RULES and REGULATIONS

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 32

[Docket No. 95-03]

RIN 1557-AA72

Lending Limits

Wednesday, February 15, 1995

*8526 AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is comprehensively revising its rules governing national bank lending limits as part of its Regulation Review Program. The final rule amends, clarifies, and reorganizes the OCC's lending limit rules.

The final rule eliminates inefficient and unduly burdensome regulatory requirements and refocuses the lending limit rules on the areas of greatest safety and soundness concern. The new rule enhances the ability of national banks to lend while protecting against situations where excessive loans to a borrower or related borrowers present safety and soundness concerns.

EFFECTIVE DATE: March 17, 1995.

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SUPPLEMENTARY INFORMATION:

Background

Although the limitations on a national bank lending to one borrower can be traced to the Currency Act of 1863, [FN1] the Garn-St Germain Depository Institutions Act (Act), Pub. L. 97-320 (1982), represents the most recent major revision of the statutory lending limits. Section 401(a) of that Act amended 12 U.S.C. 84 to raise the amount that a national bank may lend to a single borrower from 10 to 15 percent of the bank's unimpaired capital and unimpaired surplus. It also added new exceptions, defined key terms, and provided express authority for the OCC to issue regulations to implement the statute, including regulations to define or further define terms and to establish limits or requirements other than those contained in the statute for particular classes or categories of loans.

FN1 Act of Feb. 25, 1863, 12 Stat. 665 et seq., R.S. s5200.

The OCC implemented the amended 12 U.S.C. 84 with a final rule published on April 12, 1983 (48 FR 15844). The final rule created a new part 32 in title 12 of the Code of Federal Regulations which replaced and restructured existing interpretive rulings previously found at 12 CFR part 7. The OCC proposed another major regulatory revision of the lending limits for national banks on October 24, 1989 (54 FR 43398). A final rule in response to this proposal was never adopted, however.

The Proposal

On February 11, 1994 the OCC published its proposal to revise the lending limit regulation found at 12 CFR part 32 (proposal), 59 FR 6593, as part of the OCC's Regulation Review Program. The proposal sought to modernize the regulation and incorporate into the rule significant interpretive positions of the OCC. The proposal sought to comprehensively revise, reorganize, update, and simplify the regulation, and to reduce unnecessary regulatory burdens, without compromising the important safety and soundness objectives of the lending limits rule.

Comments Received and Changes Made

The final rule implements most of the initiatives contained in the proposal. However, several additional changes are made in response to the comments received. Most of these changes clarify the original intent of the proposal. Other changes alter the proposed regulation in a manner that provides additional
flexibility to banks. The final rule also includes a number of technical changes to the proposal. The OCC received 28 comment letters on the proposal. The comments received generally were very favorable. Comment letters included 16 from banks and bank holding companies, three from law firms, and eight from trade associations and the representatives of banks, thrifts, home builders, and clearing houses. The commenters welcomed the OCC's effort to reorganize part 32 and several stated that the changes made in the proposal represented a significant improvement over the old rule. Commenters generally praised the new format and the additional clarity provided by the revisions. Some predicted that the simplified regulation would reduce regulatory burden and compliance costs.

Overview of the Final Rule

The OCC reviewed the lending limit rule with the goals of reducing unnecessary regulatory burdens and providing banks with increased flexibility in their lending operations, consistent with safe and sound banking practices.

As part of this new approach, the final rule alters the definition of "capital and surplus" upon which lending limits are based. The new lending limit calculation draws upon risk-based capital components that a bank must already calculate for Call Report purposes. By relying on quarterly Call Report information, most national banks generally will be required to calculate their lending limit only once every quarter, rather than every time they propose to make a loan.

The final rule also adds a few new definitions and removes or consolidates old ones to enhance the regulation's clarity. Several modifications provide banks with greater flexibility in certain lending situations, subject to safety and soundness parameters. For example, the rule includes a new exception to the lending limits to allow a bank to advance funds to renew and complete the funding of a qualifying loan commitment under circumstances where the additional advance will protect the position of the bank. The final rule also allows a bank to advance funds to pay for taxes, insurance and other necessary expenses to protect its interest in the collateral securing a loan, and clarifies when a loan is considered "nonconforming," rather than a violation, when it exceeds a bank's lending limit, but was within the bank's lending limit when made.

Section-by-Section Discussion

The commenters focused on provisions of the proposal needing modification or further amendment. The OCC carefully considered each of the comment letters and has made a number of changes in response. Those comments and any changes are identified and explained in the section-by-section discussion that follows. A
The proposal amended the "Purpose" paragraph to expressly incorporate the objectives of safety and soundness, loan diversification, and equitable access to banking services. The final rule adds to the "Scope" paragraph new language cautioning bank management that the lending limit rule is not a "safe harbor" for lending.

The "Scope" paragraph emphasizes that the lending limit rules are only one component of a prudent lending program. National banks must always underwrite loans in accordance with prudent banking practices, in addition to adhering to specific quantitative limitations such as the lending limits. Several commenters remarked that the OCC should amend the lending limits provisions to recognize the existence of limited liability companies as bank subsidiaries, comparable to operating subsidiaries. Treatment of limited liability companies as operating subsidiaries is an issue raised in the OCC’s proposed changes to Part 5 of its regulations, and the OCC believes the question is better resolved in that context. (59 FR 61034, November 29, 1994.) In the interim, however, when a bank seeks permission to invest in a limited liability company as a subsidiary, and the bank's voting interest satisfies the operating subsidiary percentage control requirements, the bank may also seek confirmation that loans by the bank to the limited liability company subsidiary will be treated in the same way as loans to an "operating subsidiary" for purposes of lending limits.

Definitions (s32.2)

The proposal consolidated all the definitions located throughout the existing rule into a single section. Commenters raised questions about some of the revisions and additions made to the definitions. Of particular note are the following revisions.

*8528 Capital and Surplus (s32.2(b))

Under the former rule, the statutory lending limit of 15% of capital was applied to a definition of capital found in 12 CFR s3.100. The s3.100 definition serves as the capital base for certain other regulatory limitations, such as limits on purchasing investment securities, holding property and OREO, and investing in community development corporations. The s3.100 capital definition is separate and different from the leverage and risk-based capital formulae used to determine banks' capital
In order to reduce regulatory burden associated with calculating lending limits and to begin the process of reducing the multiple definitions of capital currently in use, the proposal changed the definition of capital and surplus used for lending limits purposes by employing a capital calculation that all banks already make. Under the proposal, a bank's basic lending limit would be an amount equal to 15% of the sum of its allowed Tier 1 and Tier 2 capital, plus the balance of its allowance for loan and lease losses (ALLL) not included in Tier 2 capital for the bank's risk-based capital calculation. For simplicity, the proposal used the terminology "capital and surplus" rather than the statutory terms "unimpaired capital and unimpaired surplus."

The commenters generally favored this approach to the capital definition, however, some expressed concern that the approach needed to be clarified. The new capital base for calculation of the limit in the proposal appeared to some commenters to be the sum of all Tier 1 elements and all Tier 2 elements, whether or not they exceeded the amounts that could be included in a bank's risk-based capital. The final rule adopts the proposed capital and surplus definition but with an amendment to clarify that only the amount of Tier 1 and Tier 2 capital that is actually included in a bank's risk-based capital (plus the excess ALLL) is allowed in the bank's lending limit capital base.

Loans and Extensions of Credit (s32.2(j))

The commenters generally favored the proposed amendments to the definition of loans and extensions of credit, now found at s32.2(j), which incorporates significant OCC interpretive positions clarifying the term. Section 32.2(j)(1)(iii) adds the requirement that in order to exclude a bank's purchase of Type I securities subject to a repurchase agreement, a bank must have assured control over or established rights to the securities.

Some commenters requested additional clarification of the meaning of "assured control." Assured control means that the bank has recognized and exercisable authority over the asset. For example, a bank can assure control of property subject to a repurchase agreement by taking physical possession of the security or by requiring a proper recordation of ownership of book-entry securities.

Section 32.2(j)(1)(v) excludes all intra-day or daylight overdrafts from the definition of an extension of credit. Several commenters questioned whether the terms "intra-day" or "daylight" were sufficiently adaptable for an increasingly complex and international payments system. As the commenters point out, more and more banks operate across several time zones. The financial payments systems are now global systems spanning many time zones. With this in mind, several commenters suggested that the final rule adapt the meaning of a "daylight" overdraft
to contemporary conventions. The OCC believes these concerns have merit and the final rule drops the reference to "daylight" and simplifies the definition. Intra-day overdrafts excluded from the final rule are those overdrafts for which payment is received before the bank closes its books for the calendar day. This change recognizes the reality of a rapidly expanding payments system that may eventually run 24 hours a day and looks to each bank's practice for closing its books for the calendar day.

Loans Legally Unenforceable

Section 32.2(j)(1)(vii) of the proposal was intended to incorporate OCC interpretive letters that elaborated on former §32.106, that certain loans that become legally unenforceable would not be counted in calculating a bank's lending limit. One commenter observed that in attempting to incorporate the OCC interpretive letters, the proposal effectively narrowed the effect of the interpretive ruling by excluding from lending limit calculations only loans that are discharged in bankruptcy, or by judicial decision or statute, and not excluding loans that are legally unenforceable "for any other reason."

The final rule returns to the scope of the original OCC interpretive ruling. Under the final rule, a loan (or a portion thereof) that becomes legally unenforceable for any reason and has been charged off on a bank's books, is not considered a loan or extension of credit. As a matter of prudent banking practice, the OCC expects that banks will keep sufficient documentation to show why loans are legally unenforceable. These records may include letters, memoranda, or written agreements that evidence the bank's legally enforceable forgiveness of a loan. The financial records of the bank also should reflect that the loan has been charged off.

Advances for the Benefit of the Borrower

As proposed, §32.2(j)(2)(i) exempts from the definition of "loans and extensions of credit" additional funds advanced to a borrower by a bank for taxes or insurance if the advance is made for the protection of the bank. The purpose of this exemption was to allow banks to preserve the value of the collateral securing a loan. The proposal requested that commenters address whether advances made for other purposes should be similarly exempted from the definition of loans and extensions of credit. Commenters responded that the purpose of the exemption is served by allowing an advance for any purpose that protects the collateral.

The OCC carefully considered the comments received on this issue. The OCC recognizes that there may be situations when an advance on behalf of a troubled borrower could help the lending
bank avoid greater expenses after foreclosure. For example, an advance for the purpose of repairing a leaking roof is more cost effective than waiting until after foreclosure which leads to spending more money to restore the value of water-damaged OREO. However, using the exemption to advance funds for building new property would not be consistent with the purpose of the exemption. The OCC also has concerns that banks reasonably anticipate a borrower's need to fund various expenses in determining the appropriate size of the loan that a bank is able to extend and that the exemption not create incentives for borrowers to divert or reclassify spending in order to qualify larger portions of their credit needs for the exemption. Nevertheless, the OCC believes that a moderate extension of the exemption to allow advances to pay for more than taxes and insurance is appropriate, provided that the expenses have not been structured to avoid a bank's lending limits. The final rule therefore exempts from the lending limit reasonable advances made on behalf of the borrower to pay for necessary maintenance and certain other expenditures when an advance is consistent with safe and sound banking practices and designed to protect the lending bank's interest in the collateral. *8529 As before, these advances will be treated as an extension of credit and taken into account in calculating the bank's lending limit if the bank seeks to make an additional loan to the same borrower.

Accrued and Discounted Interest

Section 32.2(j)(2)(ii) of the proposal clarified the type of accrued and discounted interest that would qualify for an exclusion from the definition of "loans and extensions of credit". The proposal also provided, however, that accrued and discounted interest would be treated as an extension of credit if a bank sought to make another loan to the borrower.

Several commenters, particularly large banks with loans to foreign governments, objected to this provision of the paragraph. One commenter stated that this provision would be a major problem for banks seeking to restructure loans to foreign governments with substantial accrued interest. The proposed provision could severely impair a bank's ability to participate in any new extensions of credit in connection with that type of sovereign debt restructuring. Other commenters pointed to the 1982 Garn-St Germain amendments, Pub. L. 97-320 (1982), which changed the language of 12 U.S.C. 84 from "total obligations" of a borrower to "loans and extensions of credit". These commenters argued that the 1982 amendment reflects a shift in the focus of the statute. They argued that the 1982 amendment confirms that s84 is not directed to interest that is contractually due but is intended to limit only the funds that actually leave the bank in the form of principal. In short, these commenters believe that the lending limits apply to money loaned, not money owed.
The OCC believes these comments have merit. In order to provide greater flexibility to banks seeking to improve their recoveries through loan work-outs and restructured loans with troubled debtors, the final rule modifies the OCC's previous approach. Under the final rule, a bank need not attribute past-due or accrued interest to a borrower for purposes of the lending limit. However, as already noted, all loans made by a national bank must be underwritten in accordance with prudent banking practices, in addition to adhering to specific quantitative limitations such as the lending limits. National banks therefore should consider the possibility of unscheduled interest accruals in determining the amount of the bank's original extension of credit, and also must bear the prudent banking practices standard in mind when extending additional credit to a borrower with past-due or accrued interest.

Renewals

The proposal incorporated an OCC interpretive position that excludes from the definition of "loans and extensions of credit" certain loan renewals or restructurings if the bank first exercised "best efforts" to bring the loan into conformity with its lending limit. Several commenters questioned whether the use of the term "best efforts" sets a standard that is too high to provide any practical application. The OCC agrees and the final rule uses the term "reasonable" efforts, which better reflects the OCC expectation and the original intent of the proposed amendment.

Items in the Process of Collection

The OCC has generally taken the interpretive position that giving credit for uncollected items is a loan or an extension of credit. However, under the proposal, the OCC also created an exception for instances where payment is required by Regulation CC of the Federal Reserve Board, 12 CFR part 229. Regulation CC specifies certain time frames within which funds must be made available. Several commenters correctly pointed out that although the intent of the proposal was to provide additional flexibility, the effect of the change did not achieve that result. In fact, the proposal may have prevented a bank from giving credit for an uncollected item prior to the day stated in the mandatory availability schedule in Regulation CC, by requiring the bank to treat that advance as an extension of credit.

The final rule amends this paragraph by providing that amounts paid on items in the normal process of collection do not constitute a loan or extension of credit. However, once an item is returned or dishonored by the paying bank, it no longer is in the normal process of collection. Payment by a bank against a
dishonored item would be an extension of credit.

Participation Loans

Section 32.2(j)(2)(vi) of the final rule revises the proposal's treatment of participation loans. The proposal incorporated interpretive positions previously found at s32.107 and included a new provision requiring a bank that originates a loan to receive funding from the participants on the same day. If the bank did not receive participant funding on the same day, the proposal required the bank to treat unfunded portions as a loan from the originating bank to the borrower. Many commenters suggested that the OCC eliminate the same-day funding requirement because it is impractical. The OCC disagrees with that contention and believes the participant funding provision is an important protection to the originating bank that will help ensure prompt funding by participants.

The commenters, however, correctly point out that delays in the timing and delivery in funding a participation are not infrequent. The OCC does not intend for inadvertent funding delays to cause lending limit violations. The final rule therefore extends the funding period to provide a more realistic timeframe to address temporary or inadvertent funding errors. The final rule provides that a participation loan is not attributed to the originating bank if it receives funding from the participants before the close of business on the day after it makes funds available to the borrower. The final rule also sets forth standards for an originating bank that, if followed, shield the bank from a lending limit violation in the event that a participant fails to fund.

Special Lending Limits (s32.3(b))

Section 32.3(b)(3)(ii) of the proposal required an inspection and valuation of livestock that is "current, taking into account the nature and frequency of turnover of the livestock" in order to qualify for the special lending limit for loans secured by documents covering livestock. Former part 32 required that an "inspection and appraisal report" be performed at least every 12 months or more frequently as deemed prudent. The proposal recognized the differences in turnover between different kinds of livestock that secure a loan. It removed the presumption that an inspection and appraisal report performed every 12 months is adequate.

Several commenters questioned this change. The commenters read the former rule to require an inspection report only once every 12 months. Although some commenters characterized the proposal as more burdensome than the old requirement, the OCC believes it is not. In fact, the former rule required an inspection and appraisal report more frequently than once a year, if it was
prudent to do so. The proposal actually reduced burden by allowing the use of valuations, rather than appraisals, when appropriate. Recognizing the need for clarity, however, the final rule includes the requirement that an inspection or valuation be made no less frequently than every 12 months.

Section 32.3(b)(5) of the proposal also provided a new exception to the lending limits to enable a bank to renew a qualifying commitment to lend in order to complete the financing of a project in process. Under the proposal, the advance had to be to protect the position of the bank, and the amount of additional advances could not exceed the lesser of the unfunded portion of the original commitment or 5 percent of the bank's capital and surplus. Commenters generally supported this position. Several suggested, however, that for the exception to accomplish its intended purpose, the OCC should allow the bank to fund the full amount of the commitment even if it was in excess of the five percent cap.

The OCC believes that this suggestion has merit, but is also concerned that full funding of the original commitment must not compromise a bank's safety and soundness. Accordingly, the final rule modifies the approach contained in the proposal to allow funding up to the amount of the original commitment, provided the renewal and additional funding thereunder is consistent with safe and sound banking practices, is made to protect the bank's position, and will enable the borrower to complete the project for which the original commitment was made.

Section 32.3(b)(6) of the proposal was not included in the final rule. This paragraph set forth a special lending limit that expired on January 1, 1995. Since the section serves no purpose after that date it is not incorporated into the final rule.

Loans Exempt From the Lending Limit (s32.3(c))

Section 32.3(c)(3) is revised in the final rule. This paragraph provides that loans collateralized by U.S. government obligations are exempt from the lending limits to the extent of the current market value of the collateral. This exemption includes loans that are secured by bonds, notes, Treasury bills, or similar obligations fully guaranteed as to principal and interest by the full faith and credit of the United States Government. This exemption was the subject of several commenter suggestions that it be expanded to include loans that are secured by instruments with comparable government backing. The OCC agrees with these comments that certain other forms of collateral that carry the full faith and credit of the U.S. government pose no greater risk of loss. Accordingly, the final rule relies on the OCC's authority under 12 U.S.C. 84(d)(1) to establish limits or requirements other than those specified in the statute, for particular classes or categories of loans, to include an additional class of loans in the exempt category--loans
guaranteed as to repayment of principal by the full faith and credit of the U.S. Government. This exemption includes qualifying Small Business Administration, Federal Housing Administration, and Veterans Administration guaranteed loans, but only to the extent of the government guarantee.

Some commenters suggested that the final rule also extend this exemption to loans that are secured by other types of instruments. The OCC has carefully considered these suggestions, but does not agree that, as a general matter, the principal and liquidity risks presented by the suggested types of instruments are sufficiently comparable to the risks of directly holding the U.S. Government securities, or government-backed loans. Accordingly, the OCC declines to add an additional category of collateral that could qualify a loan for an exemption from lending limits.

The final rule also modifies s32.3(c)(10) of the proposal. As proposed, this paragraph was intended to incorporate OCC interpretive positions on loans to leasing companies. This paragraph allows banks to attribute loans made to leasing companies to the lessees when certain conditions are met. The final rule includes minor changes to ensure that the conditions for this treatment are no more burdensome than if the bank were to act as a lessor itself subject to 12 CFR part 23. These changes better convey the current OCC interpretive position.

Frequency of the Lending Limit Calculation (s32.4)

The former rule required a bank to determine its lending limit for each loan on the date that it made a loan. The proposal simplified this requirement by allowing a bank to rely on its quarterly calculation of capital found in its Call Report. Rather than calculate daily, under the proposal the bank generally could calculate the lending limit once for the entire quarter. However, the OCC was concerned that a significant decline in capital between quarterly calculations could result in a bank lending at a level above its actual limit for the duration of the quarter.

To prevent a bank from lending in excess of a shrinking capital base, the proposal required a bank to recalculate its lending limit between quarters if there were a change in its capital category for purposes of prompt corrective action, or if a "material event" occurred that caused its capital to increase or decrease by 10 percent or more. However, it was recognized that what constitutes a "material event" for this trigger may not be readily defined. Anticipating criticism of the material event component, the proposal suggested an alternative: a simple increase or decrease of 10 percent in a bank's capital between quarters would trigger the recalculation obligation.

Comment was mixed on both approaches to the recalculation trigger. Generally, commenters characterized the "material
event" element as too vague to be useful. Many suggested that a simple percentage test would be more reliable and useful. Others questioned whether a percentage test was needed given the OCC's general ability to require more frequent calculations in individual cases. The OCC finds these arguments persuasive. The OCC has concluded that the material event element is too vague to give a reliable indication of the need to recalculate. As a result, the OCC has not included this requirement in the final rule.

Imposing the requirement that a bank recalculate whenever its capital declined by 10 percent between quarters is also problematic. Several commenters observed that the obligation to monitor the changes in capital between quarters would give a bank little comfort that its quarterly lending limit is valid for the entire quarter. In effect the obligation to monitor 10 percent swings in capital could force a bank to make a daily calculation of capital, not quarterly as proposed. This result would be contrary to the purpose of the proposed quarterly calculation.

On the other hand, the OCC also considered whether a quarterly calculation would be inappropriate for any identifiable subset of national banks, such as banks that are undercapitalized. The OCC determined not to include a different lending limit calculation frequency requirement for undercapitalized banks as a class, however, because the OCC anticipates that such banks will be subject to enhanced supervisory oversight and directives that will address the frequency of the bank's lending limit calculations in those cases where lending limit excesses are a potential problem. (For example, a bank could be undercapitalized for reasons unrelated to its lending activities, or could have poor underwriting practices and losses on loans and raise no lending limits issues). The OCC closely monitors undercapitalized banks, however, and will make appropriate adjustments to the frequency of required lending limit calculations for such banks if experience indicates that a general standard for undercapitalized banks is needed.

The final rule, therefore, deletes the 10 percent recalculation requirement *8531 but retains the explicit authority for the OCC to require a national bank to calculate its lending limits more frequently than every quarter when the OCC believes it is necessary. The OCC therefore may address unsafe or unsound lending practices or other supervisory concerns by directing any bank to calculate its lending limit more frequently than quarterly. This authority is set forth in s32.4(b).

Direct Benefit Test (s32.5(b))

Section 32.5(b) requires a loan to be attributed to a third party if the third party gains the direct benefit of the loan proceeds. The proposal narrowed the direct benefits tests to clarify that loans are not attributable to a third party when the
Loan proceeds are transferred to the third party to acquire property, goods, or services in a bona-fide arms-length transaction.

The proposal requested comment on the question of whether the direct benefits test was necessary. Several commenters argued that it was not. Some commenters suggested that the common enterprise test addresses most, and possibly all, circumstances that involve the less than a bona fide arms-length transactions that is the focus of the direct benefits test. The OCC has carefully considered these comments but has concluded that the direct benefits test uniquely addresses an area of concern in the lending limits area. The final rule therefore retains the test but with one change, designed to improve certainty regarding the application of the test. The "facts and circumstances" provision of the direct benefits test is removed. The OCC believes this part of the test was redundant and potentially confusing.

Common Enterprise Test (s32.5(c))

The final rule adopts the common enterprise test largely as stated in the proposal. The common enterprise test requires the aggregation of loans made to persons who are related through common control and financial interdependence or share a common source of income for repayment of the loan, or whenever the OCC determines the "facts and circumstances" requires aggregation. Most commenters characterized the proposed language as a much improved restatement of the test that was easier to understand. Some commenters requested further amendments, alterations, and extension of the rule.

The OCC has not adopted most of the suggestions. Many of the commenters' suggestions for change would have undermined the effectiveness of this combination rule. Most of the suggested changes would not have provided much additional clarity. Others risked diminishing the effectiveness of the rule. Although the common enterprise test may be somewhat complex to apply to certain corporate structures, the OCC has concluded that, on balance, it is an effective description of the varied circumstances when loans to separate borrowers should be combined because they present a common source of credit exposure for a bank.

The final rule makes changes to s32.5(c)(3), to clarify that the rule requires combination of only those loans that the borrowers use for the acquisition of a controlling interest in a business. The final rule also specifically clarifies that limited liability companies will be treated in the same manner as corporations, rather than as partnerships, in applying the common enterprise test.

Nonconforming Loans (s32.6)

The proposal incorporated OCC policy that a bank will not be
deemed to violate the lending limits when a loan that was legal when made becomes nonconforming as a result of several specifically defined events, provided the bank exercises "best efforts" to bring the loan into conformity with the lending limit. A number of commenters objected that the "best efforts" standard was too high. Some commenters pointed out that using best efforts to reduce a nonconforming loan could pose certain safety and soundness risks to a bank. For example, if a bank holds a loan that was legal when made and subsequently the bank's capital declines, the best efforts standard might require that the bank sell the loan off at any price. This forced sale only causes the bank to lose an asset during a period that its capital is in decline. The OCC did not intend this result of the proposed nonconforming loan provisions.

In response to commenter concerns, the final rule replaces the term "best efforts" with the term "reasonable efforts". The OCC believes this standard more accurately reflects the level of effort appropriate to bring a loan into conformance with a bank's current lending limits. The final rule also makes clear that the section does not require a bank to make efforts to bring the loan into conformity if to do so would be inconsistent with safe and sound banking practices. In addition, the final rule adds that loans that exceed a bank's lending limit as a result of changes in the capital rules or because borrowers subsequently become a common enterprise will be treated as nonconforming.

Finally, in response to commenters, the final rule changes the treatment of loans that qualify for a lending limit exemption because they are secured by certain collateral, such as U.S. government obligations. Under the former rule, as well as the proposal, a national bank was required to bring a loan into conformance through restoration of the market value of the collateral or by reducing the amount of the bank's loan by the amount that exceeds the lending limit within five business days. Several commenters characterized the five day correction period as arbitrary and unrealistic.

The OCC recognizes that there are circumstances beyond the bank's control which might cause a loan of this type to violate the lending limit, because of a decline in collateral value. Instead of the five day period, the final rule requires that a bank bring these loans into conformity within 30 calendar days. During that 30 day period, the loan will be treated as non-conforming. The OCC believes this change will provide a more realistic period to enable a bank to address restoration of proper collateral for a loan without forcing a precipitous divestiture of all or part of the loan that would not be in the best interests of the bank.

Effective Date

Section 302 of the Riegle Community Development and Regulatory
Improvement Act of 1994, 12 U.S.C. 4802, requires that a regulation that imposes new requirements take effect on the first day of the quarter following publication of the final rule. That section provides, however, that an agency may determine that the rule should take effect earlier.

The OCC believes that this regulation relieves burden by eliminating inefficient and unduly costly regulatory requirements and better focusing the lending limit rules on areas of greatest safety and soundness concern. These revisions to part 32 should not be further delayed. Accordingly, the final rule is effective 30 days after publication.

Derivation Table

Only substantive modifications, additions and changes are indicated.

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<td>Modified.</td>
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<td>(j)(2)(i)</td>
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<td>(j)(2)(ii)</td>
<td>s32.108</td>
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<td>(j)(2)(vi)</td>
<td>s32.107</td>
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<tr>
<td>(k)</td>
<td>s32.2(b)</td>
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<td>(l)</td>
<td>s32.2(f)</td>
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<td>(m)</td>
<td>s32.4(c)</td>
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<td>(n)</td>
<td>s32.6(c)(3)</td>
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<tr>
<td>(o)</td>
<td>s32.102(a)</td>
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<td>(p)</td>
<td>s32.2(e)</td>
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<tr>
<td>s32.3(a)</td>
<td>s32.3, s32.4</td>
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Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Comptroller of the Currency certifies that the final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This regulation will reduce the regulatory burden on national banks, regardless of size, by simplifying and clarifying existing regulatory requirements.

Executive Order 12866
The OCC has determined that this document is not a significant regulatory action as defined in Executive Order 12866.