



OCC 1995-11

**Subject: National Bank Lending Limits Revised
12 CFR Part 32
Date: February 16, 1995**

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

Description: Transmits Final Rule

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revising 12 CFR Part 32. The final rule implements most of the initiatives contained in the February 1994 proposed rule. However, several changes were made in response to comments received. Most of these changes clarify the original proposal. In addition, other changes alter the proposed rule to provide greater flexibility to banks, or are merely technical in nature. The revised Part 32 is effective on March 17, 1995.

Like the February proposal, the final rule amends, clarifies and reorganizes the OCC's lending limit rules. Revised Part 32 eliminates inefficient and unduly burdensome regulatory requirements on national banks while refocusing the lending limit rules on the areas of greatest safety and soundness concern. One of the most significant changes adopted as part of the final rule alters both the timing of the calculation of the bank's legal lending limit and the capital base used for its calculation.

Under the final rule, the bank's legal lending limit will be calculated quarterly, using Report of Condition data, and employing Risk Based Capital plus any disallowed Allowance for Loan and Lease Losses as the capital base. For most banks, the calculation will be performed at the end of each calendar quarter to determine the legal lending limit for the next quarter.

The rule also permits national banks to:

- renew and complete the funding of an expired qualifying commitment to lend under specific circumstances;
- advance additional funds in excess of the lending limit for the protection of the bank's interest in an asset, within certain limits;
- exclude from the lending limits the financing resulting from the sale of a bank's own assets, including OREO;
- renew or restructure nonconforming loans where the bank exercised reasonable efforts to bring the loan into conformity, but has been unable to do so;
- recognize and include a limited liability company as a corporation for lending limit purposes; and,
- employ separate requirements for bringing nonconforming loans into conformity, dependent upon the reason for the nonconformity.

In addition, the rule includes a major revision and clarification of the combination rules, including the direct benefits test and the common enterprise test. All of these items were contained in the proposal and were adopted in this final rule with minor modification.

A derivation table that lists the corresponding previous and new sections and indicates the significance of the change is included at the end of the preamble to the regulation.

For general guidance on applying this statement, contact the Office of the Chief National Bank Examiner, (202) 874-5170 .

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Related Links

- [Final Rule 501-526](#)

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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 32

[Docket No. 95-03]
RIN 1557-AA72

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 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,<SUP>1 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.

\1\Act of Feb. 25, 1863, 12 Stat. 665 et seq., R.S. Sec. 5200.

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 table summarizing the sections of the former part 32 that are amended by the final rule is included at the end of this preamble.

Authority, Purpose and Scope (Sec. 32.1)

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 (Sec. 32.2)

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. [[Page 8528]]

Capital and Surplus (Sec. 32.2(b))

Under the former rule, the statutory lending limit of 15% of capital was applied to a definition of capital found in 12 CFR Sec. 3.100. The Sec. 3.100 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 Sec. 3.100 capital definition is separate and different from the leverage and risk-based capital formulae used to determine banks' capital adequacy.

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 (Sec. 32.2(j))

The commenters generally favored the proposed amendments to the definition of loans and extensions of credit, now found at Sec. 32.2(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 Sec. 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, Sec. 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. [[Page 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 Sec. 84 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 Sec. 32.107 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 (Sec. 32.3(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 [[Page 8530]] 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 (Sec. 32.3(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 Sec. 32.3(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 (Sec. 32.4)

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 [[Page 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 Sec. 32.4(b).

Direct Benefit Test (Sec. 32.5(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 (Sec. 32.5(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 Sec. 32.5(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 (Sec. 32.6)

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 conformity 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.

[[Page 8532]]

provision	Revised provision Comments	Existing
Sec. 32.1.....		Sec. 32.1, Sec.
32.111.....	Modified.	
Sec. 32.2(a).....		Sec.
32.101.....	Added and modified.	
(b).....		Sec.
32.2(c).....	Significant change.	
(c).....		
.....	Added.	
(d).....		Sec.
32.6(h)(3).....		
(e).....		Sec.
32.6(h)(4).....		
(f).....		Sec.
32.2(d).....		
(g).....		Sec.
32.5(a)(2)(v).....	Modified.	

(h).....	Sec.
32.4(b).....	
(i).....	Sec. 32.4(c) and
(e).....	
(j)(1)(i).....	Sec.
32.2(a).....	
(j)(1)(ii).....	Sec.
32.2(a).....	
(j)(1)(iii).....	Sec.
32.103.....	Modified.
(j)(1)(iv).....	Sec.
32.104.....	Modified.
(j)(1)(v).....	Sec.
32.105.....	
(j)(1)(vi).....	Sec.
32.102(b).....	
(j)(1)(vii).....	Sec.
32.106.....	Modified.
(j)(2)(i).....	
.....	Added.
(j)(2)(ii).....	Sec.
32.108.....	Modified.
(j)(2)(iii).....	
.....	Added.
(j)(2)(iv).....	
.....	Added.
(j)(2)(v).....	
.....	Added.
(j)(2)(vi).....	Sec.
32.107.....	Significant change.
(k).....	Sec.
32.2(b).....	Modified.
(l).....	Sec.
32.2(f).....	
(m).....	Sec.
32.4(c).....	
(n).....	Sec.
32.6(c)(3).....	
(o).....	Sec.
32.102(a).....	
(p).....	Sec.
32.2(e).....	
Sec. 32.3(a).....	Sec. 32.3, Sec.
32.4.....	Modified.
(b)(1).....	Sec.
32.6(c).....	
(b)(2).....	Sec.
32.6(h).....	Modified.
(b)(3).....	Sec.
32.6(i)(1).....	Modified.
(b)(4).....	Sec.
32.6(i)(2).....	
(b)(5).....	
.....	Significant addition.
(c)(1).....	Sec.
32.6(a).....	

(c)(2).....	Sec.
32.6(b).....	
(c)(3).....	Sec.
32.6(d).....	Significant change.
(c)(4).....	Sec.
32.6(e).....	
(c)(5).....	Sec.
32.109.....	
(c)(6).....	Sec.
32.6(f).....	Modified.
(c)(7).....	Sec.
32.6(g).....	
(c)(8).....	Sec.
32.6(j).....	
(c)(9).....	Sec.
32.110.....	
(c)(10).....	
.....	Added.
Sec. 32.4.....	
.....	Significant addition.
Sec. 32.5(a).....	Sec.
32.5(a)(1).....	
(b).....	
.....	Significant change.
(c).....	Sec.
32.5(a)(2).....	Modified.
(d).....	Sec.
32.5(b).....	Modified.
(e).....	Sec.
32.5(c).....	
(f).....	Sec.
32.5(d).....	
Sec. 32.6.....	Sec.
32.7.....	Modified.

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.

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 revised to read as follows:

PART 32--LENDING LIMITS

Sec.

- 32.1 Authority, purpose and scope.
- 32.2 Definitions.
- 32.3 Lending limits.
- 32.4 Calculation of lending limits.
- 32.5 Combination rules.
- 32.6 Nonconforming loans.

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

Sec. 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, and 12 U.S.C. 93a.

(b) Purpose. The purpose of this part is to protect the safety and soundness of [[Page 8533]] national banks by preventing excessive loans to one person, or to related persons that are financially dependent, and to promote diversification of loans and equitable access to banking services.

(c) Scope. (1) This part applies to all loans and extensions of credit made by national banks and their domestic operating subsidiaries. This part does not apply to loans made by a national bank and its domestic operating subsidiaries to the bank's ``affiliates,'' as that term is defined in 12 U.S.C. 371c(b)(1), to the bank's operating subsidiaries, or to Edge Act or Agreement Corporation subsidiaries.

(2) The lending limits in this part are separate and independent from the investment limits prescribed by 12 U.S.C. 24 (Seventh), and a national bank 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) and 12 CFR part 1.

(3) Extensions of credit to executive officers, directors and principal shareholders of national banks, 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 and this part.

(4) In addition to the foregoing, loans and extensions of credit made by national banks and their domestic operating subsidiaries must be consistent with safe and sound banking practices.

Sec. 32.2 Definitions.

(a) Borrower means a person who is named as a borrower or debtor in a loan or extension of credit, 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 Sec. 32.5.

(b) Capital and surplus means--

(1) 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; 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 under part 3 of this chapter.

(c) Close of business means the time at which a bank closes its accounting records for the business day.

(d) Consumer means the user of any products, commodities, goods, or services, whether leased or purchased, but does not include any person who purchases products or commodities for resale or fabrication into goods for sale.

(e) Consumer paper means paper relating to automobiles, mobile homes, residences, office equipment, household items, tuition fees, insurance premium fees, and similar consumer items. Consumer paper also includes paper covering the lease (where the bank is not the owner or lessor) or purchase of equipment for use in manufacturing, farming, construction, or excavation.

(f) Contractual commitment to advance funds. (1) The term includes a bank's obligation to--

(i) Make payment (directly or indirectly) to a third person contingent upon default by a customer of the bank in performing an obligation and to make such payment in keeping with the agreed upon terms of the customer's contract with the third person, or to make payments upon some other stated condition;

(ii) Guarantee or act as surety for the benefit of a person;

(iii) Advance funds under a qualifying commitment to lend, as defined in paragraph (1) of this section; and

(iv) Advance funds under a standby letter of credit as defined in paragraph (p) of this section, a put, or other similar arrangement.

(2) The term does not include commercial letters of credit and similar instruments where the issuing bank expects the beneficiary to draw on the issuer, that do not guarantee payment, and that do not provide for payment in the event of a default by a third party.

(g) Control is presumed to exist when a person directly or indirectly, or acting through or together with one or more persons--

(1) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person;

(2) Controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person; or

(3) Has the power to exercise a controlling influence over the management or policies of another person.

(h) Current market value means the bid or closing price listed for an item in a regularly published listing or an electronic reporting service.

(i) Financial instrument means stocks, notes, bonds, and debentures traded on a national securities exchange, OTC margin stocks as defined in Regulation U, 12 CFR part 221, commercial paper, negotiable certificates of deposit, bankers' acceptances, and shares in money market and mutual funds of the type that issue shares in which banks may perfect a security interest. Financial instruments may be denominated in foreign currencies that are freely convertible to U.S. dollars. The term ``financial instrument'' does not include mortgages.

(j) Loans and extensions of credit means a bank'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.

(1) Loans or extensions of credit for purposes of 12 U.S.C. 84 and this part include--

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

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

(iii) A bank'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 bank's purchase of Type I securities, as defined in part 1 of this chapter, subject to a repurchase agreement, where the purchasing bank has assured control over or has established its rights to the Type I securities as collateral;

(iv) A bank'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 loan is the total unpaid balance of the paper owned by the bank less any applicable dealer reserves retained by the bank and held by the bank as collateral security. Where the seller's obligation to repurchase is limited, the bank's loan is measured by the total amount of the paper the seller may ultimately be obligated to repurchase. A bank'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;

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

(vi) 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; and

(vii) Loans or extensions of credit that have been charged off on the books of the bank 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 [[Page 8534]] maintains sufficient records to demonstrate that the loan is unenforceable.

(2) The following items do not constitute loans or extensions of credit for purposes of 12 U.S.C. 84 and this part--

(i) Additional funds advanced for the benefit of a borrower by a bank 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 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 bank's own assets, including Other Real Estate Owned, if the financing does not put the bank in a worse position than when the bank 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 bank 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 bank to the borrower (except as permitted by Sec. 32.3(b)(5)), or a new borrower replaces the original borrower, or unless the OCC determines that a renewal or restructuring was undertaken as a means to evade the bank'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 bank 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 bank 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 to the borrower. If the portions so attributed to the borrower exceed the originating bank's lending limit, the loan may be treated as nonconforming subject to Sec. 32.6, rather than a violation, if:

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

(2) The participating bank reconfirmed its participation and the originating bank 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 bank's next business day.

(k) Person means an individual; sole proprietorship; partnership; joint venture; association; trust; estate; business trust; corporation; limited liability company; not-for-profit corporation; sovereign government or agency, instrumentality, or political subdivision thereof; or any similar entity or organization.

(1) Qualifying commitment to lend means a legally binding written commitment to lend that, when combined with all other outstanding loans and qualifying commitments to a borrower, was within the bank's lending limit when entered into, and has not been disqualified.

(1) In determining whether a commitment is within the bank's lending limit when made, the bank may deduct from the amount of the commitment the amount of any legally binding loan participation commitments that are issued concurrent with the bank's commitment and that would be excluded from the definition of "loan or extension of credit" under paragraph (j)(2)(vi) of this section.

(2) If the bank subsequently chooses to make an additional loan and that subsequent loan, together with all outstanding loans and qualifying commitments to a borrower, exceeds the bank's applicable lending limit at that time, the bank's qualifying commitments to the borrower that exceed the bank's lending limit at that time are deemed to be permanently disqualified, beginning with the most recent

qualifying commitment and proceeding in reverse chronological order. When a commitment is disqualified, the entire commitment is disqualified and the disqualified commitment is no longer considered a ``loan or extension of credit.'' Advances of funds under a disqualified or non-qualifying commitment may only be made to the extent that the advance, together with all other outstanding loans to the borrower, do not exceed the bank's lending limit at the time of the advance, calculated pursuant to Sec. 32.4.

(m) Readily marketable collateral means financial instruments and bullion that are salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask price market.

(n) Readily marketable staple means an article of commerce, agriculture, or industry, such as wheat and other grains, cotton, wool, and basic metals such as tin, copper and lead, in the form of standardized interchangeable units, that is easy to sell in a market with sufficiently frequent price quotations.

(1) An article comes within this definition if--

(i) The exact price is easy to determine; and

(ii) The staple itself is easy to sell at any time at a price that would not be considerably less than the amount at which it is valued as collateral.

(2) Whether an article qualifies as a readily marketable staple is determined on the basis of the conditions existing at the time the loan or extension of credit that is secured by the staples is made.

(o) Sale of Federal funds means any transaction between depository institutions involving the transfer of immediately available funds resulting from credits to deposit balances at Federal Reserve Banks, or from credits to new or existing deposit balances due from a correspondent depository institution.

(p) Standby letter of credit means any letter of credit, or similar arrangement, that represents an obligation to the beneficiary on the part of the issuer:

(1) To repay money borrowed by or advanced to or for the account of the account party;

(2) To make payment on account of any indebtedness undertaken by the account party; or

(3) To make payment on account of any default by the account party in the performance of an obligation.

Sec. 32.3 Lending limits.

(a) Combined general limit. A national bank's total outstanding loans and extensions of credit to one borrower [[Page 8535]] may not exceed 15 percent of the bank's capital and surplus, plus an additional 10 percent of the bank's capital and surplus, if the amount that exceeds the bank's 15 percent general limit is fully secured by readily marketable collateral, as defined in Sec. 32.2(m). To qualify for the additional 10 percent limit, the bank must perfect a security interest in the collateral under applicable law and the collateral must have a current market value at all times of at least 100 percent of the amount of the loan or extension of credit that exceeds the bank's 15 percent general limit.

(b) Loans subject to special lending limits. The following loans or extensions of credit are subject to the lending limits set forth below.

When loans and extensions of credit qualify for more than one special lending limit, the special limits are cumulative.

(1) Loans secured by bills of lading or warehouse receipts covering readily marketable staples. (i) A national bank's loans or extensions of credit to one borrower secured by bills of lading, warehouse receipts, or similar documents transferring or securing title to readily marketable staples, as defined in Sec. 32.2(n), may not exceed 35 percent of the bank's capital and surplus in addition to the amount allowed under the bank's combined general limit. The market value of the staples securing the loan must at all times equal at least 115 percent of the amount of the outstanding loan that exceeds the bank's combined general limit.

(ii) Staples that qualify for this special limit must be nonperishable, may be refrigerated or frozen, and must be fully covered by insurance if such insurance is customary. Whether a staple is nonperishable must be determined on a case-by-case basis because of differences in handling and storing commodities.

(iii) This special limit applies to a loan or extension of credit arising from a single transaction or secured by the same staples, provided that the duration of the loan or extension of credit is:

(A) Not more than ten months if secured by nonperishable staples;
or

(B) Not more than six months if secured by refrigerated or frozen staples.

(iv) The holder of the warehouse receipts, order bills of lading, documents qualifying as documents of title under the Uniform Commercial Code, or other similar documents, must have control and be able to obtain immediate possession of the staple so that the bank is able to sell the underlying staples and promptly transfer title and possession to a purchaser if default should occur on a loan secured by such documents. The existence of a brief notice period, or similar procedural requirements under applicable law, for the disposal of the collateral will not affect the eligibility of the instruments for this special limit.

(A) Field warehouse receipts are an acceptable form of collateral when issued by a duly bonded and licensed grain elevator or warehouse having exclusive possession and control of the staples even though the grain elevator or warehouse is maintained on the premises of the owner of the staples.

(B) Warehouse receipts issued by the borrower-owner that is a grain elevator or warehouse company, duly-bonded and licensed and regularly inspected by state or Federal authorities, may be considered eligible collateral under this provision only when the receipts are registered with an independent registrar whose consent is required before the staples may be withdrawn from the warehouse.

(2) Discount of installment consumer paper. (i) A national bank's loans and extensions of credit to one borrower that arise from the discount of negotiable or nonnegotiable installment consumer paper, as defined at Sec. 32.2(e), that carries a full recourse endorsement or unconditional guarantee by the person selling the paper, may not exceed 10 percent of the bank's capital and surplus in addition to the amount allowed under the bank's combined general limit. An unconditional guarantee may be in the form of a repurchase agreement or separate guarantee agreement. A condition reasonably within the power of the bank to perform, such as the repossession of collateral, will not make conditional an otherwise unconditional guarantee.

(ii) Where the seller of the paper offers only partial recourse to

the bank, the lending limits of this section apply to the obligation of the seller to the bank, which is measured by the total amount of paper the seller may be obligated to repurchase or has guaranteed.

(iii) Where the bank is relying primarily upon the maker of the paper for payment of the loans or extensions of credit and not upon any full or partial recourse endorsement or guarantee by the seller of the paper, the lending limits of this section apply only to the maker. The bank must substantiate its reliance on the maker with--

(A) Records supporting the bank's independent credit analysis of the maker's ability to repay the loan or extension of credit, maintained by the bank or by a third party that is contractually obligated to make those records available for examination purposes; and

(B) A written certification by an officer of the bank authorized by the bank's board of directors or any designee of that officer, that the bank is relying primarily upon the maker to repay the loan or extension of credit.

(iv) Where paper is purchased in substantial quantities, the records, evaluation, and certification must be in a form appropriate for the class and quantity of paper involved. The bank may use sampling techniques, or other appropriate methods, to independently verify the reliability of the credit information supplied by the seller.

(3) Loans secured by documents covering livestock. (i) A national bank's loans or extensions of credit to one borrower secured by shipping documents or instruments that transfer or secure title to or give a first lien on livestock may not exceed 10 percent of the bank's capital and surplus in addition to the amount allowed under the bank's combined general limit. The market value of the livestock securing the loan must at all times equal at least 115 percent of the amount of the outstanding loan that exceeds the bank's combined general limit. For purposes of this subsection, the term ``livestock'' includes dairy and beef cattle, hogs, sheep, goats, horses, mules, poultry and fish, whether or not held for resale.

(ii) The bank must maintain in its files an inspection and valuation for the livestock pledged that is reasonably current, taking into account the nature and frequency of turnover of the livestock to which the documents relate, but in any case not more than 12 months old.

(iii) Under the laws of certain states, persons furnishing pasturage under a grazing contract may have a lien on the livestock for the amount due for pasturage. If a lien that is based on pasturage furnished by the lienor prior to the bank's loan or extension of credit is assigned to the bank by a recordable instrument and protected against being defeated by some other lien or claim, by payment to a person other than the bank, or otherwise, it will qualify under this exception provided the amount of the perfected lien is at least equal to the amount of the loan and the value of the livestock is at no time less than 115 percent of the portion of the loan or extension of credit that exceeds the bank's combined general limit. When the amount due under the grazing contract is dependent upon future performance, the resulting lien does not meet the requirements of the exception.

(4) Loans secured by dairy cattle. A national bank's loans and extensions of credit to one borrower that arise from the discount by dealers in dairy cattle of [[Page 8536]] paper given in payment for the cattle may not exceed 10 percent of the bank's capital and surplus in addition to the amount allowed under the bank's combined general limit. To qualify, the paper--

(i) Must carry the full recourse endorsement or unconditional

guarantee of the seller; and

(ii) Must be secured by the cattle being sold, pursuant to liens that allow the bank to maintain a perfected security interest in the cattle under applicable law.

(5) Additional advances to complete project financing pursuant to renewal of a qualifying commitment to lend. A national bank may renew a qualifying commitment to lend, as defined by Sec. 32.2(1), and complete funding under that commitment if all of the following criteria are met--

(i) The completion of funding is consistent with safe and sound banking practices and is made to protect the position of the bank;

(ii) The completion of funding will enable the borrower to complete the project for which the qualifying commitment to lend was made; and

(iii) The amount of the additional funding does not exceed the unfunded portion of the bank's qualifying commitment to lend.

(c) Loans not subject to the lending limits. The following loans or extensions of credit are not subject to the lending limits of 12 U.S.C. 84 or this part.

(1) Loans arising from the discount of commercial or business paper. (i) Loans or extensions of credit arising from the discount of negotiable commercial or business paper that evidences an obligation to the person negotiating the paper. The paper--

(A) Must be given in payment of the purchase price of commodities purchased for resale, fabrication of a product, or any other business purpose that may reasonably be expected to provide funds for payment of the paper; and

(B) Must bear the full recourse endorsement of the owner of the paper, except that paper discounted in connection with export transactions, that is transferred without recourse, or with limited recourse, must be supported by an assignment of appropriate insurance covering the political, credit, and transfer risks applicable to the paper, such as insurance provided by the Export-Import Bank.

(ii) A failure to pay principal or interest on commercial or business paper when due does not result in a loan or extension of credit to the maker or endorser of the paper; however, the amount of such paper thereafter must be counted in determining whether additional loans or extensions of credit to the same borrower may be made within the limits of 12 U.S.C. 84 and this part.

(2) Bankers' acceptances. A bank's acceptance of drafts eligible for rediscount under 12 U.S.C. 372 and 373, or a bank's purchase of acceptances created by other banks that are eligible for rediscount under those sections; but not including--

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

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

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

(3)(i) Loans secured by U.S. obligations. Loans or extensions of credit, or portions thereof, to the extent fully secured by the current market value of:

(A) Bonds, notes, certificates of indebtedness, or Treasury bills of the United States or by similar obligations fully guaranteed as to principal and interest by the United States;

(B) Loans to the extent guaranteed as to repayment of principal by the full faith and credit of the U.S. government, as set forth in paragraph (c)(4)(ii) of this section.

(ii) To qualify under this paragraph, the bank must perfect a security interest in the collateral under applicable law.

(4) Loans to or guaranteed by a Federal agency. (i) Loans or extensions of credit to any department, agency, bureau, board, commission, or establishment of the United States or any corporation wholly owned directly or indirectly by the United States.

(ii) Loans or extensions of credit, including portions thereof, to the extent secured by unconditional takeout commitments or guarantees of any of the foregoing governmental entities. The commitment or guarantee--

(A) Must be payable in cash or its equivalent within 60 days after demand for payment is made;

(B) Is considered unconditional if the protection afforded the bank is not substantially diminished or impaired if loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements, such as an agreement to take over only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specific period after its occurrence, or a requirement of good faith on the part of the bank.

(5) Loans to or guaranteed by general obligations of a State or political subdivision. Loans or extensions of credit to a State or political subdivision that constitutes a general obligation of the State or political subdivision, as defined in Part 1 of this chapter, and for which the lending bank has obtained the opinion of counsel that the loan or extension of credit is a valid and enforceable general obligation of the borrower, and loans or extensions of credit, including portions thereof, to the extent guaranteed or secured by a general obligation of a State or political subdivision and for which the lending bank has obtained the opinion of counsel that the guarantee or collateral is a valid and enforceable general obligation of that public body.

(6) Loans secured by segregated deposit accounts. Loans or extensions of credit, including portions thereof, to the extent secured by a segregated deposit account in the lending bank, provided a security interest in the deposit has been perfected under applicable law.

(i) Where the deposit is eligible for withdrawal before the secured loan matures, the bank must establish internal procedures to prevent release of the security without the lending bank's prior consent.

(ii) A deposit that is denominated and payable in a currency other than that of the loan or extension of credit that it secures may be eligible for this exception if the currency is freely convertible to U.S. dollars.

(A) This exception applies to only that portion of the loan or extension of credit that is covered by the U.S. dollar value of the deposit.

(B) The lending bank must establish procedures to revalue foreign currency deposits to ensure that the loan or extension of credit remains fully secured at all times.

(7) Loans to financial institutions with the approval of the Comptroller. Loans or extensions of credit to any financial institution or to any receiver, conservator, superintendent of banks, or other agent in charge of the business and property of a financial institution

when an emergency situation exists and a national bank is asked to provide assistance to another financial institution, and the loan is approved by the Comptroller. For purposes of this [[Page 8537]] paragraph, financial institution means a commercial bank, savings bank, trust company, savings association, or credit union.

(8) Loans to the Student Loan Marketing Association. Loans or extensions of credit to the Student Loan Marketing Association.

(9) Loans to industrial development authorities. A loan or extension of credit to an industrial development authority or similar public entity created to construct and lease a plant facility, including a health care facility, to an industrial occupant will be deemed a loan to the lessee, provided that--

(i) The bank evaluates the creditworthiness of the industrial occupant before the loan is extended to the authority;

(ii) The authority's liability on the loan is limited solely to whatever interest it has in the particular facility;

(iii) The authority's interest is assigned to the bank as security for the loan or the industrial occupant issues a promissory note to the bank that provides a higher order of security than the assignment of a lease; and

(iv) The industrial occupant's lease rentals are assigned and paid directly to the bank.

(10) Loans to leasing companies. A loan or extension of credit to a leasing company for the purpose of purchasing equipment for lease will be deemed a loan to the lessee, provided that--

(i) The bank evaluates the creditworthiness of the lessee before the loan is extended to the leasing corporation;

(ii) The loan is without recourse to the leasing corporation;

(iii) The bank is given a security interest in the equipment and in the event of default, may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment;

(iv) The leasing corporation assigns all of its rights under the lease to the bank;

(v) The lessee's lease payments are assigned and paid to the bank; and

(vi) The lease terms are subject to the same limitations that would apply to a national bank acting as a lessor.

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's lending limit shall be calculated as of the most recent of the following dates--

(1) When the bank's Consolidated Report of Condition and Income is required to be filed; or

(2) When there is a change in the bank's capital category for purposes of 12 U.S.C. 1831o and part 6 of this chapter.

(b) Authority of OCC to require 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.

Sec. 32.5 Combination rules.

(a) General rule. Loans or extensions of credit to one borrower will be attributed to another person and each person will be deemed a borrower--

(1) When proceeds of a loan or extension of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used; or

(2) When a common enterprise is deemed to exist between the persons.

(b) Direct benefit. The proceeds of a loan or extension of credit to a borrower will be deemed to be used for the direct benefit of another person and will be attributed to the other person when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services.

(c) Common enterprise. A common enterprise will be deemed to exist and loans to separate borrowers will be aggregated:

(1) When the expected source of repayment for each loan or extension of credit is the same for each borrower and neither borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid. An employer will not be treated as a source of repayment under this paragraph because of wages and salaries paid to an employee, unless the standards of paragraph (c)(2) of this section are met;

(2) When loans or extensions of credit are made--

(i) To borrowers who are related directly or indirectly through common control, including where one borrower is directly or indirectly controlled by another borrower; and

(ii) Substantial financial interdependence exists between or among the borrowers. Substantial financial interdependence is deemed to exist when 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues/expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments;

(3) When separate persons borrow from a bank to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests, in which case a common enterprise is deemed to exist between the borrowers for purposes of combining the acquisition loans; or

(4) When the OCC determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists.

(d) Special rule for loans to a corporate group. (1) Loans or extensions of credit by a bank to a corporate group may not exceed 50 percent of the bank's capital and surplus. This limitation applies only to loans subject to the combined general limit. A corporate group includes a person and all of its subsidiaries. For purposes of this paragraph, a corporation or a limited liability company is a subsidiary of a person if the person owns or beneficially owns directly or indirectly more than 50 percent of the voting securities or voting interests of the corporation or company.

(2) Except as provided in paragraph (d)(1) of this section, loans or extensions of credit to a person and its subsidiary, or to different subsidiaries of a person, are not combined unless either the direct benefit or the common enterprise test is met.

(e) Special rules for loans to partnerships, joint ventures, and associations.--(1) Partnership loans. Loans or extensions of credit to a partnership, joint venture, or association are deemed to be loans or extensions of credit to each member of the partnership, joint venture, or association. This rule does not apply to limited partners in limited partnerships or to members of joint ventures or associations if the partners or members, by the terms of the partnership or membership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association, and those provisions are valid under applicable law.

(2) Loans to partners. (i) Loans or extensions of credit to members of a partnership, joint venture, or association are not attributed to the partnership, joint venture, or association unless either the direct benefit or the common enterprise tests are met. Both the direct benefit and common enterprise tests are met between a member of a partnership, joint venture or association and such partnership, joint venture or association, [[Page 8538]] when loans or extensions of credit are made to the member to purchase an interest in the partnership, joint venture or association.

(ii) Loans or extensions of credit to members of a partnership, joint venture, or association are not attributed to other members of the partnership, joint venture, or association unless either the direct benefit or common enterprise test is met.

(f) Loans to foreign governments, their agencies, and instrumentalities.--(1) Aggregation. Loans and extensions of credit to foreign governments, their agencies, and instrumentalities will be aggregated with one another only if the loans or extensions of credit fail to meet either the means test or the purpose test at the time the loan or extension of credit is made.

(i) The means test is satisfied if the borrower has resources or revenue of its own sufficient to service its debt obligations. If the government's support (excluding guarantees by a central government of the borrower's debt) exceeds the borrower's annual revenues from other sources, it will be presumed that the means test has not been satisfied.

(ii) The purpose test is satisfied if the purpose of the loan or extension of credit is consistent with the purposes of the borrower's general business.

(2) Documentation. In order to show that the means and purpose tests have been satisfied, a bank must, at a minimum, retain in its files the following items:

(i) A statement (accompanied by supporting documentation) describing the legal status and the degree of financial and operational autonomy of the borrowing entity;

(ii) Financial statements for the borrowing entity for a minimum of three years prior to the date the loan or extension of credit was made or for each year that the borrowing entity has been in existence, if less than three;

(iii) Financial statements for each year the loan or extension of credit is outstanding;

(iv) The bank's assessment of the borrower's means of servicing the loan or extension of credit, including specific reasons in support of that assessment. The assessment shall include an analysis of the borrower's financial history, its present and projected economic and financial performance, and the significance of any financial support provided to the borrower by third parties, including the borrower's central government; and

(v) A loan agreement or other written statement from the borrower which clearly describes the purpose of the loan or extension of credit. The written representation will ordinarily constitute sufficient evidence that the purpose test has been satisfied. However, when, at the time the funds are disbursed, the bank knows or has reason to know of other information suggesting that the borrower will use the proceeds in a manner inconsistent with the written representation, it may not, without further inquiry, accept the representation.

(3) Restructured loans.--(i) Non-combination rule. Notwithstanding paragraphs (a) through (e) of this section, when previously outstanding loans and other extensions of credit to a foreign government, its agencies, and instrumentalities (i.e., public-sector obligors) that qualified for a separate lending limit under paragraph (f)(1) of this section are consolidated under a central obligor in a qualifying restructuring, such loans will not be aggregated and attributed to the central obligor. This includes any substitution in named obligors, solely because of the restructuring. Such loans (other than loans originally attributed to the central obligor in their own right) will not be considered obligations of the central obligor and will continue to be attributed to the original public-sector obligor for purposes of the lending limit.

(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 OCC, upon request by a bank for application of the non combination rule. The factors that the OCC will use in making this determination include, but are not limited to, the following:

(A) Whether the restructuring involves a substantial portion of the total commercial bank loans outstanding to the foreign government, its agencies, and instrumentalities;

(B) Whether the restructuring involves a substantial number of the foreign country's external commercial bank creditors;

(C) Whether the restructuring and consolidation under a central obligor is being done primarily to facilitate external debt management; and

(D) Whether the restructuring includes features of debt or debt-service reduction.

(iii) 50 percent aggregate limit. With respect to any case in which the non-combination process under paragraph (f)(3)(i) of this section applies, a national bank's loans and other extensions of credit to a foreign government, its agencies and instrumentalities, (including restructured debt) shall not exceed, in the aggregate, 50 percent of the bank's capital and surplus.

Sec. 32.6 Nonconforming loans.

(a) A loan, within a bank's legal lending limit when made, will not be deemed a violation but will be treated as nonconforming if the loan is no longer in conformity with the bank's lending limit because--

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

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

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

(c) A bank 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 lending limit within 30 calendar days, except when judicial proceedings, regulatory actions or other extraordinary circumstances beyond the bank's control prevent the bank from taking action.

Dated: February 6, 1995.
Eugene A. Ludwig,
Comptroller of the Currency.
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