

*Capital and Surplus (§ 32.2(b))*

Under the former rule, the statutory lending limit of 15% of capital was applied to a definition of capital found in 12 CFR § 3.100. The § 3.100 definition serves as the capital base for certain other regulatory limitations, such as limits on purchasing investment securities, holding property and OREO, and investing in community development corporations. The § 3.100 capital definition is separate and different from the leverage and risk-based capital formulae used to determine banks' capital adequacy.

In order to reduce regulatory burden associated with calculating lending limits and to begin the process of reducing the multiple definitions of capital currently in use, the proposal changed the definition of capital and surplus used for lending limits purposes by employing a capital calculation that all banks already make. Under the proposal, a bank's basic lending limit would be an amount equal to 15% of the sum of its allowed Tier 1 and Tier 2 capital, plus the balance of its allowance for loan and lease losses (ALLL) not included in Tier 2 capital for the bank's risk-based capital calculation. For simplicity, the proposal used the terminology "capital and surplus" rather than the statutory terms "unimpaired capital and unimpaired surplus."

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

*Loans and Extensions of Credit (§ 32.2(j))*

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

control over or established rights to the securities.

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

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

*Loans Legally Unenforceable*

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

The final rule returns to the scope of the original OCC interpretive ruling. Under the final rule, a loan (or a portion thereof) that becomes legally unenforceable for any reason and has been charged off on a bank's books, is not considered a loan or extension of credit. As a matter of prudent banking practice, the OCC expects that banks will keep sufficient documentation to

show why loans are legally unenforceable. These records may include letters, memoranda, or written agreements that evidence the bank's legally enforceable forgiveness of a loan. The financial records of the bank also should reflect that the loan has been charged off.

*Advances for the Benefit of the Borrower*

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

The OCC carefully considered the comments received on this issue. The OCC recognizes that there may be situations when an advance on behalf of a troubled borrower could help the lending bank avoid greater expenses after foreclosure. For example, an advance for the purpose of repairing a leaking roof is more cost effective than waiting until after foreclosure which leads to spending more money to restore the value of water-damaged OREO. However, using the exemption to advance funds for building new property would not be consistent with the purpose of the exemption. The OCC also has concerns that banks reasonably anticipate a borrower's need to fund various expenses in determining the appropriate size of the loan that a bank is able to extend and that the exemption not create incentives for borrowers to divert or reclassify spending in order to qualify larger portions of their credit needs for the exemption.

Nevertheless, the OCC believes that a moderate extension of the exemption to allow advances to pay for more than taxes and insurance is appropriate, provided that the expenses have not been structured to avoid a bank's lending limits. The final rule therefore exempts from the lending limit reasonable advances made on behalf of the borrower to pay for necessary maintenance and certain other expenditures when an advance is consistent with safe and sound banking practices and designed to protect the lending bank's interest in the collateral.