

**DEPARTMENT OF THE TREASURY**

**Office of the Comptroller of the Currency**

**12 CFR Parts 32, 159 and 160**

**Docket ID OCC-2012-0007**

**RIN 1557-AD59**

**Lending Limits**

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

**ACTION:** Final rule.

**SUMMARY:** The Office of the Comptroller of the Currency (OCC) is finalizing its lending limits interim final rule, with revisions. The interim final rule consolidated the lending limits rules applicable to national banks and savings associations, removed the separate OCC regulation governing lending limits for savings associations, and implemented section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amends the statutory definition of “loans and extensions of credit” to include certain credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions.

**DATES:** The effective date of amendatory instruction 2b of this final rule is July 1, 2013. The effective date of the remaining amendments made by this final rule is October 1, 2013. The effective date of amendatory instruction 3a. of the interim final rule published on June 21, 2012, 77 FR 37265, at 37277, and extended on December 31, 2012, 77 FR 76841, is changed from July 1, 2013 to October 1, 2013.

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**SUPPLEMENTARY INFORMATION:**

**I. Background**

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

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

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<sup>1</sup> Pub. L. 111-203, 124 Stat. 1376 (2010).

On June 21, 2012, the OCC published in the Federal Register an interim final rule<sup>2</sup> that amended the OCC's lending limits regulation for national banks, 12 CFR part 32, by consolidating the lending limits rules applicable to national banks and savings associations<sup>3</sup> and implementing section 610 of the Dodd-Frank Act. The interim final rule also removed the separate OCC regulation at 12 CFR 160.93 that governed lending limits for savings associations.<sup>4</sup>

## **II. Description of the Final Rule and Public Comments**

The OCC received numerous public comments from interested parties. These comments, the provisions of the interim final rule they address, and the resulting amendments to the interim final rule are discussed below.

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

The OCC received no public comments in response to the amendments included in the interim final rule that integrate savings associations into part 32.<sup>5</sup> However, upon further review,

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<sup>2</sup> 77 FR 37265 (June 21, 2012).

<sup>3</sup> The OCC has rulemaking authority for lending limits regulations applicable to national banks and to all savings associations, both state- and Federally-chartered. However, the Federal Deposit Insurance Corporation (FDIC), not the OCC, is the appropriate Federal banking agency for state savings associations and enforces these rules as to state savings associations.

<sup>4</sup> Section 160.93 specifically applied 12 U.S.C. 84 and the lending limits regulations and interpretations promulgated by the OCC for national banks to Federal and state savings associations. Section 160.93 also implemented specific statutory lending limits exceptions unique to Federal and state savings associations.

<sup>5</sup> The OCC notes that the interim final rule's integration of savings associations into part 32 applied the existing definition for national banks of "capital and surplus" set forth at § 32.2(b) to savings associations. This definition differs from the definition of "unimpaired capital and unimpaired surplus" included in former § 160.93. Under former § 160.93, savings associations could add back any deductions to capital made for investments in non-includable subsidiaries, thereby increasing their capital calculation for lending limits and, thus, the amount they could loan to one borrower. However, this add-back is not permitted under the definition of "capital and surplus" in § 32.2(b). This change resulted in a reduction in the lending limits previously applicable to savings associations' investments in non-includable service corporations. This result is consistent with the treatment of a non-includable subsidiary capital deduction in the transaction with affiliates regulation (Regulation W), 12 CFR part 223, revised by the Board of Governors of the Federal Reserve System (Federal Reserve Board) on September 13, 2011. Part 223 applies to savings associations in place of former 12 CFR 563.41, which had permitted this deduction. See generally 76 FR 56508.

the OCC is making the following technical amendments relating to the scope of the rule with respect to savings associations in order to avoid unintended or anomalous results.

1. Loans to Non-consolidated Subsidiaries.

The former lending limits rule applicable to savings associations, § 160.93(a), excluded loans made by savings associations and their subsidiaries consolidated in accordance with generally accepted accounting principles (GAAP-consolidated subsidiaries) to all subordinate organizations and savings association affiliates. Rules applicable in these situations were set forth in part 159. Specifically, § 159.5(b) established lending limits for loans by a Federal savings association and its GAAP-consolidated subsidiaries to non-consolidated subsidiaries. Section 159.5(b) did not set a specific lending limit for loans to GAAP-consolidated subsidiaries but provided that such a limit could be established if warranted by safety and soundness considerations.

The interim final rule carried over the existing exclusion from the lending limits rule for loans to GAAP-consolidated subsidiaries but did not exclude from the coverage of part 32 loans made to non-consolidated subsidiaries. Therefore, loans to non-consolidated subsidiaries of Federal savings associations were made subject to the lending limits in part 32, but no corresponding change was made to the limits set forth in part 159. As a result, the interim final rule subjected loans to non-consolidated subsidiaries of Federal savings associations to the lending limits set forth in both parts 32 and 159, which differ. This result was not intended.

This final rule corrects this overlap by replacing the lending limits set forth in § 159.5(b) with a cross-reference to part 32; by removing, as unnecessary, the reference to “loans” within § 159.5(c); and by making a conforming change to § 159.3(k)(2). This amendment also removes the provision in § 159.5(b)(2) that provides that the OCC may limit the amount of loans to GAAP-consolidated subsidiaries where safety and soundness considerations warrant such action.

This language merely restates the OCC's statutory authority to apply prudential standards to loans by both national banks and Federal savings associations for safety and soundness reasons. Therefore, removal of § 159.5(b)(2) does not affect this authority.

2. Loans by Service Corporations.

The interim final rule did not revise part 32 to address the aggregation of loans made by a service corporation with loans made by the parent savings association. For Federal savings associations, such aggregation is currently addressed by § 159.3(k)(2), which provides that loans made by a service corporation controlled by a Federal savings association are aggregated with the loans made by that savings association for purposes of the lending limits of part 32. For purposes of § 159.3(k)(2), "control" is defined by reference to 12 CFR part 174.<sup>6</sup> The control standard in part 174 is a broad standard that could potentially result in the aggregation of loans by non-consolidated service corporations with those of the parent savings association. The final rule avoids this result by revising the scope of part 32 to aggregate loans by GAAP-consolidated service corporations with those of the parent savings association. The final rule also makes conforming changes to § 159.3(k)(2).

3. Loans by Foreign Subsidiaries of Federal Savings Associations.

Prior to the interim final rule, pursuant to former §§ 160.93(a) and 159.3(k), loans made by foreign and domestic subsidiaries, as defined by part 159, of a Federal savings association were aggregated with loans made by the parent savings association. The interim final rule amended part 32 to narrow the scope of the aggregation to encompass loans by domestic operating subsidiaries of savings associations only, the same standard that applied to national banks. The interim final rule did not amend the aggregation standard in § 159.3(k). As a result,

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<sup>6</sup> 12 CFR 159.2.

part 32 and § 159.3(k) set forth different aggregation rules for loans made by foreign subsidiaries of Federal savings association.

To correct this anomaly, the final rule revises the scope section of part 32 to aggregate loans made by operating subsidiaries and GAAP-consolidated service corporations of savings associations with loans made by the parent institution. Loans by such subsidiaries will be aggregated with loans made by the parent savings association regardless of whether the subsidiary is foreign or domestic. Loans made by foreign subsidiaries of national banks will continue to be governed by the separate lending limits set forth in Regulation K.<sup>7</sup> Regulation K is not applicable to savings associations and, therefore, addressing loans made by foreign subsidiaries of savings associations in part 32 is appropriate.

The OCC also is removing the words “bank’s or savings association’s” in § 32.1(c)(1)(ii), as these words are redundant, and is making other conforming changes to § 32.1.

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

To implement the requirements of section 610 of the Dodd-Frank Act, the interim final rule amended the definition of “loans and extensions of credit” in § 32.2 to include certain credit exposure arising from a derivative transaction or a securities financing transaction, i.e., a repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction. The interim final rule defined “derivative transaction” to include any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

The interim final rule amended part 32 to provide national banks and savings associations

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<sup>7</sup> See 12 CFR 211.12(b).

with different options for measuring the credit exposures of derivative transactions and securities financing transactions for purposes of the lending limits rules. Providing these options was intended to reduce regulatory burden, particularly for smaller and mid-size banks and savings associations.

All of the comment letters received by the OCC on the interim final rule addressed the amendments implementing section 610. These comments, and any resulting amendments to part 32 made by this final rule, are discussed below.

We note that the OCC had extended, though a separate rulemaking,<sup>8</sup> the temporary exception period for the application of the section 610-related provisions of part 32 from January 1, 2013, as contained in the interim final rule, to July 1, 2013. As a result, national banks and savings associations are not currently required to comply with these provisions. However, the OCC has determined that a further extension of this temporary exception period is appropriate in light of the publication date of this final rule and in order to allow institutions that wish to use the Model Methods sufficient time to develop a model, receive approval for its use, and implement the model. Moreover, the other methods provided by the rule to measure credit exposure would not be appropriate for many institutions with large portfolios, as compared with the more risk-sensitive method of measuring credit exposures. Therefore, this final rule extends this temporary exception period through October 1, 2013. As a result, national banks and savings associations will not be required to comply with the section 610-related provisions as amended by the final rule until this date. As indicated in the preamble to the interim final rule, notwithstanding this extension, the OCC retains full authority to address credit exposures that present undue concentrations on a case-by-case basis through our existing safety and soundness authorities.

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<sup>8</sup> 77 FR 76841 (Dec. 31, 2012).

1. Scope of Rule.

Some commenters requested clarification of, or changes to, the application of the section 610-related provisions of the interim final rule to specific types of transactions. Specifically, three financial trade associations requested that the rule clarify that options sold and fully paid for are not covered by the rule because these types of exposures have no ongoing credit exposure beyond settlement, *i.e.*, when an option is paid-up, there is no further performance obligation by the counterparty and no further credit exposure. The OCC agrees that these transactions do not give rise to credit exposure for the purpose of the lending limits. When a bank sells an option and that option is fully paid, there is no counterparty credit risk because the bank is not entitled to anything further from the counterparty. This fact is evident from the nature of the transaction, and it is not necessary to amend the final rule.

Another commenter, a nonprofit organization, requested that the final rule not exempt securities financing transactions involving Federal- and state-related securities from the lending limits<sup>9</sup> because this exemption is not explicitly required by section 610 and such transactions are not free from the risk to the institution of counterparty default. The OCC disagrees with this recommendation. These types of transactions typically involve less risk than other securities financing transactions. Moreover, this exception is consistent with the longstanding exceptions in sections 5200(c)(4) and (5) and §§ 32.3(c)(3), through (c)(5), which provide exceptions for loans secured by U.S. obligations, loans to or guaranteed by Federal agencies, or loans to or guaranteed by state or local governments. In addition, section 5200(d) grants the OCC the authority to establish limits or requirements other than those specified in the statute for particular classes or categories of loans or extensions of credit. Furthermore, an exemption for these types

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<sup>9</sup> The interim final rule exempts Type I securities, as defined in 12 CFR 1.2(j), in the case of national banks; and securities listed in section 5(c)(1)(C), (D), (E), and (F) of HOLA and general obligations of a state or subdivision as listed in section 5(c)(1)(H) of HOLA, 12 U.S.C. 1464(c)(1)(C), (D), (E), (F), and (H), in the case of savings associations.



of securities financing transactions is consistent with the treatment of reverse repurchase agreements in § 32.2(q)(1)(vii), under which such transactions are treated as loans subject to an exception for transactions relating to Type I securities as defined in 12 CFR part 1.<sup>10</sup> We therefore decline to remove this exemption in the final rule.

2. Methods to Measure Credit Exposure.

In general. The interim final rule provides three methods for calculating credit exposure of derivative transactions other than credit derivatives, and two methods for securities financing transactions.<sup>11</sup> Unless required to use a specific method by the appropriate Federal banking agency for safety and soundness reasons, a national bank or savings association may choose which of these methods it will use.<sup>12</sup> However, under the interim final rule, a national bank or savings association must use the same method for calculating credit exposure arising from all derivative transactions and the same method for all securities financing transactions.<sup>13</sup>

A number of financial institution trade associations requested that the OCC apply the requirement to use a specific method as determined by the appropriate Federal banking agency only prospectively and to phase it in over time. These commenters also asked the OCC to set forth the factors it might use in exercising discretion to impose this requirement. The OCC declines to limit this provision only to future transactions. We find that the discretion of the appropriate Federal banking agency to require, on a case-by-case basis, application of a specific method to prior and/or future transactions is a necessary supervisory tool for safety and

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<sup>10</sup> This specific provision will be removed when the rule's temporary exception period for derivative and securities financing transactions expires, as it will then be unnecessary.

<sup>11</sup> We note that the Basel Committee on Banking Supervision has established a working group to examine the risks associated with weaknesses and inconsistencies in large exposure limit regimes across jurisdictions and to decide whether an international agreement on large exposure limits is warranted. If such an agreement is reached, the OCC would consider whether further amendments to part 32 are necessary and appropriate.

<sup>12</sup> See § 32.9(b)(3), renumbered as §32.9(b)(4) in the final rule, and § 32.9(c)(2).

<sup>13</sup> See §§ 32.9(b)(1) and 32.9(c)(1).

soundness purposes. This discretion would permit the agency to phase in the required method, as appropriate. Examiners will coordinate with the bank or savings association to ensure any change in methods is managed fairly and is consistent with safety and soundness.

Commenters also requested that the OCC permit these institutions to apply different calculation methods based on transaction or product type, and that the rule should provide guidance with respect to transitioning between methods. While the OCC does not intend to permit institutions to exercise unlimited discretion to pick and choose among the calculation methods for different derivative or securities financing transactions, we recognize that there may be circumstances in which the use of only one calculation method for all transactions may present safety and soundness concerns or may not be practically feasible. For example, an institution may develop a new transaction type after it has developed, and received approval for the use of, its model. As discussed above, examiners already have the flexibility under the interim final rule to require that a particular measurement method for a particular subset of derivative or securities financing transactions be used to calculate credit exposure. However, in order to clarify that an institution may request to use a specific method, and that the OCC may permit a specific method to be used for one or more transactions or transaction types, we have amended both § 32.9(b)(3) (renumbered in the final rule as §§ 32.9(b)(4)) and 32.9(c)(2) to provide that the appropriate Federal banking agency may, at its discretion, permit a national bank or savings association to use a specific method to calculate credit exposure, and that this method may apply to all or specific transactions if the appropriate Federal banking agency finds that such method is consistent with the safety and soundness of the bank or savings association. Institutions obtaining permission to use an alternative method should work with their examiners to ensure a proper transition to use of the new method.

Internal Model for Derivative Transactions and Securities Financing Transactions. The interim final rule permits national banks and savings associations to calculate credit exposure for derivative transactions and securities financing transactions through the use of an internal model. For derivative transactions, § 32.9(b)(1)(i) provides that counterparty credit exposure is measured by adding the current credit exposure (the greater of zero or the mark-to-market (MTM) value) of the transaction and the potential future exposure (PFE) of the transaction. Under § 32.9(b)(1)(i)(C) of the interim final rule, a bank or savings association must calculate its PFE by using an internal model that has been approved for purposes of Section 53 of the Internal-Ratings-Based and Advanced Measurement Approaches Appendix (Advanced Approaches Appendix) of the appropriate Federal banking agency's capital rules<sup>14</sup> or any other appropriate model approved by the appropriate Federal banking agency. Section 32.9(b)(1)(i)(D) provides that a national bank or savings association that calculates its credit exposure arising from derivative transactions by using an internal model may net exposures arising under the same qualifying master netting agreement, thereby reducing the institution's exposure to the borrower to the net exposure under the master netting agreement.

Similarly, for securities financing transactions, § 32.9(c)(1)(i) of the interim final rule permits an institution to calculate credit exposure by using an internal model approved by the appropriate Federal banking agency for purposes of Section 32(d) of the Internal-Ratings-Based Appendices of the appropriate Federal banking agency's capital rules,<sup>15</sup> as appropriate, or any other appropriate model approved by the appropriate Federal banking agency.

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<sup>14</sup> 12 CFR part 3, Appendix C, Section 53 for national banks; 12 CFR part 167, Appendix C, Section 53 for Federal savings associations; and 12 CFR 390, subpart Z, Appendix A, Section 53 for state savings associations.

<sup>15</sup> 12 CFR part 3, Appendix C, Section 32(d) for national banks; 12 CFR part 167, Appendix C, Section 32(d) for Federal savings associations; and 12 CFR 390, subpart Z, Appendix A, Section 32(d) for state savings associations.

Most commenters discussed this modeling option. One commenter, a nonprofit organization, stated that institutions should not be permitted to use internal models for lending limits purposes. The OCC disagrees with this comment and is retaining the modeling option in the final rule. The use of an internal model, with the safeguards described below, improves the accuracy of the calculation of the institution's credit exposures to derivative and securities financing transactions. Not including such a modeling option, as advocated by the commenter, would result in a rule that would not accurately reflect counterparty exposure for certain banks. Importantly, the rule applies appropriate supervisory safeguards to a national bank's or savings association's use of an internal model. Specifically, a national bank or savings association may not use an internal model unless the use of the model has been approved by the appropriate Federal banking agency for purposes of the Advanced Approaches Appendix of the agency's capital rule (and, as discussed below, the institution has provided prior written notice to the agency of its use of the model for part 32 purposes) or specifically approved by the agency for purposes of the lending limits rule. Furthermore, also as discussed below, this final rule provides that the use of the model for lending limits purposes following any subsequent substantive change to it must be approved by the appropriate Federal banking agency.

Some commenters requested the OCC to clarify the nature of the internal model approval process, including the standards for approval and duration of the process. For the use of a model not previously approved pursuant to the Advanced Approaches Appendix, the OCC intends that the OCC approval process will include a thorough institution and OCC review of the model's specific use for part 32 and the institution's ability to monitor the risks associated with the transactions, and will be separate and apart from any approval of the use of a model for other purposes. In addition, the approval of the use of the model will be in writing. We have amended § 32.9 to specify these criteria. National banks or Federal savings associations that

seek approval for the use of a model pursuant to part 32 should contact their examiner-in-charge to begin the approval process.<sup>16</sup> As indicated above, we also have amended § 32.9 to require a bank or savings association to provide prior written notice to the appropriate Federal banking agency before using an internal model for lending limits purposes the use of which has been previously approved by the agency for purposes of the Advanced Approaches Appendix.<sup>17</sup> Also as indicated above, we have added to the final rule a requirement that if a national bank or savings association makes a substantive revision to a model after the appropriate Federal banking agency's approval, either pursuant to the Advanced Approaches Appendix or part 32, the use of the revised model must be approved by the agency before it may be used for purposes of part 32.<sup>18</sup>

Commenters also requested that in the event that the use of a bank's internal model is not yet approved, or approved and not yet implemented, by the end of the temporary exception period, the appropriate Federal banking agency should approve on a provisional basis a bank's or savings association's calculation of credit exposures using existing internal models.

Furthermore, these commenters said that the agency should approve for lending limits purposes on a provisional basis, if appropriate, the use of models that are in the process of being approved. The OCC disagrees. As discussed above, to appropriately support the determination that a model is appropriate for measuring the credit exposure of a derivative transaction or securities financing

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<sup>16</sup> We note that this preamble discusses the OCC's process for approval of the use of internal models for national banks and Federal savings associations. The FDIC, in the case of state savings associations, and the Federal Reserve Board, in the case of state-licensed branches of foreign banking organizations, will have their own internal processes for approving the use of such models. Some commenters requested that the OCC coordinate with the FDIC and Federal Reserve Board to ensure that such agencies will be in a position to approve internal models by the expiration of the temporary exception for compliance. The OCC will, as appropriate, consult with both the FDIC and Federal Reserve Board. However, these agencies are responsible for implementing this rule for their regulated institutions.

<sup>17</sup> 12 CFR 32.9(b)(1)(i)(C)(1)(i) and 12 CFR 32.9(c)(1)(i)(A)(1) of the final rule.

<sup>18</sup> 12 CFR 32.9(b)(1)(i)(C)(2) and 12 CFR 32.9(c)(1)(i)(B) of the final rule.

transaction under part 32 and adequately addresses the risks of the transaction, approval of the use of a model must be made specifically for part 32 and must be obtained prior to the model's use for this purpose, unless the use of the model has already been approved for purposes of the Advanced Approaches Appendix. Therefore, in order to ensure the safety and soundness of a national bank or Federal savings association, for part 32 purposes the OCC will not approve the use of a model on a provisional basis and will not permit the model's use before final approval. However, we do not intend that this approval requirement necessitate the development of a new model specifically for use under part 32. A national bank or Federal savings association may present an existing internal model for approval by the OCC for use as a lending limits model. For example, an institution may present an internal model it has developed for use under the Advanced Approaches Appendix but which has not yet been approved for that use. Because most complex banks have developed such models that address counterparty risk, we believe compliance with the approval requirement will be possible prior to the end of the extended exception period.

Commenters also requested clarification regarding the interim final rule's reference in §§ 32.9(b)(1)(i)(C) and 32.9(c)(1)(i) to an internal model that has been approved by the appropriate Federal banking agency for purposes of the Advanced Approaches Appendix. Technically, pursuant to the Advanced Approaches Appendix, the agency does not separately approve the use of the institution's model but instead approves the institution's exit from parallel run and its use of the Advanced Approaches, for which the institution has developed the internal model.<sup>19</sup> We confirm that this approval to exit parallel run constitutes "approval" of the use of the institution's

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<sup>19</sup> See 12 CFR part 3, Appendix C, Section 21 for national banks; 12 CFR part 167, Appendix C, Section 21 for Federal savings associations; and 12 CFR 390, subpart Z, Appendix A, Section 21 for state savings associations.

model for purposes of part 32, and have added language to §§ 32.9(b)(1)(i)(C) and 32.9(c)(1)(i) of the final rule to clarify this point.

We also have further clarified the rule by changing the name of the method provided by §§ 32.9(b)(1)(i) and 32.9(c)(1)(i) in the final rule from “Internal Model Method” to “Model Method.” This change should alleviate confusion with the Internal Models Approach for calculating the risk-weighted asset amount for equity exposures included in the agencies’ capital rules.

Furthermore, we have replaced the provisions of the Advanced Approaches Appendix referenced in the model methods. For derivative transactions, in response to a commenter, we have amended § 32.9(b)(1)(i)(C) to replace the reference to Section 53 of the Advanced Approaches Appendix with a reference to Section 32(d) of the Appendix. Section 53 refers to the modeling of equity risk (a form of market risk) rather than counterparty risk and is more general in nature. Section 32(d) more appropriately refers to the modeling of counterparty credit exposure arising from derivatives, *i.e.* credit risk, and specifically accounts for collateral. Likewise, for securities financing transactions, we have amended § 32.9(c)(1)(i) so that it references Section 32(b) of the Advanced Approaches Appendix instead of Section 32(d) of the Appendix. The OCC finds that the model provided for by Section 32(b) of this Appendix is the more appropriate model for measuring credit exposure of securities financing transactions for the lending limits rule.

Non-Model Methods. The interim final rule provides two non-model measurement methods for credit exposures arising from derivative transactions and one non-model measurement method for credit exposures arising from securities financing transactions.

For derivative transactions, national banks and savings associations may choose either the Conversion Factor Matrix Method, set forth in § 32.9(b)(1)(ii), or the Remaining Maturity

Method, as set forth in § 32.9(b)(1)(iii). Under the Conversion Factor Matrix Method, the credit exposure is equal to, and remains fixed at, the PFE of the derivative transaction, as determined at execution of the transaction by reference to a simple look-up table (Table 1 of the interim final rule). To clarify this calculation, the OCC has made a technical amendment to the rule to provide that the PFE of the derivative transaction under this method equals the product of the notional amount of the derivative transaction and a fixed multiplicative factor determined by reference to Table 1 of this section.

The credit exposure for derivative transactions calculated under the Remaining Maturity Method incorporates both the current MTM and the transaction's remaining maturity (measured in years) as well as a fixed add-on for each year of the transaction's remaining life by adding the current MTM value of the transaction to the product of the notional amount of the transaction, the remaining maturity of the transaction, and a fixed multiplicative factor. These multiplicative factors differ based on product type and are determined by a look-up table (Table 2 of the interim final rule).

One commenter stated that the credit exposures under the Conversion Factor Matrix Method for derivative transactions should be marked-to-market rather than fixed at inception in order to properly value the amount of credit risk. Because the market value of these transactions can change significantly from the time of execution, the commenter notes that this approach could cause an institution's exposure to a borrower to exceed the lending limits on a MTM basis routinely without being required to reduce the exposure. The OCC disagrees. As noted in the preamble to the interim final rule, we are aware that, under the Conversion Factor Matrix Method, the actual MTM value at a given point in the life of a derivative contract may exceed the initially estimated PFE, and that it would be possible for a bank to make a new loan that, combined with the actual exposure (were such exposure based on current MTM value), could



exceed the lending limits. However, the OCC believes that the risks in such case are limited and can be addressed in the institutions likely to use this method (smaller, less complex institutions) during the supervisory process by examiners appropriately responding to transactions or concentrations that raise safety and soundness concerns. For example, examiners could require the bank or savings association to measure credit exposure by means of a different method if doing so is appropriate for safety and soundness purposes. Allowing non-complex banks and savings associations to “lock-in” the attributable exposure at the execution of the contract provides for certainty and simplicity, with limited risk.<sup>20</sup>

A number of trade association and financial institution commenters also recommended that the OCC amend the final rule to permit the use of the “Current Exposure Methodology” (“CEM”) as an additional option for measuring credit exposure of derivative transactions. The CEM is used under the Federal banking agencies’ current regulatory capital rules, both Basel I and II capital regimes, and would be retained under the Standardized and Advanced Approaches Basel III-related proposals released by the OCC and the other Federal banking agencies.<sup>21</sup> Under the CEM, a bank calculates the credit exposure for derivative transactions by adding the current exposure (the greater of zero or the MTM value) and the PFE (calculated by multiplying the notional amount by a specified conversion factor which varies based on the type and remaining maturity of the contract) of the derivative transactions. In particular, the commenters note that the CEM incorporates additional calculations for netting

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<sup>20</sup> We have revised Table 1 in the final rule to conform the format of its content; there are no substantive changes.

<sup>21</sup> See 12 CFR part 3, Appendix C, Sections 32(c)(5)-(7), 12 CFR part 167, Appendix C, Sections 32(c)(5)-(7), or 12 CFR part 390, subpart Z, Appendix A, Sections 32(c)(5)-(7), as appropriate. Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, Joint Notice of Proposed Rulemaking, 77 FR 52792 (August 30, 2012). Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, Joint Notice of Proposed Rulemaking, 77 FR 52888 (August 30, 2012). Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule, Joint Notice of Proposed Rulemaking, 77 FR 52978 (August 30, 2012).

arrangements and collateral and uses multipliers that are more tailored to computing the PFE of derivative transactions. The CEM, they reason, would provide a more refined analysis of credit exposure than either the Conversion Factor Matrix Method or the Remaining Maturity Method. In addition, because of its use in the capital rules, these commenters note that the CEM is familiar to both the industry and regulators as an available measure of derivative exposures and its use for measuring credit exposure under the lending limits rule would therefore introduce less burden and operational risk than would the use of a new and different methodology for a narrow regulatory purpose.

The OCC agrees with these commenters that the CEM should be permitted for use by national banks and savings associations in calculating credit exposure arising from derivative transactions (other than credit derivative transactions). For the reasons noted above, it is superior to the Remaining Maturity Method for institutions that do not model exposures but want to adopt a more risk-sensitive method than that provided by the Conversion Factor Matrix Method. Therefore, the OCC is amending part 32 to replace the Remaining Maturity Method option with a CEM option.

A number of commenters recommended that, as with the Model Method, the OCC should permit banks and savings associations using the non-model approaches to net transactions under a qualifying master netting agreement and to recognize collateral in measuring credit exposure. These commenters note that the capital rules, payment system risk reduction efforts, and the current lending limits rule recognizes the beneficial effects of netting or collateral in reducing credit exposure. Additionally, the commenters request that the rule outline the forms of collateral the bank may rely on to offset credit exposure and suggest that this collateral should reduce the credit exposure as long as the collateral is permissible and appropriate under a valid and legally enforceable agreement. The OCC notes that the CEM option as added by this final

rule provides for some netting of PFEs and, therefore, along with the presence in the rule of the Model Method option, addresses the commenters' netting concerns. The OCC also notes that part 32 already provides for exemptions for loans and extensions of credit secured by certain types of collateral, and, as noted above, the CEM incorporates additional calculations for collateral.<sup>22</sup> These exemptions apply to the credit exposures arising from derivative transactions, as well as securities financing transactions, now covered by the lending limits rule just as they do to other loans and extensions of credit. Therefore, no amendment is necessary to recognize collateral that may reduce credit exposure for derivative transactions.

Some commenters noted that the non-model methods for derivative transactions do not differentiate between the credit exposures of interest rate swaps that are amortized from those that are not amortized. These commenters suggest that the final rule should reflect amortization in any calculation of the PFE of these swaps because the risk associated with a swap that is amortized is reduced as the notional amount decreases over the life of the swap. While we acknowledge the commenters' concerns, we do not agree that a change to the rule text to address this comment is needed. The Conversion Factor Matrix Method and the CEM provide institutions with a simple, albeit more conservative, approach to measuring credit exposure. Preserving the simplicity of these non-model methods outweighs any added accuracy that may be achieved by distinguishing between amortized and non-amortized instruments. Additionally, the CEM included in the current regulatory capital rules does not distinguish between an amortizing swap and a non-amortizing swap; therefore, we believe that it is reasonable to preserve this treatment for purposes of the legal lending limits. Further, we note that institutions may use the Model Method to account for credit exposures arising from derivative transactions, including amortizing interest rate swaps, should they so desire.

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<sup>22</sup> E.g. 12 CFR 32.3(c)(3), (4) and (5).

For securities financing transactions, the calculation of the credit exposure under the Non-Model Method in the interim final rule is based on the type of securities financing transaction at issue. For a repurchase agreement or a securities loan where the collateral is cash, exposure under the lending limits is equal to and remains fixed at the net current exposure, i.e., the market value at execution of the transaction of securities transferred to the other party, less cash received from the other party.<sup>23</sup> For securities lending transactions where the collateral is other securities (i.e., not cash), the exposure is equal to and remains fixed at the product of the higher of the two haircuts associated with the securities, as determined by a look-up table included in the regulation (Table 3 in the interim final rule, renamed Table 2 in the final rule), and the higher of the two par values of the securities.<sup>24</sup> The credit exposure arising from a reverse repurchase agreement, also known as an asset repo, or a securities borrowing transaction where the collateral is cash, equals and remains fixed at the product of the haircut associated with the collateral received, as determined in this same table, and the amount of cash transferred to the other party.<sup>25</sup> For a securities borrowing transaction where the collateral is other securities (i.e., not cash), the credit exposure equals and remains fixed at the product of the higher of the two haircuts associated with the securities, as determined in the table, and the higher of the two par values of the securities.<sup>26</sup>

Commenters requested that the OCC permit banks to measure credit exposure of securities financing transactions by applying the standard supervisory haircuts for such transactions using the current risk-based capital rules of the appropriate Federal banking

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<sup>23</sup> 12 CFR 32.9(c)(1)(ii)(A) and 12 CFR 32.9(c)(1)(ii)(B)(1).

<sup>24</sup> 12 CFR 32.9(c)(1)(ii)(B)(2). The haircuts in this table are consistent with the standard supervisory market price volatility haircuts in 12 CFR part 3, Appendix C, Section 32(b)(2)(ii).

<sup>25</sup> 12 CFR 32.9(c)(1)(ii)(C) and 12 CFR 32.9(c)(1)(ii)(D)(1).

<sup>26</sup> 12 CFR 32.9(c)(1)(ii)(D)(2).

agency's capital rules<sup>27</sup> or the proposed Basel III Advanced Approaches rules<sup>28</sup> once finalized (collectively, the Basel Collateral Haircut Approach) as an additional non-model approach. These commenters note that under the Basel Collateral Haircut Approach, exposure value changes as the market value of the securities changes, while under the Non-Model Method in the interim final rule, exposure remains fixed at the inception of the securities financing transaction. Furthermore, the Basel Collateral Haircut Approach applies haircuts to the market value of the securities for both repurchase/securities lending transactions and reverse repurchases/securities borrowing transactions, while the Non-Model Method of the interim final rule applies haircuts only to the cash amount of a reverse repurchase agreement/securities borrowing transaction. In addition, these commenters note that not allowing banks to use the Basel Collateral Haircut Approach means that banks would be required to perform two separate calculations, one for the lending limits rule and one for Basel II/III, even though the different calculations would not result in materially different exposure amounts.

The OCC agrees with these commenters and has included in the final rule this additional method of measuring credit exposure for securities financing transactions, named in the rule as the Basel Collateral Haircut Method, as a new § 32.9(c)(1)(iii). We find that this approach permits a more accurate characterization of the true exposure over the life of the transaction for those national banks or savings associations that do not use an internal model and for which the existing non-model approach in the interim final rule is not optimal. In addition, because this approach is currently used by certain national banks and savings associations for purposes of the capital rules, it will eliminate redundancy and associated regulatory burden for these institutions.

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<sup>27</sup> 12 CFR part 3, Appendix C, Section 32(b)(2)(i) and (ii); 12 CFR part 167, Appendix C, Section 32(b)(2)(i) and (ii); or 12 CFR part 390, subpart Z, Appendix A, Section 32(b)(2)(i) and (ii), as appropriate.

<sup>28</sup> See footnote 21.

As a result of adding this new non-model method for securities financing transactions, the final rule changes the name of the “Non-Model Method” included in the interim rule to “Basic Method.” The final rule also makes a technical correction to renamed Table 2 to describe the correct length of maturity for sovereign entities with maturities of more than 5 years.

3. Exposures to Central Counterparties.

Under the interim final rule, exposures to central counterparties are credit exposures subject to the lending limits. Industry commenters to the interim final rule recommended that the OCC either exclude these exposures from an institution’s lending limits or assign the exposures a higher lending limit. These commenters believe that the OCC should not subject these exposures to the lending limits because the Dodd-Frank Act has mandated the migration of many derivative transactions to central counterparties, and those parties will be subject to regulation. In addition, the commenters note that applying the lending limits rule to central counterparty exposures could reduce the incentive to use central counterparties or prevent some institutions from engaging in certain transactions, thus limiting the availability of certain products to customers. One commenter also notes that applying the lending limits to exposures to central counterparties is unnecessary because central counterparties are more akin to a group of borrowers than “one borrower,” with the central counterparty insulating each clearing member and clearing customer from risks associated with the default of an individual counterparty.

Commenters also addressed the issue of applying the lending limits rule to an institution’s contributions to a central counterparty’s guaranty fund. Some commenters stated that the lending limits rule should apply to these contributions because they are equivalent to committed lines of credit. Others argued that the rule should not apply, or its application should be tailored.

The OCC does not agree that the lending limits rule should exclude credit exposures to central counterparties or central counterparty guaranty funds given the concentrated nature of these exposures. The lending limits serve the purpose of preventing an undue concentration of credit risk to one party, including an institution's credit exposures to central counterparties. Furthermore, permitting banks to use models to measure their exposure to central counterparties, combined with prudent credit risk management practices by clearing member banks, makes it unlikely that applying the rule to such credit exposures will cause an institution's exposures to one borrower to reach the institution's legal limit. To clarify how banks and savings associations must measure counterparty exposures to central counterparties, we have added a new § 32.9(b)(3). This new provision says that, in addition to the amount calculated under § 32.9(b), the measure of exposure to a central counterparty shall include the sum of the initial margin posted, plus any contributions to a guaranty fund at the time such contribution is made, if not already reflected in the calculation. This new provision is generally consistent with interpretive positions taken by the OCC.<sup>29</sup> However, the OCC recognizes that the role of central counterparties in the domestic and international financial industry is dynamic and that uncertainties exist as to how this role will evolve, especially given the role assigned to central clearinghouses by the Dodd-Frank Act and choices of the bank's or savings association's client as to using certain central counterparties.<sup>30</sup> Therefore, the OCC will continue to monitor the role of central counterparties and will revisit our lending limits rule for exposures to such entities if necessary.

#### 4. Credit derivatives.

The OCC received a number of comments on the interim final rule's treatment of credit

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<sup>29</sup> See, e.g., OCC Interpretive Letter No. 1113, March 4, 2009.

<sup>30</sup> In general, section 723 of the Dodd-Frank Act requires the central clearing of certain derivatives.

exposures arising from credit derivatives. Section 32.9(b)(2) of the interim final rule applies a special rule for calculating the credit exposure of credit derivatives, a transaction in which a national bank or savings association buys or sells credit protection against loss on a third-party reference entity. Specifically, a protection purchaser that uses one of the non-model methods for derivative transactions, or that uses a model without entering an effective margining arrangement with its counterparty as defined in § 32.2(l) of the interim final rule, calculates the counterparty credit exposure arising from credit derivatives by adding the net notional value of all protection purchased from the counterparty across all reference entities.<sup>31</sup> In addition, a protection seller calculates the credit exposure to a reference entity arising from credit derivatives by adding the notional value of all protection sold on that reference entity.<sup>32</sup> However, the protection seller may reduce its exposure to a reference entity by the amount of any eligible credit derivative, which is defined in § 32.2(m) of the interim final rule as a single-name credit derivative or standard, non-tranched index credit derivative that meets certain requirements, purchased on that reference entity from an eligible protection provider, as defined in § 32.2(o).

Some commenters requested that the OCC amend the definition of “eligible credit derivative” to allow banks to obtain relief for the purchase of credit protection using standard tranched index credit derivatives in addition to standard non-tranched index credit derivatives. As both tranched and non-tranched index credit derivatives are highly standardized, rely on the same triggering events for payments, and calculate payments from the protection provider on the

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<sup>31</sup> The protection buyer is exposed to the counterparty risk of the seller; the buyer expects payment from the seller if there is a default. Technically, the seller also bears a degree of counterparty credit risk; this risk is not being captured by the lending limits.

<sup>32</sup> Section 610 of the Dodd-Frank Act applies the lending limits to counterparty credit exposures arising from derivative transactions (“credit exposure to a person arising from a ... transaction between the national banking association and the person”) (emphasis added). Section 610 (a)(1), as codified at 12 U.S.C. 84(b)(1)(C). The OCC’s authority to apply the lending limits to exposures to reference entities in credit derivatives derives from 12 U.S.C. 84(b)(1)(B) (loans subject to the lending limits include “to the extent specified by the Comptroller of the Currency, any liability . . . to advance funds to or on behalf of a person pursuant to a contractual commitment”).



basis of the same auction-determined prices, the commenters do not believe that an institution's ability to reduce its exposures under the rule should be limited to only non-tranched index credit derivatives. The OCC disagrees with these comments and has not amended the final rule to define "eligible credit derivative" to include standard tranched index credit derivatives at this time. We will address this issue if we later determine, after experience implementing this rule, that such a change is warranted.

Commenters also recommended that the OCC clarify that the definition of "eligible credit derivative" includes, in the case of sovereign or municipality reference obligors, contracts in which the credit event is a restructuring. Because bankruptcy and insolvency regimes generally do not exist for these types of reference obligors, standard credit default swap (CDS) contracts on sovereign and municipal reference exposures instead cover the buyer of protection for restructurings that, while not conducted by a bankruptcy court or receiver, nonetheless bind the holders of the sovereign or municipal debt to changes in principal, interest, or similar economic terms of the debt. It was not the OCC's intent to exclude restructurings of such obligors in this definition. Therefore, we have amended the definition of "eligible credit derivative," at § 32.2(m)(3)(ii), by specifically including a restructuring for obligors not subject to bankruptcy or insolvency as a credit event for a CDS.

Some commenters opposed the provision in the interim final rule, § 32.9(b)(2), that requires a national bank or savings association to enter an effective margining arrangement in order to use an internal model approach to calculate counterparty exposure arising from a credit derivative. Absent the effective margining arrangement, the bank or savings association must calculate its counterparty credit risk exposure by adding notional amounts across all reference entities for each counterparty. The interim final rule defines "effective margining arrangement" as a master legal agreement governing derivative transactions between a bank or savings

association and a counterparty that requires the counterparty to post, on a daily basis, variation margin to fully collateralize that amount of the bank's net credit exposure to the counterparty that exceeds \$1 million created by the derivative transactions covered by the agreement. These commenters stated that selection of a \$1 million threshold is arbitrary and unnecessary because an effective model should take into account whatever threshold is applicable for a particular margining arrangement. The OCC does not agree with this comment and finds that variation margin is an important credit risk mitigation tool for prudent participation in over-the-counter derivatives markets. Beyond a prudently established variation margin threshold, the OCC does not believe it is appropriate to permit an institution to use the Model Method for credit derivatives transactions. Many large institutions currently require, or likely soon will require, that all credit exposures from derivative transactions be fully collateralized. Therefore, we believe defining "effective margining arrangement" to include a threshold is appropriate from a safety and soundness perspective, conforms with current and evolving industry standards, and is consistent with efforts to prevent the type of uncollateralized credit derivatives exposures that proved problematic during the financial crisis.

After further review of this issue, however, we believe that it is appropriate to increase the threshold amount in the definition of effective margining arrangement to reflect any existing agreements with thresholds above \$1 million. This change would allow banks and savings associations with such existing margining agreements to use the Model Method without having to renegotiate and modify the agreements. We have limited this increase to \$25 million, an amount that we believe adequately covers the bulk of these existing agreements. To help ensure that this increase in threshold amount will not raise new safety and soundness concerns, we have adjusted the rule to provide that the amount of the threshold under an effective margining arrangement is added to the amount of counterparty exposure calculated by the Model

Method. Thus, the amount of the threshold would be subject to the lending limit. Of course, this adjustment to the rule in no way obviates or modifies the ongoing requirement that an institution's margining arrangements, including as to the threshold amounts that do not exceed the threshold used in the lending limits rule, must be consistent with safe and sound banking practices.

Commenters also requested that the OCC permit national banks to purchase credit protection, such as default or total return swaps, to reduce all types of credit exposure to a borrower.<sup>33</sup> Under the interim final rule, the purchase of credit protection can only reduce credit derivative exposure to a reference obligor, not other exposures such as traditional loans and extensions of credit. The commenters note that the purchase of credit protection is a well-accepted risk management technique and is recognized in the Comptroller's Handbook on Concentrations of Credit as a useful strategy for managing credit concentration risk.<sup>34</sup> They recommend that where the protection contract maturity is as long as the maturity for the other exposure, protection purchased from an eligible protection provider should be permitted under the rule to be used to reduce all types of covered credit exposure.

After careful consideration, the OCC agrees that credit protection purchased should be allowed to offset other types of credit exposures, under certain circumstances as suggested by the commenters, but only on a limited basis. Specifically, we have added a new § 32.2(q)(2)(vii) to exclude from the lending limits rule that part of a loan or extension of credit for which a national bank or savings association has purchased protection if: that protection is by way of a single-name credit derivative that meets the requirements for an eligible credit derivative contained in

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<sup>33</sup> The OCC notes that a national bank or savings association may only purchase such credit protection if the transaction is otherwise permitted under applicable law. See e.g., 12 USC 1851 and any implementing regulations.

<sup>34</sup> See Comptroller's Handbook, Concentration of Credit, December 2011, p. 13.

§32.2(m)(1) through (7); the credit derivative is purchased from an eligible protection provider; the reference obligor is the same legal entity as the borrower in the loan or extension of credit; and the amount and maturity of the protection purchased equals or exceeds the amount and maturity of the loan or extension of credit. However, even if all of these requirements are satisfied, the total amount of such exclusion may not exceed 10 percent of the bank's or savings association's capital and surplus.<sup>35</sup> We believe this policy strikes an appropriate balance by conforming the lending limits rule to existing agency policy on the purchase of credit protection (such as the policy cited by the commenters) while placing a ceiling on a bank's ability to obtain relief from the lending limits in this manner.

Three financial trade associations stated that the interim final rule is not clear as to whether, and, if so, how, it covers credit exposures arising from tranching index credit derivatives. The commenters noted that the rule requires banks to use "notional value" to calculate credit exposure on protection sold, but there are several different notional amounts identified in tranching index CDS documentation, and none of these can reasonably be understood as a proxy for credit exposure.

The OCC understands that the interim final rule does not resolve questions regarding measurement of exposures arising from tranching credit derivatives, whether they are standard index or bespoke tranches. However, because there are different notional amounts that could apply to tranching exposures, none of which may be indicative of the risk to a particular reference entity, it is difficult to apply a specific rule for all situations. Instead, we intend to address the issue through OCC interpretations. This approach will allow the OCC to more thoroughly

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<sup>35</sup> Where a protection seller reduces its credit derivative exposure under § 32.9(b)(2)(ii) by purchasing protection, such reduction is not subject to the 10 percent limit.

examine the transactions at issue and apply approaches that most accurately calculate the notional amount attributable to each reference entity in a specific tranche.

5. Securities financing transaction-specific provisions.

A number of comments were directed specifically to the interim final rule's treatment of securities financing transactions.

Some commenters asked the OCC to clarify that “repurchase agreement” and “reverse repurchase agreement” as used in the definition of “securities financing transaction” are limited to transactions in securities. The lack of a definition for these specific terms could result in the impression that the same lending limits rule applicable to securities financing transactions in § 32.9 applies to other types of repurchase agreements and reverse repurchase agreements that do not involve securities. It does not.<sup>36</sup> However, to address this concern we have added a definition of “security” to the final rule, which cross-references to the definition of this term in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)). This definition clarifies that the transactions that are referred to as “securities financing transactions” are transactions that involve securities.

As indicated above, under the renamed Basic Method, the credit exposure arising from either a securities lending transaction or a securities borrowing transaction where the collateral is other securities will equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined in Table 2 of the final rule (formerly Table 3 of the interim final rule), and the higher of the two par values of the securities. Commenters questioned how the credit exposure would be calculated when more than one type of securities collateral is provided in these transactions. We agree that this circumstance should be addressed

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<sup>36</sup> Instead, the other provisions of part 32 should be consulted. For example, extensions of credit secured by loans, whether effected by reverse repurchase agreements or otherwise, have always been within the scope of the general lending limits rules (including any applicable exceptions) and continue to be so after the enactment of the Dodd-Frank Act and promulgation of this rule.

in the rule. Accordingly, we have amended the provisions in the rule regarding these non-cash collateral transactions, §§ 32.9(c)(1)(ii)(B)(2) and 32.9(c)(1)(ii)(D)(2), to provide that where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security borrowed and the notional-weighted average of the haircuts associated with the securities provided as collateral.

Commenters also requested that the OCC clarify that the securities lending transactions secured by Federal and state (or political subdivision) obligations should receive the same treatment as “cash collateralized” transactions under the rule when calculating credit exposure. The OCC notes that the rule currently provides that credit exposures arising from securities financing transactions in which the securities financed are type I securities, as defined in 12 CFR 1.2(j), in the case of national banks (generally Federal and state securities), or securities listed in sections 5(c)(1)(C), (D), (E), and (F) of HOLA and general obligations of a state or subdivision as listed in section 5(c)(1)(H) of HOLA,<sup>37</sup> in the case of savings associations, are exempt from the lending limits. Therefore, no further change is needed.

#### 6. Nonconforming Loans and Extensions of Credit.

The interim final rule added a new paragraph (a)(3) to § 32.6 to provide that a credit exposure arising from a derivative transaction or securities financing transaction and determined by a model pursuant to § 32.9(b)(1)(i) or § 32.9(c)(1)(i), respectively, will not be deemed a violation of the lending limits statute or regulation and will be treated as nonconforming if the extension of credit was within the national bank's or savings association's legal lending limits at execution and is no longer in conformity because the exposure has increased since execution. One commenter requested that credit exposures that exceed the limits after inception of the derivative transaction should be treated as violations of the lending limits rule rather than as

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<sup>37</sup> 12 U.S.C. 1464(c)(1)(C), (D), (E), (F), and (H).

nonconforming, asserting that otherwise there would be an incentive to game the limits. We disagree with this comment. Because of the nature of these transactions, it would not be possible for an institution to predict with any certainty the maximum exposure amount at the execution of a transaction. Furthermore, once a transaction becomes nonconforming, the rule requires the institution to use reasonable efforts to bring it into conformity with the lending limits unless doing so would be inconsistent with safety and soundness. The OCC enforces this provision accordingly.

Other commenters requested that derivative transactions calculated using a non-model method also should be treated as “nonconforming” if credit exposure arising from the derivative transaction increases after execution of the transaction. Without this change, institutions choosing a non-model method could face violations of the lending limits due to increases in credit exposure post-execution, while banks using internal models, in similar circumstances, would only be subject to an instance of nonconformance with the opportunity to correct the nonconformance before it is deemed a violation. We agree that the provision on nonconforming loans and extensions of credit should apply to transactions calculated using a non-model method. Although the OCC intended this treatment when issuing the interim final rule, the text of the rule did not accomplish it. We therefore have made this technical change by adding reference to the Current Exposure Method as well as the Basel Collateral Haircut Method, which we have added as an additional non-model method for securities financing transactions, to § 32.6(a)(3) of the final rule.<sup>38</sup>

## 7. Other provisions.

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<sup>38</sup> It is not necessary to include the Conversion Factor Matrix method for derivative transactions or the Basic Method for securities financing transactions in § 32.6(a)(3) because the measured credit exposure of a transaction for lending limits purposes remains fixed under these methods.

Unless specifically noted in the rule, all provisions of part 32 apply to credit exposures arising from a derivative transaction or a securities financing transaction, including the lending limits calculation rules of § 32.4 and the combination rules of § 32.5. Some commenters took issue with the application of the direct benefit test in § 32.5, which provides for the attribution and combination of loans and extensions of credit under certain circumstances, to derivative and securities financing transactions. They stated that the direct benefit test would be difficult to monitor in these transactions because of the complexity of these transactions and would likely require significant changes to market practices or revisions to standard documentation to implement. Instead they recommend that for these transactions the direct benefit test should be limited by its terms to situations of evasion. The OCC has carefully considered this comment. The direct benefit test is dependent on the facts of a particular case, and the OCC understands that the nature of derivative and securities financing transactions may raise factual issues not found in traditional loan transactions. However, the OCC has determined not to make changes to the long-established text of the direct benefit test at this time. The OCC will continue to apply the test sensibly to these transactions in light of their facts and circumstances and will review the direct benefit test once it has experience with its application to the exposures arising from derivative transactions and securities financing transactions.

### III. Explanatory Table

The table below is provided as an aid in understanding the final rule. A prior version was included in the interim final rule and we have revised it to simplify it and to reflect the changes included in the final rule. It is not a substitute for the final rule itself.

Transaction Type	Credit Exposure	Calculation Examples under Final Rule
<b>Derivatives</b>		
Interest Rate Swap	Institutions that have an approved model can use the model to determine the attributable credit exposure.	<u>Non-modeled bank:</u> Bank A without an approved model executes a \$10 million, 5-year, interest



Transaction Type	Credit Exposure	Calculation Examples under Final Rule
	<p>If no model, institutions must use either the Conversion Factor Matrix Method or the Current Exposure Method.</p> <p><u>Conversion Factor Matrix Method:</u> Attributable credit exposure is locked-in or fixed at the PFE on day 1 by simply multiplying notional principal amount by a conversion factor provided in table. No requirement to calculate daily mark-to-market or re-calculate PFE.</p> <p><u>Current Exposure Method:</u> Attributable credit exposure is calculated by adding the current exposure (the greater of zero or the MTM value) and the PFE (calculated by multiplying the notional amount by a specified conversion factor taken from Table 4 of the Advanced Approaches Appendix of the capital rules, which varies based on the type and remaining maturity of the contract) of the derivative transaction.</p>	<p>rate swap. It receives a fixed rate and pays floating. The current mark-to-market is \$0.</p> <p><u>Under the Conversion Factor Matrix Method,</u> the PFE factor for this swap is 6%. Bank A “locks-in” attributable exposure of \$600,000 (\$10 million x 6%), the day-one PFE amount.</p> <p><u>Under the Current Exposure Method (CEM),</u> exposure is equal to the current mark-to-market, plus an “add-on” determined by multiplying the notional amount times a factor appropriate for the swap’s maturity. The factor for a 5-year swap is 0.5 percent. Bank A’s attributable exposure would be \$50,000 (0+(\$10 million x 0.5%)).</p>
Credit Derivative	<p><u>To Counterparty</u><sup>39</sup> Institutions that model derivatives exposures determine the attributable exposure based on the model, provided there is an effective margining arrangement. They add in to the amount calculated under the model any net credit exposure under an effective margining arrangement with respect to which the counterparty is not required to fully collateralize.</p> <p>Institutions that use the Conversion Factor Matrix Method or CEM for other derivative transactions, or that model but do not have an effective margining arrangement, calculate the attributable exposure as the sum of all net notional protection purchased amounts across reference entities.</p> <p><u>To Reference Entities</u><sup>40</sup> Institutions calculate the exposure as the</p>	<p><u>Modeled bank with effective margining arrangement:</u> Bank A buys and sells credit protection from and to Bank B on Firms X, Y and Z. There is an effective margining arrangement between the banks with a collateralization threshold of \$2,000,000. Banks A and B use their models to determine their counterparty credit exposures and add to the calculation \$2,000,000.</p> <p><u>Non-modeled bank or bank without effective margining arrangement:</u></p> <p><u>Example 1</u> Bank A buys and sells credit protection from and to Bank B on Firms X, Y and Z. Bank A’s net notional protection purchased from Bank B is \$50 for Firm X and \$100 for Firm Y. Bank A’s net protection sold to Bank B is \$35 for Firm Z. The lending limits exposure of Bank A</p>

<sup>39</sup> The protection buyer is exposed to the counterparty risk of the seller; the buyer expects payment from the seller if there is a default. Technically, the seller also bears a degree of counterparty credit risk; this risk is not being captured by the lending limits.

<sup>40</sup> Upon default of the reference entity, the protection seller must make a payment to the buyer.

Transaction Type	Credit Exposure	Calculation Examples under Final Rule
	<p>net notional protection sold amount. The net protection sold amount is the gross notional protection sold on a reference entity less the amount of any eligible credit derivative purchased on that reference entity from an eligible protection provider.</p>	<p>to Bank B is a <u>counterparty credit exposure</u> of \$150. (Bank A also has a lending limits exposure to Firm Z of \$35 due to <u>reference entity exposure</u>.)</p> <p><u>Example 2</u></p> <p>Bank C sells credit protection on Firms 1 and 2. Bank C's gross notional protection sold is \$100 for Firm 1 and \$200 for Firm 2. Bank C also purchases \$25 of protection on Firm 2 from an eligible protection provider (EPP) via an eligible credit derivative. The lending limits exposure of Bank C to Firm 1 is \$100 and to Firm 2 is \$175. If Bank C models its exposures and has an effective margining agreement with the EPP, its counterparty exposure to the EPP for this transaction, as well as all other derivatives transactions in the same netting set, is calculated by the model. If Bank C has no effective margining agreement with the EPP or does not model, its counterparty exposure to the EPP is \$25.</p> <p><u>Example 3</u></p> <p>Bank D funds a loan to Borrower Inc. in the amount of \$100,000. Bank D purchases protection on Borrower Inc. in the amount of \$40,000 from an eligible protection provider (EPP) via a single-name credit derivative that meets the requirements of § 32.2(m)(1) through (7). The amount of \$40,000 does not exceed 10% of Bank D's capital and surplus. Bank D's counterparty exposure to Borrower Inc. is \$60,000 for lending limits purposes (\$100,000 - \$40,000). Bank D, a bank whose use of models for legal lending limits purposes has been approved by the appropriate Federal banking agency, has an effective margining agreement with the EPP and so will model the counterparty exposure to the EPP on this credit derivative transaction as part of a portfolio of derivative transactions with the EPP.</p>
<b>Securities Financing</b>		
Reverse Repurchase Agreement (asset repo)	<p>Institutions that have an approved model can use the model to determine the attributable credit exposure.</p> <p>Banks that do not have an approved</p>	<p><u>Using the Basic Method:</u></p> <p>Bank executes a reverse repo in which it lends \$100 and receives as collateral 7-year Treasury securities worth \$102 that have a haircut, based on Table 2 of the</p>

Transaction Type	Credit Exposure	Calculation Examples under Final Rule
	<p>model can determine attributable credit exposure using either the Basic Method or the Basel Collateral Haircut Method.</p> <p><u>Basic Method:</u> Attributable credit exposure for lending limit purposes is the product of the haircut associated with the collateral received and the amount of cash transferred.</p> <p><u>Basel Collateral Haircut Method:</u> Attributable credit exposure for lending limit purposes is determined pursuant to Sections 32(b)(2)(i) and (ii) of the Advanced Approaches Appendix of the capital rules.</p>	<p>final rule, of 4%. Attributable exposure is \$4 (<math>\\$100 \times 4\%</math>).</p> <p><u>Using the Basel Collateral Haircut Method:</u> Bank executes a reverse repo in which it lends \$100 and receives as collateral 7-year Treasury securities worth \$102 that have a haircut of 4%, based on Table 3 of Section 32(b)(2) of the Advanced Approaches Appendix of the capital rules. Attributable exposure is <math>(\\$100 - \\$102) + (\\$100 \times 0\%) + (\\$102 \times 4\%) = \\$2.08</math>.</p>
Repurchase Agreement	<p>Institutions that have an approved model can use the model to determine the attributable credit exposure.</p> <p>Banks that do not have an approved model can determine attributable credit exposure using either the Basic Method or the Basel Collateral Haircut Method.</p> <p><u>Basic Method:</u> Attributable credit exposure for lending limit purposes is the difference between the market value of securities transferred less cash received (i.e., the net current credit exposure).</p> <p><u>Basel Collateral Haircut Method:</u> Attributable credit exposure for lending limit purposes is determined pursuant to Sections 32(b)(2)(i) and (ii) of the Advanced Approaches Appendix of the capital rules.</p>	<p><u>Using the Basic Method:</u> Bank executes a repo in which it borrows \$100, pledging 7-year Treasury securities worth \$102. Attributable exposure is \$2, the amount of net current credit exposure.</p> <p><u>Using the Basel Collateral Haircut Method:</u> Bank executes a repo in which it borrows \$100, pledging 7-year Treasury securities worth \$102 that have a haircut of 4%, based on Table 3 of Section 32(b)(2) of the Advanced Approaches Appendix of the capital rules. Attributable exposure is <math>(\\$102 - \\$100) + (\\$100 \times 0\%) + (\\$102 \times 4\%) = \\$6.08</math>.</p>
Securities Borrowing Transaction	<p>Institutions that have an approved model can use the model to determine the attributable credit exposure.</p> <p>Banks that do not have an approved model can determine attributable credit exposure using either the Basic Method or the Basel Collateral Haircut Method.</p> <p><u>Basic Method:</u> If collateral is cash, treat the same as reverse repo: Attributable credit exposure for lending purposes is the product of the haircut associated with the collateral received and the amount of cash transferred.</p>	<p><u>Using the Basic Method, cash as collateral:</u> Bank borrows \$100 par value 7-year Treasury securities that have a fair value of \$102. The bank pledges \$100 in cash. The haircut associated with the security is 4%, based on Table 2 of the final rule. The attributable exposure is \$4 (<math>\\$100 \times 4\%</math>).</p> <p><u>Using the Basic Method, securities as collateral:</u> Bank borrows \$100 par value 7-year Treasury securities (with fair value \$101) and pledges 5-year bank eligible corporate bonds with a par value of \$100 and fair</p>

Transaction Type	Credit Exposure	Calculation Examples under Final Rule
	<p><u>If collateral is securities:</u> Attributable credit exposure for lending limit purposes is the product of the higher of the two haircuts associated with the two securities and the higher of the two par values of the securities.</p> <p><u>Basel Collateral Haircut Method:</u> Attributable credit exposure for lending limit purposes is determined pursuant to Sections 32(b)(2)(i) and (ii) of the Advanced Approaches Appendix of the capital rules.</p>	<p>value of \$102. The haircut on the borrowed security is 4% and the haircut on the pledged security is 6%, based on Table 2 of the final rule. The attributable exposure is \$6 (<math>\\$100 \times 6\%</math>), based upon the higher of the two security haircuts and the higher of the two par values (here the par values were the same).</p> <p><u>Using the Basel Collateral Haircut Method, cash as collateral:</u> Bank borrows \$100 par value 7-year Treasury securities that have a fair value of \$102. The bank pledges \$100 in cash. The haircut associated with the security is 4%, based on Table 3 of Section 32(b)(2) of the Advanced Approaches Appendix of the capital rules. The attributable exposure is <math>(\\$100 - \\$102) + (\\$100 \times 0\%) + (\\$102 \times 4\%) = \\$2.08</math>.</p> <p><u>Using the Basel Collateral Haircut Method, securities as collateral:</u> Bank borrows \$100 par value 7-year Treasury securities (with fair value \$101) and pledges 5-year bank eligible corporate bonds with a par value of \$100 and a fair value of the \$102. The haircut on the borrowed security is 4% and the haircut on the pledged security is 6%, based on Table 3 of Section 32(b)(2) of the Advanced Approaches Appendix of the capital rules. The attributable exposure is: <math>(\\$102 - \\$101) + (\\$102 \times 6\%) + (\\$101 \times 4\%) = \\$11.16</math>.</p>
Securities Lending Transaction	<p>Institutions that have an approved model can use the model to determine the attributable credit exposure.</p> <p>Banks that do not have an approved model can determine attributable credit exposure using either the Basic Method or the Basel Collateral Haircut Method.</p> <p><u>Basic Method:</u> If collateral received is cash, treat the same as a repo: The attributable credit exposure for lending limit purposes is the net current credit exposure.</p> <p>If the collateral received is other securities: The attributable credit exposure for lending limit purposes is the product of the higher of the two haircuts associated with the two securities and the</p>	<p><u>Using the Basic Method, cash as collateral:</u> Bank lends \$100 par value 7-year Treasury securities with fair value of \$102 and receives \$100 in cash collateral. Attributable exposure is \$2, the net current credit exposure.</p> <p><u>Using the Basic Method, securities as collateral:</u> Bank lends \$100 par value 7-year Treasury securities with fair value of \$101 and receives as collateral a 5-year bank eligible corporate bond with a \$100 par value and \$102 fair value. The haircuts on the loaned and borrowed securities are 4% and 6%, respectively, based on Table 2 of the final rule. Attributable exposure is \$6 (<math>\\$100 \times 6\%</math>), based upon the higher of the two security haircuts and the higher</p>

Transaction Type	Credit Exposure	Calculation Examples under Final Rule
	<p>higher of the two par values of the securities.</p> <p><u>Basel Collateral Haircut Method:</u> Attributable credit exposure for lending limit purposes is determined pursuant to Sections 32(b)(2)(i) and (ii) of the Advanced Approaches Appendix of the capital rules.</p>	<p>of the two par values (here the par values were the same).</p> <p><u>Using the Basel Collateral Haircut Method cash as collateral:</u> Bank lends \$100 par value 7-year Treasury securities with fair value of \$102 and receives \$100 in cash collateral. The haircut on the security is 4%, based on Table 3 of Section 32(b)(2) of the Advanced Approaches Appendix of the capital rules. Attributable exposure is <math>(\\$102 - \\$100) + (\\$100 \times 0\%) + (\\$102 \times 4\%) = \\$6.08</math>.</p> <p><u>Using the Basel Collateral Haircut Method, securities as collateral:</u> Bank lends a \$100 par value 7-year Treasury security with a fair value of \$101 and receives a 5-year bank eligible corporate bond as collateral, with a \$100 par value and \$102 fair value. The haircuts on the loaned and borrowed securities are 4% and 6%, respectively, based on Table 3 of Section 32(b)(2) of the Advanced Approaches Appendix of the capital rules. Attributable exposure is <math>(\\$101 - \\$102) + (\\$102 \times 6\%) + (\\$101 \times 4\%) = \\$9.16</math>.</p>

#### IV. Effective and Compliance Dates

The Administrative Procedure Act (APA) requires that a substantive rule must be published not less than 30 days before its effective date, unless, among other things, the rule grants or recognizes an exemption or relieves a restriction.<sup>41</sup> Current 12 CFR 32.1(d) provides a temporary exception period for the application of the section 610-related provisions of part 32 that expires on July 1, 2013. This final rule amends § 32.1(d) to extend this temporary exception period through October 1, 2013. Because this amendment postpones the application of the section 610-related provisions to national banks and savings associations, thereby relieving banks and savings associations from compliance with the section 610-related provisions on July

<sup>41</sup> 5 U.S.C. 553(d)(1).

1, 2013, the amendment may take effect less than 30 days from publication. Because this extension must take effect before July 1, 2013 to prevent the current exception period from expiring, we have made the amendment to 12 CFR 32.1(d) contained in this final rule effective on [INSERT DATE PUBLISHED IN THE FEDERAL REGISTER].

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4802) (RCDRIA) requires that regulations imposing additional reporting, disclosure, or other requirements on insured depository institutions take effect on the first day of the calendar quarter after publication of the final rule, unless, among other things, the agency determines for good cause that the regulations should become effective before such time. Because the amendment to extend the temporary compliance period does not impose any additional reporting, disclosure, or other requirements, the OCC finds good cause to dispense with the delayed effective date otherwise required by RCDRIA for this provision.

All other amendments made by this final rule will take effect on the first day of the calendar quarter after publication of the final rule, October 1, 2013.

## **V. Regulatory Analysis**

### **Regulatory Flexibility Act**

Pursuant to the Regulatory Flexibility Act (RFA),<sup>42</sup> 5 U.S.C. 603, an agency must prepare a regulatory flexibility analysis for all proposed and final rules that describe the impact of the rule on small entities, unless the head of an agency certifies that the rule will not have “a significant economic impact on a substantial number of small entities.” However, the RFA applies only to rules for which an agency publishes a general notice of proposed rulemaking

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<sup>42</sup> Pub. L. 96-354, Sept. 19, 1980.

pursuant to 5 U.S.C. 553(b).<sup>43</sup> Because the OCC did not publish a notice of proposed rulemaking pursuant to 5 U.S.C. 553(b)(B),<sup>44</sup> the RFA does not apply to this final rule.

### **Unfunded Mandates Reform Act**

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (2 U.S.C. 1532) (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating any rule likely to result in a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC has determined that there is no Federal mandate imposed by this rulemaking that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. Accordingly, final rule is not subject to section 202 of the Unfunded Mandates Act.

### **Paperwork Reduction Act**

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521), the OCC may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. Part 32 contains information collection requirements under the PRA, which have been previously approved by OMB under OMB Control No. 1557-0221. The OCC is seeking renewal of OMB PRA approval separately from this rulemaking for these

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<sup>43</sup> 5 U.S.C. 603(a), 604(a).

<sup>44</sup> Section 553(b)(B) provides that general notice and an opportunity for public comment are not required prior to the issuance of a final rule when an agency, for good cause, finds that “notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”

requirements. The OCC now is seeking OMB approval of the model approval process contained in § 32.9 of this final rule.

In response to comments received, we have clarified the model approval process in § 32.9(b)(1)(i)(C). The use of a model (other than the model approved for purposes of the Advanced Measurement Approach in the capital rules) must be approved by the OCC specifically for part 32 purposes and must be approved in writing. If a national bank or Federal savings association proposes to use an internal model that has been approved by the OCC for purposes of the Advanced Measurement Approach, the institution must provide prior written notification to the OCC prior to use of the model for lending limits purposes. OCC approval is also required before substantive revisions are made to a model that is used for lending limits purposes.

Estimated Number of Respondents: 238.

Estimated Burden per Respondent: 1 hour per model; 2 models per respondent.

Estimated Total Burden: 476 hours.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the OCC's functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the information collection burden, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.



Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by e-mail if possible. Comments may be sent to: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, Suite 3E-218, Mail Stop 9W-11, Attention: 1557-NEW, 400 7<sup>th</sup> Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to (571) 465-4326 or by electronic mail to [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov). You may personally inspect and photocopy comments at the OCC, 400 7<sup>th</sup> Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

All comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

Additionally, please send a copy of your comments by mail to: OCC Desk Officer, 1557-NEW, U.S. Office of Management and Budget, 725 17th Street, NW., #10235, Washington, DC 20503, or by email to: [oira\\_submission@omb.eop.gov](mailto:oira_submission@omb.eop.gov).

### **List of Subjects**

12 CFR Part 32

National banks, Reporting and recordkeeping requirements

12 CFR Part 159

Reporting and recordkeeping requirements, Savings associations

12 CFR Part 160

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

For the reasons set forth in the preamble, the interim final rule amending chapter I of title 12 of the Code of Federal Regulations that was published at 77 FR 37265 on June 21, 2012 is adopted as final with the following amendments.

## **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, 93a, 1462a, 1463, 1464(u), and 5412(b)(2)(B).

2. Section 32.1 is amended by:

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

b. Amending paragraph (d) by removing “July 1, 2013” and inserting in its place “October 1, 2013”.

The revision reads as follows:

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

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

(b) Purpose. The purpose of this part is to protect the safety and soundness of national banks and savings associations 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) Except as provided by paragraphs (c) and (d) of this section, this part applies to all loans and extensions of credit made by national banks and their domestic operating subsidiaries and to all loans and extensions of credit made by savings associations, their operating subsidiaries, and their service corporations that are consolidated under Generally

Accepted Accounting Principles (GAAP). For purposes of this part, the term “savings association” includes Federal savings associations and state savings associations, as those terms are defined in 12 U.S.C. 1813(b).

(2) This part does not apply to loans or extensions of credit made to the bank's or savings association's:

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

(ii) Operating subsidiaries;

(iii) Edge Act or Agreement Corporation subsidiaries; or

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

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

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

(5) In addition to the foregoing, loans and extensions of credit must be consistent with safe and sound banking practices.

\* \* \* \* \*

3. Section 32.2 is amended by:

a. Revising paragraph (l);

b. In paragraph (m)(3)(ii), inserting after “insolvency,” the phrase “restructuring (for obligors not subject to bankruptcy or insolvency),” and adding a comma after the phrase “as they become due”;

c. In paragraph (q)(2):

(i) Removing the “and” at the end of paragraph (q)(2)(v),

(ii) Removing the period at the end of paragraph (q)(2)(vi) and adding in its place “; and”, and

(iii) Adding new paragraph (q)(2)(vii); and

d. Redesignating paragraphs (bb), (cc) and (dd) as paragraphs (cc), (dd) and (ee), respectively, and adding new paragraph (bb).

The additions and revisions read as follows:

**§ 32.2 Definitions.**

\* \* \* \* \*

(l) Effective margining arrangement means a master legal agreement governing derivative transactions between a bank or savings association and a counterparty that requires the counterparty to post, on a daily basis, variation margin to fully collateralize that amount of the bank's or savings association's net credit exposure to the counterparty that exceeds \$25 million created by the derivative transactions covered by the agreement.

\* \* \* \* \*

(q) \* \* \*

(2) \* \* \*

(vii) That portion of one or more loans or extensions of credit, not to exceed 10 percent of capital and surplus, with respect to which the national bank or savings association has purchased protection in the form of a single-name credit derivative that meets the requirements of § 32.2(m)(1) through (7) from an eligible protection provider if the reference obligor is the same legal entity as the borrower in the loan or extension of credit and the maturity of the protection purchased equals or exceeds the maturity of the loan or extension of credit.

\* \* \* \* \*

(bb) Security has the same meaning as in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)).

\* \* \* \* \*

#### **§ 32.6 [Amended]**

4. Section 32.6(a)(3) is amended by:

a. Removing the word “Internal”; and

b. Adding “the Current Exposure Method specified in § 32.9(b)(1)(iii), or the Basel Collateral Haircut Method specified in § 32.9(c)(1)(iii)” after “Model Method specified in § 32.9(b)(1)(i) or § 32.9(c)(1)(i)”.

5. Section 32.9 is amended by:

a. In paragraph (b)(1):

i. In the first sentence, removing the phrase “paragraphs (b)(2) and (b)(3) of this section” and adding in its place the phrase “paragraphs (b)(2), (b)(3) and (b)(4) of this section”; and

ii. In the second sentence, removing the phrase “Subject to paragraph (b)(3)” and adding in its place “Subject to paragraph (b)(4)”;

b. Revising the heading in paragraph (b)(1)(i);

- c. Revising paragraph (b)(1)(i)(C);
- d. Revising paragraph (b)(1)(ii);
- e. Revising Table 1 in paragraph (b)(1)(ii);
- f. Revising paragraph (b)(1)(iii);
- g. Revising paragraph (b)(2);
- h. Redesignating paragraph (b)(3) as paragraph (b)(4), and revising it;
- i. Adding a new paragraph (b)(3);
- j. Revising paragraph (c)(1)(i);
- k. Revising the heading in paragraph (c)(1)(ii);
- l. Adding a sentence at the end of paragraphs (c)(1)(ii)(B)(2) and (c)(1)(ii)(D)(2);
- m. In paragraph (c)(1)(ii)(B) through (D), removing the phrase “Table 3” each time it appears and replacing it with the phrase “Table 2”;
- n. Removing Table 2 and renaming Table 3 as Table 2, and revising;
- o. Adding a new paragraph (c)(1)(iii); and
- p. Revising paragraph (c)(2).

The revisions and additions read as follows:

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

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*(i) Model Method. \* \* \*

(C) Calculation of potential future credit exposure. (1) A bank or savings association shall calculate its potential future credit exposure by using either:

(i) An internal model the use of which has been approved in writing for purposes of 12 CFR part 3, Appendix C, Section 32(d), 12 CFR part 167, Appendix C, Section 32(d), or 12 CFR

part 390, subpart Z, Appendix A, Section 32(d), as appropriate, provided that the bank or savings association provides prior written notice to the appropriate Federal banking agency of its use for purposes of this section; or

(ii) Any other appropriate model the use of which has been approved in writing for purposes of this section by the appropriate Federal banking agency.

(2) Any substantive revisions to a model made after the bank or savings association has provided notice of the use of the model to the appropriate Federal banking agency pursuant to this paragraph (b)(1)(i)(C)(1)(i) or after the appropriate Federal banking agency has approved the use of the model pursuant to this paragraph (b)(1)(i)(C)(1)(ii) must be approved by the agency before a bank or savings association may use the revised model for purposes of part 32.

\* \* \* \* \*

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

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

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

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

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

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

(iii) Current Exposure Method. The credit exposure arising from a derivative transaction (other than a credit derivative transaction) under the Current Exposure Method shall be calculated pursuant to 12 CFR part 3, Appendix C, Sections 32(c)(5),(6) and (7); 12 CFR part 167, Appendix C, Sections 32(c)(5), (6), and (7); or 12 CFR part 390, subpart Z, Appendix A, Sections 32(c)(5), (6) and (7), as appropriate.

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

(B) Special rule for certain effective margining arrangements. A bank or savings association must add the EMA threshold amount to the counterparty credit exposure arising from credit derivatives calculated under the Model Method. The EMA threshold is the amount under an effective margining arrangement with respect to which the counterparty is not required to post variation margin to fully collateralize the amount of the bank’s or savings association’s net credit exposure to the counterparty.



(ii) Reference entity exposure. A national bank or savings association shall calculate the credit exposure to a reference entity arising from credit derivatives entered into by the bank or savings association by adding the net notional value of all protection sold on the reference entity. A bank or savings association may reduce its exposure to a reference entity by the amount of any eligible credit derivative purchased on that reference entity from an eligible protection provider.

(3) Special rule for central counterparties. (i) In addition to amounts calculated under §§ 32.9(b)(1) and (2), the measure of counterparty exposure to a central counterparty shall also include the sum of the initial margin posted by the bank or savings association, plus any contributions made by it to a guaranty fund at the time such contribution is made.

(ii) Paragraph (b)(3)(i) of this section does not apply to a national bank or saving association that uses an internal model pursuant to paragraph (b)(1)(i) of this section if such model reflects the initial margin and any contributions to a guaranty fund.

(4) Mandatory or alternative method. The appropriate Federal banking agency may in its discretion require or permit a national bank or savings association to use a specific method or methods set forth in paragraph (b)(1) of this section to calculate the credit exposure arising from all derivative transactions or any specific, or category of, derivative transactions if it finds, in its discretion, that such method is consistent with the safety and soundness of the bank or savings association.

(c) \* \* \*(1) \* \* \*

(i) Model Method. (A) A national bank or savings association may calculate the credit exposure of a securities financing transaction by using either:

(1) An internal model the use of which has been approved in writing by the appropriate Federal banking agency for purposes of 12 CFR part 3, Appendix C, Section 32(b); 12 CFR part 167, Appendix C, Section 32(b); or 12 CFR part 390, subpart Z, Appendix A, Section 32(b), as

appropriate, provided the bank or savings association provides prior written notice to the appropriate Federal banking agency of its use for purposes of this section; or

(2) Any other appropriate model the use of which has been approved in writing for purposes of this section by the appropriate Federal banking agency.

(B) Any substantive revisions to a model made after the bank or savings association has provided notice of the use of the model to the appropriate Federal banking agency pursuant to this paragraph (c)(1)(i)(A)(1) or after the appropriate Federal banking agency has approved the use of the model pursuant to this paragraph (c)(1)(i)(A)(2) must be approved by the agency before a bank or savings association may use the revised model for purposes of part 32.

(ii) Basic Method. \* \* \*

(B) \* \* \*

(2) \* \* \* Where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security lent and the notional-weighted average of the haircuts associated with the securities provided as collateral.

\* \* \* \* \*

(D) \* \* \*

(2) \* \* \* Where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security borrowed and the notional-weighted average of the haircuts associated with the securities provided as collateral.

TABLE 2--COLLATERAL HAIRCUTS

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

**CORPORATE AND MUNICIPAL BONDS THAT ARE BANK-ELIGIBLE INVESTMENTS**

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

**OTHER ELIGIBLE COLLATERAL**

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

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

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

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

(iii) Basel Collateral Haircut Method. A national bank or savings association may calculate the credit exposure of a securities financing transaction pursuant to 12 CFR part 3, Appendix C, Sections 32(b)(2)(i) and (ii); 12 CFR part 167, Appendix C, Sections 32(b)(2)(i) and (ii); or 12 CFR part 390, subpart Z, Appendix A, Sections 32(b)(2)(i) and (ii), as appropriate.

(2) Mandatory or alternative method. The appropriate Federal banking agency may in its discretion require or permit a national bank or savings association to use a specific method or methods set forth in paragraph (c)(1) of this section to calculate the credit exposure arising from all securities financing transactions or any specific, or category of, securities financing transactions if the appropriate Federal banking agency finds, in its discretion, that such method is consistent with the safety and soundness of the bank or savings association.

**PART 159 – SUBORDINATE ORGANIZATIONS**

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

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

7. Section 159.3 is amended by revising paragraph (k)(2) to read as follows:

**§ 159.3 What are the characteristics of, and what requirements apply to, subordinate organizations of Federal savings associations?**

\* \* \* \* \*

(k) \* \* \*

(2) The LTOB regulation does not apply to loans from you to your GAAP-consolidated service corporation or from your GAAP-consolidated service corporation to you. However, part 32 imposes restrictions on the amount of loans you may make to non-consolidated service corporations. Loans made by a GAAP-consolidated service corporation are aggregated with your loans for LTOB purposes.

\* \* \* \* \*

8. Section 159.5 is amended by revising paragraphs (b) and (c) to read as follows:

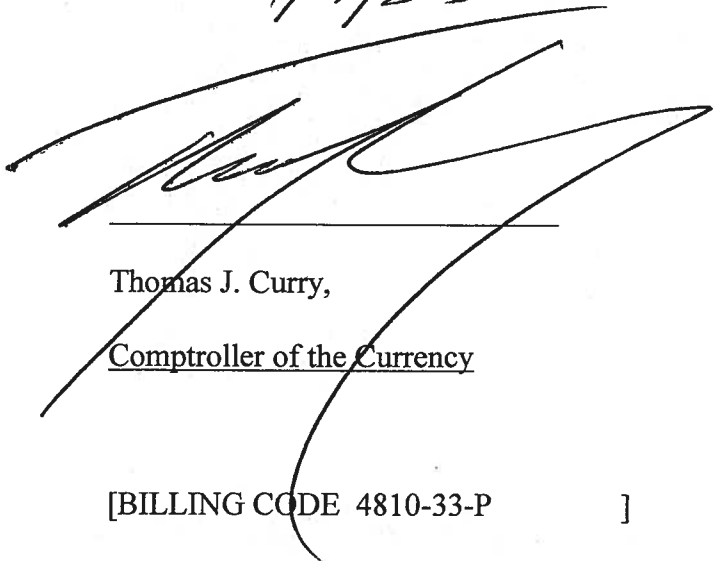
**§ 159.5 How much may a Federal savings association invest in service corporations or lower-tier entities?**

\* \* \* \* \*

(b) In addition to the amounts you may invest under paragraph (a) of this section, and to the extent that you have authority under other provisions of section 5(c) of the HOLA and part 160 of this chapter, and available capacity within any applicable investment limits, you may make loans to any non-consolidated subsidiary, subject to the lending limits in part 32 of this chapter.

(c) For purposes of this section, the term “obligations” includes all loans and other debt instruments (except accounts payable incurred in the ordinary course of business and paid within 60 days) and all guarantees or take-out commitments of such loans or debt instruments.

DATED: 6/19/2013



Thomas J. Curry,  
Comptroller of the Currency

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