

DEPARTMENT OF THE TREASURY**Office of the Comptroller of the
Currency****12 CFR Part 32****[Docket No. 01-12]****RIN 1557-AB82****Community Bank-Focused Regulation
Review: Lending Limits Pilot Program****AGENCY:** Office of the Comptroller of the
Currency, Treasury.**ACTION:** Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is publishing a final rule amending part 32, the regulation governing the percentage of capital and surplus that a national bank may loan to any one borrower. This final rule establishes a three-year pilot program that creates new special lending limits for 1-4 family residential real estate loans and loans to small businesses. Eligible national banks with main offices located in states that have a lending limit available for residential real estate, small business or unsecured loans that is higher than the current Federal limit may apply to take part in the pilot program. We will review and evaluate national banks' experience with the special limits over the three-year pilot period and determine at the end of the pilot whether to extend the program and retain, modify or rescind the exceptions. The final rule also permanently modifies the lending limit exemption for loans to or guaranteed by obligations of state and local governments.**EFFECTIVE DATE:** The final rule is effective on September 10, 2001.**FOR FURTHER INFORMATION CONTACT:** Deborah Katz, Senior Counsel, or Stuart Feldstein, Assistant Director, Legislative and Regulatory Activities Division, (202) 874-5090; Jonathan Fink, Senior Attorney, Bank Activities and Structure Division (202) 874-5300.**Background**

On May 12, 1999, the OCC issued an advance notice of proposed rulemaking (ANPR) inviting comment on possible regulatory changes that could benefit community banks. 64 FR 25469. The purpose of this community bank-focused regulation review was to explore ways that our regulations could be modified, consistent with safety and soundness, to reflect the fact that community banks operate with more limited resources and often present different risk profiles than larger institutions. We sought to identify

regulations where it would be appropriate to develop alternative or differential regulatory approaches that would minimize burden on community banks and promote community banks' competitiveness.

We received thirty-five letters in response to the ANPR commenting on various aspects of the national bank lending limit. Twelve U.S.C. 84, the national bank lending limit, governs the percentage of capital and surplus that a bank may loan to any one borrower. OCC regulations implementing section 84 are set forth at 12 CFR 32. Under section 84 and part 32, a national bank can make unsecured loans of up to 15 percent of its unimpaired capital and surplus to a single borrower and extend an amount up to an additional 10 percent of unimpaired capital and surplus to the same borrower, if the amount of the loan that exceeds the 15 percent limit is secured by "readily marketable collateral." Part 32 refers to these lending limits as "the combined general limit." The statute and regulation also provide other exceptions to and exemptions from the combined general limit for various types of loans and extensions of credit. Finally, the statute authorizes the OCC to establish lending limits "for particular classes or categories of loans" that are different from those expressly provided by the statute's terms. 12 U.S.C. 84(d)(1).

A majority of commenters on the ANPR stated that the national bank lending limits are especially problematic for community banks because, according to these commenters, the current lending limits have prevented many community banks from continuing to lend to creditworthy customers, and that this has caused a loss in potential income, especially from valued customers whose credit needs have increased with the growth of their businesses or increase in local property values. Many commenters also noted that some states provide higher lending limits than those set forth in section 84 and part 32. These commenters suggested that Federal lending limits should be the same as those available for state banks so that national banks can compete on an equal basis with other financial service providers in the markets they serve.

On September 22, 2000, the OCC issued a notice of proposed rulemaking (NPRM) soliciting comment on a pilot program to modify certain aspects of the lending limit to respond to these concerns (65 FR 57292). We proposed to use the authority afforded by section 84(d)(1) to create new exceptions or special lending limits for loans secured by 1-4 family residential real estate and

loans to small businesses for banks with main offices located in states where a lending limit higher than the current Federal limit applies. To ensure that national banks use this additional lending authority in a way that is consistent with safe and sound banking practices, we proposed making the new special limits available only to "eligible banks," subject to an application process. We also proposed an aggregate limit on the amount a bank could lend under this new authority. The proposal stated that OCC would review national banks' experience with the new exceptions over the three-year pilot period and determine whether to retain, modify, or rescind the exceptions.

The proposed rule also contained a separate amendment to part 32 that modified the requirements for obtaining a lending limit exemption for loans to or guaranteed by obligations of state and local governments.

Overview of Comments Received

The NPRM was published in the **Federal Register** on September 22, 2000. The public comment period closed on November 21, 2000. The OCC received seventeen comments on the proposal, including comments from one individual, one savings and loan association, ten banks, one bank holding company and four bank trade associations.

The majority of the commenters strongly supported the proposal as an effort to reduce regulatory burden on community banks and to enhance the ability of community banks to compete in today's banking environment. The majority of commenters also specifically supported the new special lending limits. They stated that an increase in the lending limit is essential to level the playing field for community national banks operating in states with a higher lending limit. One commenter suggested that an increase in the lending limits would enhance safety and soundness because it would minimize loan participations and thus allow a bank to manage the risk of a credit "without outside influences or outside changes in policy."

One commenter also suggested that the OCC implement the regulation as a permanent modification to the lending limit, instead of as a pilot project. This commenter thought that the expense involved in implementing the pilot program may not be recouped by the marginal profits made on any loans extended at the higher limits and would discourage banks from taking advantage of the pilot. The commenter suggested that, in place of a pilot program, the OCC consider permanently raising the

limit by five percent and then, after three years, consider an additional five percent increase. Finally, two commenters thought that the regulatory burden created by the conditions imposed by the proposal governing a bank's ability to take advantage of the new exceptions would compromise any benefits that might be gained from the proposal.

We have considered these comments carefully, but have determined not to modify the proposal in the ways suggested by these commenters. The Federal lending limit is an important safeguard against undue concentration of credit risk in the national banking system. Adjustments to the limit need to be calibrated to enable both the OCC and the banks affected to gauge the impact of additional flexibility. In our view, the incremental approach reflected in the proposal best achieves that objective, as a first step. Accordingly, after consideration of the comments received, we have adopted a final regulation that is similar to the proposal, with some modifications and the clarifying changes that are described below. Because the final rule establishes a pilot program, however, there will be an opportunity to revisit the constraints imposed by the proposal at any time, and certainly as the three-year timeframe of the pilot nears a conclusion.

Section-by-Section Analysis

New Special Limits for 1-4 Family Residential Real Estate and Small Business Loans

1. Categories of Loans Chosen for Special Limits

Proposed § 32.3(b)(6) contained new limits for two categories of loans: Those secured by 1-4 family residential real estate and small business loans. The proposal solicited comment on whether the categories of loans identified would alleviate the burden and mitigate some of the competitive disparity for community banks.

Several commenters, including those from trade associations representing community banks, urged the OCC to revise the proposal to include farm loans. These commenters urged the OCC to include agricultural loans in the pilot, so that rural community banks could benefit from the proposal. The commenters suggested that agricultural loans are no riskier than small business loans. In addition, some commenters noted that agricultural community banks have comparable experience and expertise in making farm loans as they do small business loans. Other commenters suggested that the OCC

create new limits for secured or unsecured commercial loans.

We have decided not to expand the categories of loans subject to special limits until we have some experience with the new limits initially proposed for the pilot. We will continue to analyze the risk characteristics of agricultural loans of different types (e.g., secured by farmland or by crops) to determine whether the goals of the pilot program would be furthered by including some categories of agriculture loans.¹

Accordingly, in beginning this pilot, we have chosen categories—residential real estate and small business loans—that represent typical, longstanding business lines for most community banks. In this way, we hope to obtain information and experience about the effects of the pilot program modifications to the lending limit on a broad cross-section of community banks. We expect to use what we learn, not only as the basis for deciding whether the new special limits should be continued beyond the 3-year pilot period, but also for considering whether more categories of loans should be added.

2. Limit for Residential Real Estate Loans

Under the proposal, the special limit in § 32.3(b)(6)(i) applied to “residential real estate loans,” defined under § 32.2(p) to mean only loans secured by a perfected first-lien security interest in 1–4 family residential real estate in an amount that did not exceed 80 percent of the appraised value of the collateral at the time the loan was made.

The OCC received one comment on this special limit. The commenter questioned whether an increased lending limit for 1–4 family homes will have any impact because few community banks make large dollar residential real estate loans to one borrower. Based upon our experience with community banks, however, we continue to believe that this special limit will be helpful to community banks located in areas where the price of real estate is high. Therefore, § 32.7(a)(1) of the final rule retains a special limit for residential real estate loans.

¹ The lending limit statute and regulations currently contain special enhanced limits for certain loans secured by documents transferring or securing title to readily marketable staples (35 percent, in addition to the bank’s combined general limit), livestock and dairy cattle (both 10 percent, in addition to the bank’s combined general limit). See 12 U.S.C. 84(c)(3), 12 CFR 32.3(b)(1); 12 U.S.C. 84(c)(9)(A), 12 CFR 32.3(b)(3); 12 U.S.C. 84(c)(9)(B), 12 CFR 32.3(b)(4).

However, the final rule contains a clarification of the definition of “residential real estate loans.” The definition was used to determine whether a state had a higher lending limit for residential real estate loans and to restrict the type of real estate loan that a national bank could make under the authority contained in the pilot program. The final rule moves the requirements that residential real estate loans be secured by a “perfected first-lien” and can “not exceed 80 percent of the appraised value of the collateral at the time the loan was made” from the definition of a residential real estate loan to the description of which loans qualify for the pilot program contained in § 32.7(a)(1). This change clarifies that a national bank will be required to comply with certain prudential requirements when making residential real estate loans, but will not be disqualified from participating in the pilot program because a state’s lending limits contain different prudential limits for residential real estate loans, for example, a lower loan-to-value ratio.

3. Limit for Small Business Loans

The proposed special limit in § 32.3(b)(6)(ii) for “small business loans,” defined in § 32.2(r), extended additional lending authority for loans that could be unsecured, or secured in a manner that is not specified by regulation. The proposal invited comment on whether the special limit for small business loans should require specific collateral.

One commenter suggested requiring the borrower to provide real estate collateral to use the expanded lending authority for small business loans. Other commenters recommended that collateral not be required. One reasoned that only well run banks will be able to use this special limit and they will likely have prudent lending policies that require collateral as appropriate. The remaining commenters felt that such loans should be secured by specific collateral only if this requirement is imposed on state banks.

Small business loans are typically secured by many different types of collateral. Accordingly, the OCC has concluded that to specify the type of collateral required would impose undue constraints on the use of this special limit. Therefore, the rule does not require that the borrower secure small business loans in order for the loan to qualify under the pilot program. The type of small business loans eligible for the special limit is adopted as proposed, in section § 32.2(r) of the final rule, with some adjustment to the definition of

“small business loan” as discussed below.

Section 32.2(r) of the proposal defined “small business loan” by cross-referencing the definition of “loans to small businesses” from the instructions for preparation of the Consolidated Reports of Condition and Income (Call Report). This definition includes “loans with original amounts of \$1 million or less,” * * * “secured by nonfarm nonresidential properties,” and certain “commercial and industrial loans.” The NPRM requested comment on the definition of “small business loan.”

One commenter thought that the cross-reference to the Call Report was difficult to find and urged that the regulation include its own definition of small business loan. Another commenter suggested that the OCC eliminate the \$1 million cap on small business loans and permit a bank to loan the lesser of \$10 million or 10 percent of its capital to any one company.

We continue to believe that a cross-reference to the Call Report is a readily available and easy-to-use method of defining business loans. Moreover, banks are familiar with the Call Report definitions which they regularly use when filing their quarterly Call Reports. However, we agree that the dollar limitation in the Call Report definition of “loans to small businesses” is unnecessary because of the separate percentage and dollar limits established as part of the special limit for small business loans. Therefore, the final rule eliminates the \$1 million cap that was part of the definition of small business loan. However, the definition continues to identify the small business loans covered by the pilot program by cross-reference to the definitions of “secured by nonfarm nonresidential properties,” and “commercial and industrial loans” set forth in the Call Report instructions, Schedule RC–C, Part I (rev. 3–01).

4. Additional Lending Authority

Under § 32.3(b)(6) of the proposal, a bank was permitted to extend another ten percent of its capital and surplus, in addition to the amounts permissible under the currently applicable lending limits, to a single borrower for certain real estate and small business loans, respectively, if a bank’s main office was located in a state with a higher limit that applies to these categories of loans.

Commenters on this provision, including those representing community banks, agreed that ten percent is an appropriate and sufficient amount to alleviate the current competitive disadvantage faced by community banks. However, one

commenter thought that the limits per borrower should be the same as state-chartered non-member banks.

A regulation that would provide exact parity between a national and a state bank located in the same state would be complicated if the goal is to achieve lending limit parity for all fifty states, but only for two categories of loans, and no others. We believe that this complexity would reduce the utility of the new special limits. For this reason, we originally proposed allowing national banks in the pilot program to simply extend ten percent of its capital and surplus to a single borrower for real estate and small business loans, respectively, if a bank's main office is located in a state with a higher limit available for these categories of loans, without regard to the amount of the state limit. However, it is not the goal of the pilot program to provide national banks with a competitive advantage over similarly situated state banks in states where the applicable limit is lower than the additional 10 percent we proposed to permit for national banks. Thus, we have modified the two special limits in § 32.7(a)(1) and (2) of the final rule to permit additional extensions of credit to a single borrower in the lesser of the following two amounts: (i) 10 percent of its capital and surplus; or (ii) the percentage of capital and surplus that a state bank is permitted to lend under a state lending limit that would be available for residential real estate, small business or unsecured loans in the state where the main office of the national bank is located and that exceeds 15 percent—the general unsecured limit for national banks set forth in 12 CFR 32.2(a). Under this approach, for example, in any state where the state unsecured limit is 20 percent (and the state has no other, higher, special lending limit available for 1–4 family residential real estate loans or small business loans), the special limits available to a national bank under the pilot program would be the lesser of 5 percent or \$10 million.

Section 32.3(b)(6) of the proposal also provided that to be eligible for the pilot program a national bank's main office had to be located in a state where the "state lending limit" that is available for residential real estate or small business loans is higher than the limit for national banks. However, state lending limits may involve higher percentage limits, a different method of calculating the percentage of bank capital and surplus that can be loaned to a single borrower, or different rules for combining loans. In order to simplify this process, the special limits described above now make clear that only

situations where the state has a higher percentage limit that would be available for residential real estate or small business loans will trigger a national bank's eligibility for the pilot program.

The preamble to the proposed regulations also stated that to demonstrate its eligibility for the pilot program, a bank could reference a state's "specific, general or other limit that applies to 1–4 family residential real estate or small business loans." Sections 32.7(a)(1) and (2) now clarify that the applicable limit is the state lending limit for state banks that is available for residential real estate loans or small business loans, as defined in the final rule, or the state unsecured limit. Thus, for example, where the state unsecured limit is 20 percent and the state also has a 5 percent special lending limit available for 1–4 family residential real estate loans, the special limits available to a national bank would be the lesser of 10 percent or \$10 million for residential real estate loans, and the lesser of 5 percent or \$10 million for small business loans.²

5. Applicable Safeguards

The proposal incorporated a number of safeguards to ensure that a national bank's use of the additional authority provided by the new special limits is consistent with safety and soundness. The OCC solicited comment on each of these safeguards and invited comment on whether additional safeguards were warranted.

The first proposed safeguard, set forth in proposed § 32.3(b)(6)(i) and (ii), was a dollar cap of \$10 million dollars limiting loans to a single borrower for real estate and small business loans, respectively, in addition to the percentage limits described in the preceding section, for loans made in reliance upon the new special limits.

We received one comment on this dollar cap from a trade association representing community banks. This commenter stated that the \$10 million cap is adequate for the majority of community national banks. We believe this limit is appropriate, particularly during the period of the pilot program. Therefore, this safeguard is adopted as proposed in § 32.7(a)(1) and (2) of the final rule.

The second proposed safeguard, found in § 32.3(b)(6)(iii), was an aggregate lending cap on all loans, to all

² However, as described in section 6, below, the total outstanding amount of a national bank's loans and extensions of credit to one borrower made pursuant to 12 CFR 32.3(a) and (b), together with loans and extensions of credit to the borrower made under the pilot program, cannot exceed 25 percent of the bank's capital and surplus.

of a bank's borrowers made in reliance upon the real estate and small business special limits. Under the proposal, the total amount of these loans, or portions of loans, together, could not equal more than 100 percent of a bank's capital and surplus.

Some commenters supported an aggregate lending cap. Other commenters thought that the aggregate cap would create an unnecessary burden and would make compliance with part 32 more complicated as national banks will have to keep track of aggregate totals. Some commenters thought that the proposed aggregate cap was too restrictive and should be increased to 150 or 200 percent of capital.

We agree that the aggregate cap will require banks to monitor the total amount of loans extended under this new authority. However, this additional requirement is consistent with the purpose of the cap. Throughout, and at the conclusion of the pilot program, we will be in a position to consider whether the cap is too restrictive and whether it should be increased. Therefore the aggregate cap is adopted as proposed in § 32.7(a)(4).

The third safeguard made the special limits in § 32.3(b)(6)(i) and (ii) available only to "eligible banks," defined in § 32.2(i), as a bank that is well capitalized, as defined in 12 CFR 6.4(b)(1),³ and has a rating of 1 or 2 under the Uniform Financial Institutions Rating System, with at least a rating of 2 for the management component of this rating system.

We did not receive any comments on this safeguard, however, upon further consideration, we have determined that adding the qualification that the bank must have received a rating of at least 2 for the asset quality component of its rating to the other qualifications of an "eligible bank," will help to ensure that only those banks that have demonstrated sound lending practices are eligible to participate in the pilot program. Accordingly, the final rule includes this qualification standard, in addition to those proposed.

In addition, § 32.3(b)(6)(iv) of the proposed rule required a bank to apply

³ Under 12 CFR 6.4(b), "well capitalized" means that the bank: (1) Has a total risk-based capital ratio of 10.0 percent or greater; (2) has a Tier 1 risk-based capital ratio of 6.0 percent or greater; (3) has a leverage ratio of 5.0 percent or greater; and (4) is not subject to any written agreement, order or capital directive, or prompt corrective action directive issued by the OCC pursuant to section 8 of the Federal Deposit Insurance Act (FDI Act), the International Lending Supervision Act of 1983 or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

to its supervisory office and receive approval before using either of the new special limits. The proposal required an application to contain the following information to be deemed complete: (1) Certification that the applicant is an eligible bank; (2) citation to relevant state laws or regulations showing that the bank's main office is located in a state where the state lending limit available for residential real estate or small business loans or unsecured loans is higher than the limit for national banks; (3) a written resolution by the majority of the bank's board of directors approving the use of the new special limits and confirming the terms and conditions for use of this lending authority; and (4) a description of how the bank's board intends to exercise its continuing responsibility to oversee the use of this lending authority.

While one commenter supported this application procedure, most commenters criticized this approach as too complicated and burdensome. Two commenters suggested that the OCC consider establishing minimum requirements and a notice procedure, for example, for banks that are 1 or 2 rated and "well-capitalized." One of these commenters felt that the application requirement would create unnecessary paperwork and discourage banks from making use of this new lending authority.

We believe that an application process will better enable us to monitor use of the new lending authority and will help to ensure bank safety and soundness is not compromised under the pilot program. We will revisit the application requirement after we have had experience with the benefits, as well as burdens, that arise. Therefore, § 32.7(b) of the final rule adopts the proposed application procedures with the clarifying changes noted below.

Some commenters specifically objected to the requirement in § 32.3(b)(6)(iv)(B) that the application cite to relevant state laws and regulations showing that the bank's main office is located in a state with higher lending limits available for residential real estate or small business loans. One commenter suggested that the OCC expand the lending authority to all banks without regard to where a bank's main office is located. This commenter noted that nothing in 12 U.S.C. 84 requires competitive equality between national and state-chartered banks. Another commenter thought that the regulation should reference the location of the origination of the loan, and not the location of the head office of the bank, since that is the location where a bank will be competing.

The special limits are designed to afford some degree of competitive parity between national banks and state chartered lenders. Therefore, these new limits are available only to banks located in states where they are operating at an artificial competitive disadvantage as compared to state banks. The second commenter seems to suggest that the state lending limit of the location of the borrower should determine whether a special limit applies. Determining the location of a borrower often may be complicated. For example, a company may be incorporated in Delaware and have offices in multiple states. Further, this suggestion would be inconsistent with the OCC's approach in other areas where the location of the bank, rather than the borrower, is the operative control. Therefore, we have not adopted this suggestion.

Finally, because state lending limits vary so greatly among the states, the scope of a national bank's ability to use the pilot program may be unclear. Where such questions arise, the OCC's Chief Counsel will determine the extent to which the pilot program is available for national banks located in a particular state.

6. New Safeguards

The OCC also has determined that two additional safeguards are necessary to balance the flexibility afforded to banks through the new special limits with safety and soundness concerns. The first of these safeguards addresses a concern that a bank's use of the special limits, together with its combined limit and the other available statutory limits, may result in an undue concentration of loans to a single borrower. To address this issue, § 32.7(a)(3) of the final rule provides that the total outstanding amount of a national bank's loans and extensions of credit to one borrower made pursuant to § 32.3 (a) and (b),⁴ together with loans and extensions of credit to the borrower made under the pilot program, cannot exceed 25 percent of the bank's capital and surplus.

As is the case with all the general and specific lending limits, these new special lending limit thresholds do not insulate loans below the thresholds from supervisory oversight. Thus, loans within the parameters of the pilot program are still subject to criticism if

⁴ Section 32.3 is the provision containing the general and existing special lending limits and exceptions to the lending limits. This section includes a bank's combined general limit for unsecured loans and loans secured by readily marketable collateral (§ 32.3(a)); and other special lending limits (§ 32.3(b)), such as limits for loans secured by documents covering livestock.

they are poorly underwritten, poorly administered, or if loans made under the program are part of an excessive concentration by a bank in certain types of loans.⁵

Moreover, we also have included in the final rule a procedure to rescind a bank's authority to use the special lending limits in the event that safety and soundness problems arise. Under § 32.7(a)(4)(d) of the final rule, the OCC reserves the right to rescind a bank's authority to use the special lending limits, based upon concerns about credit quality, undue concentrations in the bank's portfolio of residential or small business loans, or about a bank's overall credit risk management systems and controls. The bank must cease new extensions of credit in reliance on the special lending limits after receiving written notice from the OCC that its authority has been rescinded.

7. Duration of Approval

The proposed rule was structured as a three-year pilot program. However, § 32.3(b)(v) of the proposal stated that OCC approval of a bank's authority to use the special limits would be effective for three years and could be renewed. Section 32.7(c) of the final rule corrects this provision by clarifying that a bank that has received OCC approval to participate in the pilot program may continue to make loans under the special lending limits only for the duration of the three-year program, provided the bank remains an eligible bank. Accordingly, a bank that receives OCC approval to participate in the pilot program one year after the effective date of this regulation may use the authority granted under this pilot program for no longer than two more years.

8. Duration of Program

As described above, the proposed rule was structured as a three-year pilot program. The final rule retains the three-year duration that we proposed. Accordingly, new section § 32.7(e) of the final rule contains an express termination date of June 11, 2004. This section also states that the OCC also retains the ability to terminate the pilot program prior to that date. We contemplate that the circumstance where the pilot program could be terminated early would be where our monitoring of loans made under the program indicates that overall experience with the program is raising

⁵ The documentation exemption described in the "Interagency Policy Statement on Documentation for Loans to Small- and Medium-sized Businesses and Farms" contained in Banking Bulletin 93-18, issued by the OCC on April 2, 1993, is not available for loans made under the Pilot Program.

significant safety and soundness concerns. Prior to the conclusion of the three-year pilot program the OCC will evaluate the experience under the program and determine whether, and under what circumstances, the program should be extended. In its evaluation of the program and its consideration of conditions under which the program might be extended, the OCC will consider, among other matters, whether increases in concentration resulting from any new authority should be offset by additional portfolio diversification requirements.

9. Transition Issues

The preamble to the proposal stated that as long as a bank was "eligible," any loan made by the bank during the three year period following approval would remain legal, even if the bank subsequently became ineligible.

Two comments raised transition issues. One commenter requested that the OCC clarify that a national bank that made a loan in compliance with the pilot program would not be found in violation of part 32 if the bank subsequently were to become disqualified as an eligible bank during the three-year period. A second commenter requested that the OCC clarify that any loans made when a bank was eligible to use the higher limits will not have to be reduced or called early, if after three years, the bank becomes ineligible or the program is discontinued.

We agree that various transition issues may arise and should be addressed in the final rule. Therefore, § 32.7(f) of the final rule now clarifies that loans made by a bank in compliance with the requirements of the pilot program will not be deemed a lending limit violation and will not be treated as nonconforming under § 32.6 if, for example, the bank becomes ineligible or the pilot program is discontinued. However, no additional funds may be advanced to the borrower as long as the outstanding amount of a national bank's loans and extensions of credit to the borrower exceed the lending limit.

Exemptions for Loans Secured by State and Local Governments

Part 32 provides that a loan or extension of credit made by a national bank to, or guaranteed by general obligations of a State or political subdivision is exempt from any lending limit. See 12 CFR 32.3(c)(5). The term "general obligation" is defined in 12 CFR part 1. In addition, to obtain this exemption, this section currently requires the bank to obtain an opinion of counsel that the loan or extension of

credit or guarantee is a valid and enforceable general obligation of the State or political subdivision. However, the requirement for an opinion of counsel is not statutorily required.

The proposed rule revised § 32.3(c)(5) to allow a bank to either obtain an opinion of counsel or rely on the opinion of a State attorney general (or other State legal official with authority to opine on the obligation in question) on the validity and enforceability of the obligation, extension of credit, or guarantee in question. All but one commenter supported this change. These commenters agreed that obtaining an opinion of counsel can be expensive and time consuming for community banks, particularly for those banks that make a substantial number of agricultural loans under loan guarantee programs. They stated that allowing community banks to rely upon an opinion of a State's attorney general is a significant improvement.

One commenter thought that it would be more difficult to obtain an opinion of a state's attorney general than an opinion of counsel. The OCC notes that this provision provides national banks with more and not less flexibility. It will permit a bank to obtain *either* an opinion of counsel, an opinion of a state's attorney general or other State legal official with authority to opine on the obligation in question, whichever is easier. Moreover, in some cases, banks may be able to rely on existing opinions from state officials to satisfy this requirement. See, e.g., OCC Interpretive Letter No. 899 (May 15, 2000), *reprinted in* Fed. Banking L. Rep. (CCH) ¶81-418 (for purposes of qualifying for the exemption in 12 CFR 32.3(c)(5), national banks may rely on an Illinois Attorney General opinion providing that loans guaranteed by the Illinois Farm Development Authority are backed by the full faith and credit of the State of Illinois). Therefore, this provision is adopted as proposed in § 32.3(c)(5) of the final rule.

Regulatory Analysis

A. Paperwork Reduction Act

The OCC may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

OMB has reviewed and approved the collection of information requirements contained in this rule under control number 1557-0221, in accordance with the Paperwork Reduction of 1995 (44 U.S.C. 3501 *et seq.*). OMB clearance will expire on December 31, 2003.

The OCC sought comment on all aspects of the burden estimates for the information collection contained in the proposed rule. The OCC received no comments.

The information collection requirements contained in 12 CFR part 32 are contained in section 32.7(b). Under this section, the final regulation would require national banks to provide the OCC with certain information in connection with an application to receive approval from its supervisory office before using the new special lending limits for 1-4 family residential real estate loans and loans to small businesses for national banks.

The potential respondents are national banks.

Estimated number of respondents: 2,140

Estimated number of responses: 2,140

Estimated burden hours per response:

26

Estimated total burden: 55,640

The OCC has a continuing interest in the public's opinion regarding collections of information. Members of the public may submit comments, at any time, regarding any aspects of these collections of information. Comments may be sent to Jessie Dunaway, Clearance Officer, Office of the Comptroller of the Currency, 250 E Street, SW, Mailstop 8-4, Washington, DC 20219.

B. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (RFA), 5 U.S.C. 605(b), the regulatory flexibility analysis otherwise required under section 603 of the RFA, 5 U.S.C. 603, is not required if the head of the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and the agency publishes such certification and a statement explaining the factual basis for such certification in the **Federal Register** along with its final rule.

On the basis of the information currently available, the OCC is of the opinion that this final rule will not have a significant impact on a substantial number of small entities, within the meaning of those terms as used in the RFA. The final regulation requires national banks that would like to participate in the pilot program to submit an application containing certain information and receive approval from its supervisory office before using the new special limits for 1-4 family residential real estate loans and loans to small businesses. However, the OCC does not believe that this application requirement will have a significant

impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis not required.

C. Executive Order 12866 Determination

The Comptroller of the Currency has determined that this final rule would not constitute a "significant regulatory action" for the purposes of Executive Order 12866. Under the most conservative cost scenarios that the OCC can develop on the basis of available information, the impact of the final rule falls well short of the thresholds established by the Executive Order.

D. Unfunded Mandates Reform Act of 1995 Determinations

Section 202 of the Unfunded Mandates Reform Act of 1995, 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 the agency to identify and consider a reasonable number of regulatory alternatives before promulgating the rule. However, an agency is not required to assess the effects of its regulatory actions on the private sector to the extent that such regulations incorporate requirements specifically set forth in law. 2 U.S.C. 1531.

The OCC has determined that this final rule will not result in expenditures by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

List of Subjects in 12 CFR Part 32

National banks, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set forth in the preamble, part 32 of chapter I of title 12 of the Code of Federal Regulations is amended as follows:

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, and 93a.

2. In § 32.2:

A. Paragraph (p) is redesignated as paragraph (s);

B. Paragraph (o) is redesignated as paragraph (q);

C. Paragraphs (i) through (n) are redesignated as paragraphs (j) through (o); and

D. New paragraphs (i), (p), and (r) are added to read as follows:

§ 32.2 Definitions.

* * * * *

(i) Eligible bank means a national bank that:

(1) Is well capitalized as defined in 12 CFR 6.4(b)(1); and

(2) Has a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System in connection with the bank's most recent examination or subsequent review, with at least a rating of 2 for asset quality and for management.

* * * * *

(p) Residential real estate loan means a loan or extension of credit that is secured by 1-4 family residential real estate.

* * * * *

(r) Small business loan means a loan or extension of credit "secured by nonfarm nonresidential properties" or "a commercial or industrial loan" as defined in the instructions for preparation of the Consolidated Report of Condition and Income.

* * * * *

3. In § 32.3, paragraph (c)(5) is revised to read as follows:

§ 32.3 Lending limits.

* * * * *

(c) * * *

(5) Loans to or guaranteed by general obligations of a State or political subdivision. (i) A loan or extension of credit to a State or political subdivision that constitutes a general obligation of the State or political subdivision, as defined in part 1 of this chapter, and for which the lending bank has an opinion of counsel or the opinion of that State Attorney General, or other State legal official with authority to opine on the obligation in question, that the loan or extension of credit is a valid and enforceable general obligation of the borrower; and

(ii) A loan or extension of credit, including portions thereof, to the extent guaranteed or secured by a general obligation of a State or political subdivision and for which the lending bank has an opinion of counsel or the opinion of that State Attorney General, or other State legal official with authority to opine on the guarantee or collateral in question, that the guarantee or collateral is a valid and enforceable general obligation of that public body.

* * * * *

4. A new § 32.7 is added to read as follows:

§ 32.7 Pilot program for residential real estate and small business loans.

(a) Residential real estate and small business loans. (1) In addition to the amount that a national bank may lend to one borrower under § 32.3, an eligible national bank may make residential real estate loans or extensions of credit to one borrower in the lesser of the following two amounts: 10 percent of its capital and surplus; or the percent of its capital and surplus, in excess of 15 percent, that a State bank is permitted to lend under the State lending limit that is available for residential real estate loans or unsecured loans in the State where the main office of the national bank is located. Any such loan or extension of credit must be secured by a perfected first-lien security interest in 1-4 family real estate in an amount that does not exceed 80 percent of the appraised value of the collateral at the time the loan or extension of credit is made. In no event may a bank lend more than \$10 million to one borrower under this authority.

(2) In addition to the amount that a national bank may lend to one borrower under § 32.3, an eligible national bank may make small business loans or extensions of credit to one borrower in the lesser of the following two amounts: 10 percent of its capital and surplus; or the percent of its capital and surplus, in excess of 15 percent, that a State bank is permitted to lend under the State lending limit that is available for small business loans or unsecured loans in the State where the main office of the national bank is located. In no event may a bank lend more than \$10 million to one borrower under this authority.

(3) The total outstanding amount of a national bank's loans and extensions of credit to one borrower made under §§ 32.3(a) and (b), together with loans and extensions of credit to the borrower made pursuant to paragraphs (a)(1) and (2) of this section, shall not exceed 25 percent of the bank's capital and surplus.

(4) The total outstanding amount of a national bank's loans and extensions of credit to all of its borrowers made pursuant to the special lending limits provided in paragraphs (a)(1) and (2) of this section may not exceed 100 percent of the bank's capital and surplus.

(b) Application process. An eligible bank must submit an application to, and receive approval from, its supervisory office before using the special lending limits in paragraphs (a)(1) and (2) of this section. The supervisory office may approve a completed application if it

finds that approval is consistent with safety and soundness. To be deemed complete, the application must include:

(1) Certification that the bank is an "eligible bank" as defined in § 32.2(i);

(2) Citations to relevant State laws or regulations;

(3) A copy of a written resolution by a majority of the bank's board of directors approving the use of the limits provided in paragraphs (a)(1) and (2) of this section, and confirming the terms and conditions for use of this lending authority; and

(4) A description of how the board will exercise its continuing responsibility to oversee the use of this lending authority.

(c) *Duration of approval.* Except as provided in § 32.7(d), a bank that has received OCC approval may continue to make loans and extensions of credit under the special lending limits in paragraphs (a)(1) and (2) of this section until the date three years after September 10, 2001, provided the bank remains an "eligible bank."

(d) *Discretionary termination of authority.* The OCC may rescind a bank's authority to use the special lending limits in paragraphs (a)(1) and (2) of this section based upon concerns about credit quality, undue concentrations in the bank's portfolio of residential or small business loans, or concerns about the bank's overall credit risk management systems and controls. The bank must cease making new loans or extensions of credit in reliance on the special limits upon receipt of written notice from the OCC that its authority has been rescinded.

(e) *Duration of pilot program.* The pilot program will terminate on June 11, 2004, unless it is terminated sooner by the OCC.

(f) *Existing loans.* Any loans or extensions of credit made by a bank under the special lending limits in paragraphs (a)(1) and (2) of this section, that were in compliance with this section when made, will not be deemed a lending limit violation and will not be treated as nonconforming under § 32.6.

Dated: May 31, 2001.

John D. Hawke, Jr.,

Comptroller of the Currency.

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