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Transmittal – See OCC 2020-11

Lending Limits: Final Rule

To

Chief Executive Officers of All National Banks and Federal Savings Associations, Department and Division Heads, All Examining Personnel, and Other Interested Parties

The Office of the Comptroller of the Currency (OCC) has issued a final rule that amends the OCC's rule governing lending limits.[1] On June 21, 2012, the OCC published an interim final rule amending 12 CFR part 32 to implement section 610 of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the act) and to consolidate the lending limits rules applicable to national banks and federal and state savings associations (collectively, banks). (See OCC Bulletin 2012-19.) The act revises the lending limits statute applicable to banks to include credit exposures arising from derivative transactions and repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions (collectively, securities financing transactions).

Effective Date

The interim final rule contained a temporary exception period through July 1, 2013, for the application of the rule's requirements as to derivative transactions and securities financing transactions. The final rule extends this temporary exception period through October 1, 2013, to allow additional time for banks to comply with the final rule. All other amendments made by this final rule are effective on October 1, 2013.

Information for Community Banks

The final rule minimizes the compliance burden on small and midsize banks of measuring the credit exposure of derivative transactions and securities financing transactions by providing different options for measuring the exposures for each transaction type. The options permit banks to adopt compliance alternatives that fit their size and risk management requirements, consistent with safety and soundness and the goals of the statute. Community banks should note that derivative transactions include interest rate swaps; however, community banks may use the Conversion Factor Matrix Method, which is an easy-to-use lookup table that locks in the attributable exposure at the execution of the transaction. The final rule specifically exempts securities financing transactions relating to Type I securities from lending limits calculations. For other securities financing transactions, the Basic Method, which locks in the attributable exposure based on the type of transaction, is the simplest method.

Summary

The final rule outlines the methods that banks can choose from to measure credit exposures of derivative transactions and securities financing transactions. In most cases, a bank may choose which method it will use; the OCC, however, may specify that a bank use a particular method for safety and soundness reasons. Banks may request OCC approval to use a different method to calculate credit exposure for certain transactions. If the Internal Model Method is used, the OCC must approve the use of the model and any subsequent changes to an approved model. The final rule continues to provide that loans and extensions of credit, including those that arise from derivative transactions and securities financing transactions, must be consistent with safe and sound banking practices. The following summarizes the methods available:

Derivative Transactions

Banks can generally choose to measure the credit exposure of derivative transactions through

- the *Conversion Factor Matrix Method*, which uses a simple lookup table that locks in the attributable exposure at the execution of the transaction.
- the *Current Exposure Method*, which replaces the Remaining Maturity Method included in the interim final rule and provides a more precise calculation of credit exposure. It does this by incorporating additional calculations for netting arrangements and collateral and by using multipliers that are tailored to computing the potential future exposure of derivative transactions.
- an *OCC-approved internal model*, which provides the most precise measurement of credit exposure for these transactions.

For credit derivatives (transactions in which banks buy or sell credit protection against loss on a third-party reference entity), the final rule provides a special rule for calculating credit exposure based on exposure to the counterparty and reference entity.

Securities Financing Transactions

As with the interim final rule, the final rule specifically exempts securities financing transactions relating to Type I securities (U.S. or state government obligations, etc.) from the lending limits calculations. For other securities financing transactions, banks can choose to measure credit exposure by the following methods:

- *Locking in the attributable exposure* based on the type of transaction.
- Using an *OCC-approved internal model*.
- As added by the final rule, using the *Basel Collateral Haircut Method*. This last method applies standard supervisory haircuts (the percentage reduction of the amount that will be repaid to creditors) for measuring counterparty credit risk for such transactions under the capital rules' Basel II Advanced Internal Ratings-Based Approach[2] or the Basel III Advanced Approaches.

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Related Link

- Final Rule (PDF)

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[1]12 CFR 32.

[2]12 CFR 3, appendix C, section 32(b)(2)(i and ii); 12 CFR 167, appendix C, section 32 (b)(2)(i and ii); or 12 CFR 390, subpart Z, appendix A, section 32(b)(2)(i and ii), as appropriate.