

but retains the explicit authority for the OCC to require a national bank to calculate its lending limits more frequently than every quarter when the OCC believes it is necessary. The OCC therefore may address unsafe or unsound lending practices or other supervisory concerns by directing any bank to calculate its lending limit more frequently than quarterly. This authority is set forth in § 32.4(b).

#### *Direct Benefit Test (§ 32.5(b))*

Section 32.5(b) requires a loan to be attributed to a third party if the third party gains the direct benefit of the loan proceeds. The proposal narrowed the direct benefits tests to clarify that loans are not attributable to a third party when the loan proceeds are transferred to the third party to acquire property, goods, or services in a bona-fide arms-length transaction.

The proposal requested comment on the question of whether the direct benefits test was necessary. Several commenters argued that it was not. Some commenters suggested that the common enterprise test addresses most, and possibly all, circumstances that involve the less than a bona fide arms-length transactions that is the focus of the direct benefits test. The OCC has carefully considered these comments but has concluded that the direct benefits test uniquely addresses an area of concern in the lending limits area. The final rule therefore retains the test but with one change, designed to improve certainty regarding the application of the test. The "facts and circumstances" provision of the direct benefits test is removed. The OCC believes this part of the test was redundant and potentially confusing.

#### *Common Enterprise Test (§ 32.5(c))*

The final rule adopts the common enterprise test largely as stated in the proposal. The common enterprise test requires the aggregation of loans made to persons who are related through common control and financial interdependence or share a common source of income for repayment of the loan, or whenever the OCC determines the "facts and circumstances" requires aggregation. Most commenters characterized the proposed language as a much improved restatement of the test that was easier to understand. Some commenters requested further amendments, alterations, and extension of the rule.

The OCC has not adopted most of the suggestions. Many of the commenters'

suggestions for change would have undermined the effectiveness of this combination rule. Most of the suggested changes would not have provided much additional clarity. Others risked diminishing the effectiveness of the rule. Although the common enterprise test may be somewhat complex to apply to certain corporate structures, the OCC has concluded that, on balance, it is an effective description of the varied circumstances when loans to separate borrowers should be combined because they present a common source of credit exposure for a bank.

The final rule makes changes to § 32.5(c)(3), to clarify that the rule requires combination of only those loans that the borrowers use for the acquisition of a controlling interest in a business. The final rule also specifically clarifies that limited liability companies will be treated in the same manner as corporations, rather than as partnerships, in applying the common enterprise test.

#### *Nonconforming Loans (§ 32.6)*

The proposal incorporated OCC policy that a bank will not be deemed to violate the lending limits when a loan that was legal when made becomes nonconforming as a result of several specifically defined events, provided the bank exercises "best efforts" to bring the loan into conformity with the lending limit. A number of commenters objected that the "best efforts" standard was too high. Some commenters pointed out that using best efforts to reduce a nonconforming loan could pose certain safety and soundness risks to a bank. For example, if a bank holds a loan that was legal when made and subsequently the bank's capital declines, the best efforts standard might require that the bank sell the loan off at any price. This forced sale only causes the bank to lose an asset during a period that its capital is in decline. The OCC did not intend this result of the proposed nonconforming loan provisions.

In response to commenter concerns, the final rule replaces the term "best efforts" with the term "reasonable efforts". The OCC believes this standard more accurately reflects the level of effort appropriate to bring a loan into conformance with a bank's current lending limits. The final rule also makes clear that the section does not require a bank to make efforts to bring the loan into conformity if to do so would be inconsistent with safe and sound banking practices. In addition, the final rule adds that loans that exceed a bank's

lending limit as a result of changes in the capital rules or because borrowers subsequently become a common enterprise will be treated as nonconforming.

Finally, in response to commenters, the final rule changes the treatment of loans that qualify for a lending limit exemption because they are secured by certain collateral, such as U.S. government obligations. Under the former rule, as well as the proposal, a national bank was required to bring a loan into conformity through restoration of the market value of the collateral or by reducing the amount of the bank's loan by the amount that exceeds the lending limit within five business days. Several commenters characterized the five day correction period as arbitrary and unrealistic.

The OCC recognizes that there are circumstances beyond the bank's control which might cause a loan of this type to violate the lending limit, because of a decline in collateral value. Instead of the five day period, the final rule requires that a bank bring these loans into conformity within 30 calendar days. During that 30 day period, the loan will be treated as nonconforming. The OCC believes this change will provide a more realistic period to enable a bank to address restoration of proper collateral for a loan without forcing a precipitous divestiture of all or part of the loan that would not be in the best interests of the bank.

#### *Effective Date*

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994, 12 U.S.C. 4802, requires that a regulation that imposes new requirements take effect on the first day of the quarter following publication of the final rule. That section provides, however, that an agency may determine that the rule should take effect earlier.

The OCC believes that this regulation relieves burden by eliminating inefficient and unduly costly regulatory requirements and better focusing the lending limit rules on areas of greatest safety and soundness concern. These revisions to part 32 should not be further delayed. Accordingly, the final rule is effective 30 days after publication.

#### **Derivation Table**

Only substantive modifications, additions and changes are indicated.