



RESCINDED

Director of the Office of the Comptroller of the Currency
Administrator of the Federal Reserve System
U.S. Department of the Treasury

OCC 1998-10

Subject: Lending Limits
Date: April 6, 1998

**To: Chief Executive Officers of all National
Banks, Department and Division Heads, and all
Examining Personnel**

Description: Final Rule

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to clarify the current rule.

The final rule does not adopt the proposed expansion of the exemption from the definition of "loans and extensions of credit" to include additional funds advanced to preserve personal property securing a loan. As a result of its continued monitoring of credit quality standards, the OCC has decided it would not be appropriate at this time to modify this prudential safeguard that limits the amount a bank may lend to any one borrower.

For further information, contact Saumya R. Bhavsar, attorney, Legislative and Regulatory Activities, at (202) 874-5090, or Aline J. Henderson, senior attorney, Bank Activities and Structure, at (202) 874-5300.

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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 32

[Docket No. 98-04]

RIN 1557-AB55

Lending Limits

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

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is revising its lending limits regulation by making several technical changes designed to clarify certain provisions in the current rule.

EFFECTIVE DATE: May 1, 1998.

FOR FURTHER INFORMATION CONTACT: William C. Kerr, Special Assistant, Special Supervision, (202) 874-5170; Saumya R. Bhavsar, Attorney, Legislative and Regulatory Activities, (202) 874-5090; or Aline J. Henderson, Senior Attorney, or Laura Goldman, Attorney, Bank Activities and Structure, (202) 874-5300. Office of the Comptroller of Currency, 250 E Street, SW, Washington, DC 20219.

SUPPLEMENTARY INFORMATION:

Background

The OCC comprehensively revised its regulations in 12 CFR part 32 in 1995 (60 FR 8526 (February 15, 1995)), as part of its Regulation Review Program (Program) to update and streamline the regulation and eliminate requirements that imposed inefficient and costly regulatory burdens on national banks. These amendments to part 32 included changing the definition of ``loans and extensions of credit'' to exempt, under certain circumstances, additional funds advanced for the payment of maintenance and operating expenses necessary to preserve the value of real property securing a loan. See 12 CFR 32 .2(j)(2)(i). In addition, the amendments changed the definition of ``capital and surplus'' to allow a national bank, in most instances, to calculate its lending limit based on information contained in the bank's most recent quarterly Consolidated Report of Condition and Income (Call Report). See id. Sec. 32 .4. Some of the part 32 changes prompted requests for: (a) further clarification and extension of the exemption for funds advanced to preserve and maintain collateral to loans secured by personal property as well as loans secured by real property; and (b) clarification of the date on which a national bank must recalculate its capital and surplus. In response to these requests, the OCC published a notice of proposed rulemaking (proposal) on July 17, 1996 (61 FR 37227), to address these

issues. The proposal also made several technical changes designed to improve part 32 without changing its substance. The proposal reflected the OCC's continuing commitment to assess the effectiveness of the rules it has revised under the Program and to make further changes where necessary to improve a regulation.

Comments Received and Changes Made

The OCC received 11 comments on the proposal, six of which came from banks and bank holding companies and five from trade associations. Most commenters supported the OCC adding increased flexibility and clarity to the lending limits regulation. Commenters generally commended the OCC's efforts, while some commenters offered alternatives to certain of the proposed changes.

Upon further review, the OCC has decided not to adopt the proposal's exemption from the lending limit for additional funds advanced to preserve and maintain collateral to loans secured by personal property. However, the OCC has adopted the proposal's other changes.

Discussion

Exemption for Funds Advanced to Protect Personal Property Collateral (Sec. 32 .2(j))

Under Sec. 32 .2(j)(2)(i), additional funds advanced for the benefit of a borrower by a bank for the payment of certain expenses necessary to preserve the value of real property are not considered to be a ``loan or extension of credit'' for purposes of 12 U.S.C. 84 and part 32 under certain circumstances. The OCC proposed amending Sec. 32 .2(j)(2)(i) to include advances to protect personal property collateral and to treat any additional advance to protect collateral--whether personal property or real property--the same.

Commenters supported this proposed amendment. Upon further review, however, the OCC has determined that it would be inappropriate to adopt the change to Sec. 32 .2(j)(2)(i) at this time. As a result of its continued monitoring of credit quality standards, the OCC is concerned that credit standards have been relaxed since the proposed rule was published. Accordingly, the OCC has decided it would not be appropriate at this time to modify this prudential

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safeguard that limits the amount a bank may lend to any one borrower.

The OCC is retaining the existing exemption for advances made to protect real property collateral. Certain factors supporting the exemption for real property collateral do not necessarily apply to personal property. For instance, in the case of real estate, foreclosure is a time-consuming process in many states, often making it necessary for a borrower to undertake repairs and incur other expenses to maintain the value of the collateral while the foreclosure action proceeds. Thus, the final rule leaves unchanged the existing rule governing additional funds advanced to protect collateral.

Calculation of Lending Limits (Sec. 32 .4)

Former Sec. 32 .4(a) required a bank to calculate its lending limit as of the later of the date when the bank's Call Report ``is required to be filed'' or when the bank's capital category changes for purposes of the prompt corrective action provisions of 12 U.S.C. 1831o and 12 CFR part 6 (unless the OCC requires a national bank to calculate its lending limit more frequently for safety and soundness reasons).

Because the General Instructions to the Call Report refer to two separate ``filing'' dates, questions arose under the former rule concerning the date on which a recalculated lending limit is to become effective. The first potential filing date identified in the General

Instructions, termed the ``report date,'' is defined as the last calendar day of each calendar quarter. The second potential filing date, termed the ``submission date,'' is the date by which the appropriate Federal banking agency must receive the Call Report. For most banks, the maximum submission date is 30 days after the report date. Thus, the reference in the former rule to the date when the Call Report ``is required to be filed'' could produce some confusion as to when a recalculated limit becomes effective, depending on which ``filing'' date is used.

Proposed Sec. 32 .4 resolved this ambiguity by distinguishing the ``calculation date'' of a lending limit from its ``effective date.'' Assuming that a national bank's capital category has not changed, the bank is to calculate its lending limit using numbers reported in the bank's most recent Call Report, and, therefore, base its lending limit on the bank's capital and surplus as of the end of the most recent calendar quarter (the calculation date). However, this new limit will not be effective until the earlier of the date on which the bank submits its Call Report or the date by which the bank is required to submit the Call Report (the effective date). The proposal amended Sec. 32 .4(a)(1), redesignated current Sec. 32 .4(b) as Sec. 32 .4(c), and added a new Sec. 32 .4(b) that set forth the effective date for using the updated numbers to accomplish this result.

Under the proposal, if a bank's capital category for prompt corrective action purposes changes, then the bank must determine its lending limit as of the date on which the capital category changes. The new limit in this instance will be effective on the date that the limit is to be recalculated. The proposal also stated that the OCC also would continue its practice of permitting a recalculation of lending limits at a point during a quarter when there is a material change in a bank's capital arising from corporate activities such as a merger or stock issuance.

The OCC received seven comments on the proposal. Five commenters agreed with the clarification of the ``calculation date'' versus ``effective date,'' noting that the change removes ambiguity as to when a national bank's recalculated lending limit becomes effective.

Two commenters disagreed with the proposal. One commenter opposed the proposal because, in this commenter's views, the proposal would further delay implementation of a new lending limit by 25 days. The OCC notes that the proposed change would simply clarify what is the industry practice under the current rule, and would not create any additional delay in the implementation of an effective date. Under both the former rule and this final rule, a bank is to calculate its lending limit based on the capital in the bank as of the last day of a calendar quarter. However, it will not be able to calculate this new lending limit until it gathers most of the information it will need to prepare and file its Call Report.

Another commenter opposed the date of submission of a bank's Call Report as the effective date because the commenter thought that the flexibility to submit Call Reports on any day of the month up to the mandatory submission date would allow for inconsistent effective dates. The commenter recommended that the date should be either the date the Call Report is required to be submitted or as per letter of instruction from the OCC.

While it is true that the effective date for new lending limits will be determined in most cases by when a bank submits its Call Report, the OCC believes that the benefits of clarifying when a new lending limit is effective outweigh the minimal risk that a bank will make an unsafe loan in anticipation of a lower lending limit. Any loan that becomes nonconforming because of a drop in the bank's lending limit is subject to the provisions of Sec. 32 .6, which require a bank to use reasonable efforts to bring the loan into conformity with the lending limit unless to do so would be inconsistent with safe and sound banking practices. Moreover, the clarification regarding the effective date of a new lending limit will not affect the amount of the limit, because lending limits are to be calculated by using data from the last day of a calendar quarter. The OCC believes that the final rule is

sufficiently flexible to accommodate the commenter's concern while also removing any ambiguity that may have existed concerning the difference between the calculation date of a new lending limit and its effective date.

Technical Amendments (Secs. 32 .2(b) and 32 .3(c))

The proposal made several clarifying technical amendments to part 32. These amendments do not affect the substance of the current rule. The technical amendments are summarized below.

Former Sec. 32 .2(b) stated that capital and surplus includes, among other things, a bank's Tier 1 and Tier 2 capital ``included in the bank's risk-based capital under the OCC's Minimum Capital Ratios in Appendix A of part 3 of this chapter.'' The proposal clarified this definition by changing that language to refer to a bank's Tier 1 and Tier 2 capital ``calculated under the OCC's risk-based capital standards set forth in Appendix A to 12 CFR part 3 as reported in the bank's Consolidated Report of Condition and Income as filed under 12 U.S.C. 161.''

Former Sec. 32 .3(c)(4)(ii) exempted a loan from the lending limits to the extent that the loan is secured by an unconditional takeout commitment or guarantee of a Federal agency. In explaining when a commitment or guarantee is unconditional, former Sec. 32 .3(c)(4)(ii)(B) noted that protection against loss is not materially diminished or impaired by a procedural requirement, such as ``an agreement to take over only in the event of default . . .'' The proposal clarified that the phrase ``an agreement to take over'' means an agreement to pay on an obligation.

Finally, former Sec. 32 .3(c)(6)(ii)(B) stated that a bank must establish procedures to revalue foreign currency deposits to ensure that the loan or extension of credit remains fully secured at all times. The proposal clarified that the revaluation must be periodic.

The OCC requested comment on the proposed technical changes and

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suggestions for other technical changes that would clarify or improve the rule. Three commenters addressed the technical amendments, and all three supported the changes. One commenter specifically supported the clarification that Tier 1 and Tier 2 capital is to be calculated under the OCC's risk-based capital standards and as reported in the Call Report. In light of the comments received and the OCC's further deliberations, the final rule adopts the technical changes as proposed.

Regulatory Flexibility Act

It is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. As is explained in greater detail in the preamble to this final rule, the final rule makes only stylistic changes designed to clarify various sections of part 32. The rule imposes no new burden of any sort on national banks. Accordingly, a regulatory flexibility analysis is not required.

Executive Order 12866

The OCC has determined that this final rule is not a significant regulatory action under Executive Order 12866.

Unfunded Mandates Act of 1995

The OCC has determined that this final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of more than \$100 million in any one year. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed in this final rule the regulatory alternatives considered, as would

otherwise be required by the Unfunded Mandates Act of 1995. As discussed in the preamble, this final rule only clarifies certain provisions of the former rule.

List of Subjects in 12 CFR Part 32

National banks, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set out in the preamble, part 32 of 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 continues to read as follows:

Authority: 12 U.S.C. 1 et seq., 84, and 93a.

Sec. 32 .2 [Amended]

2. In Sec. 32 .2, paragraph (b) is revised to read as follows:

Sec. 32 .2 Definitions.

* * * * *

(b) Capital and surplus means--

(1) A bank's Tier 1 and Tier 2 capital calculated under the OCC's risk-based capital standards set forth in Appendix A to 12 CFR part 3 as reported in the bank's Consolidated Report of Condition and Income filed under 12 U.S.C. 161; plus

(2) The balance of a bank's allowance for loan and lease losses not included in the bank's Tier 2 capital, for purposes of the calculation of risk-based capital described in paragraph (b)(1) of this section, as reported in the bank's Call Report filed under 12 U.S.C. 161.

* * * * *

Sec. 32 .3 [Amended]

3. In Sec. 32 .3, paragraph (c)(4)(ii)(B) is amended by removing the term ``take over'' from the second sentence and adding in lieu thereof the term ``pay on the obligation'', and paragraph (c)(6)(ii)(B) is amended by adding the word ``periodically'' before the word ``revalue''.

4. Section 32 .4 is revised to read as follows:

Sec. 32 .4 Calculation of lending limits.

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

(1) The last day of the preceding calendar quarter; or

(2) The date on which there is a change in the bank's capital category for purposes of 12 U.S.C. 1831o and 12 CFR 6.3.

(b) Effective date. (1) A bank's lending limit calculated in accordance with paragraph (a)(1) of this section will be effective as of the earlier of the following dates:

(i) The date on which the bank's Call Report is submitted; or

(ii) The date on which the bank's Call Report is required to be submitted.

(2) A bank's lending limit calculated in accordance with paragraph (a)(2) of this section will be effective on the date that the limit is

to be calculated.

(c) More frequent calculations. If the OCC determines for safety and soundness reasons that a bank should calculate its lending limit more frequently than required by paragraph (a) of this section, the OCC may provide written notice to the bank directing the bank to calculate its lending limit at a more frequent interval, and the bank shall thereafter calculate its lending limit at that interval until further notice.

Dated: March 20, 1998.

Eugene A. Ludwig,
Comptroller of the Currency.
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