such method is necessary to promote the safety and soundness of the bank or savings association.

(c) Securities financing transactions. (1) In general. Except as provided by paragraph (c)(2) of this section, a national bank or savings association shall calculate the credit exposure arising from a securities financing transaction by one of the following methods. A national bank or savings association shall use the same method for calculating credit exposure arising from all of its securities financing transactions.

(i) Internal Model Method. A national bank or savings association may calculate the credit exposure of a securities financing transaction by using an internal model approved by the appropriate Federal banking agency for purposes of 12 CFR part 3, Appendix C, Section 32(d), 12 CFR part 167, Appendix C, Section 32(d), or 12 CFR part 390, subpart Z, Appendix A, Section 32(d), as appropriate, or any other appropriate model approved by the appropriate Federal banking agency.

(ii) Non-Model Method. A national bank or savings association may calculate the credit exposure of a securities financing transaction as follows:

(A) Repurchase agreement. The credit exposure arising from a repurchase agreement shall equal and remain fixed at the market value at execution of the transaction of the securities transferred to the other party less cash received.

(B) Securities lending. (1) Cash collateral transactions. The credit exposure arising from

a securities lending transaction where the collateral is cash shall equal and remain fixed at the market value at execution of the transaction of securities transferred less cash received.

(2) Non-cash collateral transactions. The credit exposure arising from a securities lending transaction where the collateral is other securities shall equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined in Table 3 of this section, and the higher of the two par values of the securities.

(C) Reverse repurchase agreements. The credit exposure arising from a reverse repurchase agreement shall equal and remain fixed as the product of the haircut associated with the collateral received, as determined in Table 3 of this section, and the amount of cash transferred.

(D) Securities borrowing. (1) Cash collateral transactions. The credit exposure arising from a securities borrowed transaction where the collateral is cash shall equal and remain fixed as the product of the haircut on the collateral received, as determined in Table 3 of this section, and the amount of cash transferred to the other party.

(2) Non-cash collateral transactions. The credit exposure arising from a securities borrowed transaction where the collateral is other securities shall equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined in Table 3 of this section, and the higher of the two par values of the securities.

TABLE 3--COLLATERAL HAIRCUTS

SOVEREIGN ENTITIES		
	Residual maturity	Haircut without currency mismatch <sup>1</sup>
OECD Country Risk Classification <sup>2</sup> 0-1.....	<= 1 year.....	0.005
	>1 year, <= 5 years.....	0.02
	>5 years.....	0.04
OECD Country Risk Classification 2-3.....	<= 1 year.....	0.01
	>1 year, <= 5 years.....	0.03
	> 5 years.....	0.06

CORPORATE AND MUNICIPAL BONDS THAT ARE BANK-ELIGIBLE INVESTMENTS

	Residual maturity for debt securities	Haircut without currency mismatch
All.....	<= 1 year.....	0.02
All.....	>1 year, <= 5 years.....	0.06
All.....	> 5 years.....	0.12

OTHER ELIGIBLE COLLATERAL

Main index <sup>3</sup> equities (including convertible bonds).....	0.15
Other publicly traded equities (including convertible bonds)...	0.25
Mutual funds .....	Highest haircut applicable to any security in which the fund can invest
Cash collateral held.....	0

<sup>1</sup> In cases where the currency denomination of the collateral differs from the currency denomination of the credit transaction, an addition 8 percent haircut will apply.

<sup>2</sup> OECD Country Risk Classification means the country risk classification as defined in Article 25 of the OECD's February 2011 Arrangement on Officially Supported Export Credits Arrangement.

<sup>3</sup> Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the covered company can demonstrate to the satisfaction of the Federal Reserve that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

(2) Mandatory use of Internal Model Method. The appropriate Federal banking agency may require a national bank or savings association to use either the Internal Model Method set forth in paragraph (c)(1)(i) of this section or the Non-Model Method set forth in paragraph

(c)(1)(ii) of this section to calculate the credit exposure of securities financing transactions if the appropriate Federal banking agency finds that such method is necessary to promote the safety and soundness of the bank or savings association.

11. Appendix A to part 32 is added to read as follows:

## **APPENDIX A TO PART 32—INTERPRETATIONS**

### Section 1. Interrelation of General Limitation With Exception for Loans To Develop Domestic Residential Housing Units

1. The §32.3(d)(2) exception for loans to one borrower to develop domestic residential housing units is characterized in the regulation as an “alternative” limit. This exceptional \$30,000,000 or 30 percent limitation does not operate in addition to the 15 percent General Limitation or the 10 percent additional amount a savings association may loan to one borrower secured by readily marketable collateral, but serves as the uppermost limitation on a savings association's lending to any one person once a savings association employs this exception.

Example: Savings Association A's lending limitation as calculated under the 15 percent General Limitation is \$800,000. If Savings Association A lends Y \$800,000 for commercial purposes, Savings Association A cannot lend Y an additional \$1,600,000, or 30 percent of capital and surplus, to develop residential housing units under the paragraph §32.3(d)(2) exception. The §32.3(d)(2) exception operates as the uppermost limitation on all lending to one borrower (for savings associations that may employ this exception) and includes any amounts loaned to the same borrower under the General Limitation. Savings Association A, therefore, may lend only an additional \$800,000 to Y, provided §32.3(d)(2) prerequisites have been met. The amount loaned under the authority of the General Limitation (\$800,000), when added to the amount loaned under the exception (\$800,000), yields a sum that does not exceed the 30 percent uppermost limitation (\$1,600,000).

2. a. This result does not change even if the facts are altered to assume that some or all of the \$800,000 amount of lending permissible under the General Limitation's 15 percent basket is not used, or is devoted to the development of domestic residential housing units.

b. In other words, using the above example, if Savings Association A lends Y \$400,000 for commercial purposes and \$300,000 for residential purposes—both of which would be permitted under its \$800,000 General Limitation—Savings Association A's remaining permissible lending to Y would be: first, an additional \$100,000 under the General Limitation, and then another \$800,000 to develop domestic residential housing units if the savings association meets the paragraph §32.3(d)(2) prerequisites. (The latter is \$800,000 because in no event may the total lending to Y exceed 30 percent of unimpaired capital and unimpaired surplus). If Savings Association A did not lend Y the remaining \$100,000 permissible under the General Limitation, its permissible loans to develop domestic residential housing units under §32.3(d)(2) would be \$900,000 instead of \$800,000 (the total loans to Y would still equal \$1,600,000).

3. In short, under the §32.3(d)(2) exception, the 30 percent or \$30,000,000 limit will always operate as the uppermost limitation, unless the savings association does not avail itself of the exception and merely relies upon its General Limitation.

## Section 2. Interrelationship Between the General Limitation and the 150 Percent Aggregate Limit on Loans to all Borrowers To Develop Domestic Residential Housing Units

Numerous questions have been received regarding the allocation of loans between the different lending limit “baskets,” i.e., the 15 percent General Limitation basket and the 30 percent Residential Development basket. In general, the inquiries concern the manner in which a savings association may “move” a loan from the General Limitation basket to the Residential Development basket. The following example is intended to provide guidance:

Example: Savings Association A's General Limitation under §32.3(a) is \$15 million. In January, Savings Association A makes a \$10 million loan to Borrower to develop domestic residential housing units. At the time the loan was made, Savings Association A had not received approval under an order issued by the appropriate Federal banking agency to avail itself of the residential development exception to lending limits. Therefore, the \$10 million loan is made under Savings Association A's General Limitation.

2. In June, Savings Association A receives authorization to lend under the Residential Development exception. In July, Savings Association A lends \$3 million to Borrower to develop domestic residential housing units. In August, Borrower seeks an additional \$12 million commercial loan from Savings Association A. Savings Association A cannot make the loan to Borrower, however, because it already has an outstanding \$10 million loan to Borrower that counts against Savings Association A's General Limitation of \$15 million. Thus, Savings Association A may lend only up to an additional \$5 million to Borrower under the General Limitation.

3. However, Savings Association A may be able to reallocate the \$10 million loan it made to Borrower in January to its Residential Development basket provided that: (1) Savings Association A has obtained authority under an order issued by the appropriate Federal banking agency to avail itself of the additional lending authority for residential development and maintains compliance with all prerequisites to such lending authority; (2) the original \$10 million loan made in January constitutes a loan to develop domestic residential housing units as defined; and (3) the housing unit(s) constructed with the funds from the January loan remain in a stage of "development" at the time Savings Association A reallocates the loan to the domestic residential housing basket. The project must be in a stage of acquisition, development, construction, rehabilitation, or conversion in order for the loan to be reallocated.

4. If Savings Association A is able to reallocate the \$10 million loan made to Borrower in January to its Residential Development basket, it may make the \$12 million commercial loan requested by Borrower in August. Once the January loan is reallocated to the Residential Development basket, however, the \$10 million loan counts towards Savings Association A's 150 percent aggregate limitation on loans to all borrowers under the residential development basket (§ 32.3(d)(2)).

5. If Savings Association A reallocates the January loan to its domestic residential housing basket and makes an additional \$12 million commercial loan to Borrower, Savings Association A's totals under the respective limitations would be: \$12 million under the General Limitation; and \$13 million under the Residential Development limitation. The full \$13 million residential development loan counts toward Savings Association A's aggregate 150 percent limitation.

## **PART 159 – SUBORDINATE ORGANIZATIONS**

12. The authority citation for part 159 continues to read as follows:

**Authority:** 12 U.S.C. 1462, 1462a, 1463, 1464, 1828, 5412(b)(2)(B).

### **§ 159.3 [Amended]**

13. Section 159.3 is amended, in paragraph (k) introductory text, by removing “§160.93 of this chapter” and adding in its place the phrase “12 CFR part 32”.

## **PART 160—LENDING AND INVESTMENTS**

14. The authority citation for part 160 continues to read as follows:

**Authority:** 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1701j–3, 1828, 3803, 3806, 5412(b)(2)(B); 42 U.S.C. 4106.

### **§ 160.40 [Amended]**

15. Section 160.40 is amended, in paragraph (a)(3), by removing “§160.93(c) of this part” and adding in its place the phrase “§32.3(a) of this chapter”.

**§ 160.60 [Amended]**

16. Section 160.60 is amended, in paragraph (b)(3), by removing “§§ 160.93 and 163.43 of this chapter” and adding in its place the phrase “12 CFR part 32 and § 163.43 of this chapter”.

**§ 160.93 [Amended]**

17. Section 160.93 is removed.

DATED: June 14, 2012

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Thomas J. Curry,  
*Comptroller of the Currency*

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