August 6, 2012

Office of the Comptroller of the Currency
250 E Street SW
Mail Stop 2-3
Washington, DC 20219
Docket ID OCC-2012-0007; RIN 1557-AD59

Re: Lending Limits

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("**The Clearing House**"), the American Bankers Association (the "**ABA**") and The Financial Services Roundtable ("**The Roundtable**" and, together with The Clearing House and the ABA, the "**Associations**")[1] appreciate the opportunity to comment on the interim final rule (the "**Rule**")[2] issued by the Office of the Comptroller of the Currency (the "**OCC**") pursuant to Section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").[3] Section 610 amends the statutory definition of "extensions of credit" for purposes of calculating the lending limit applicable to national banks and state and federal savings associations (together, "**banks**") to include credit exposures arising from derivative and securities financing transactions.[4]

The Associations and their members support a robust and effective regulatory system, and a fundamental element of that system is appropriately designed rules to limit risk concentrations, including exposures of a bank to a single counterparty. The Associations acknowledge and appreciate the OCC's efforts to develop a rule that accomplishes this regulatory objective while allowing banks flexibility in implementation. This flexibility both

1 The Associations collectively represent financial institutions accounting for a substantial majority of banking and financial assets in the United States. Descriptions of the Associations are provided immediately following the signature page of this comment letter.

2 77 Fed. Reg. 37265 (June 21, 2012).

3 Pub. L. No. 111-201 (2010).

4 The Rule also includes a number of provisions relating to the OCC's restructuring of the lending limit rules applicable to savings associations. These amendments are not discussed in this comment letter.

enables small- and medium-sized banks to avoid undue regulatory burden by providing optional simplified approaches to calculating credit exposure and enhances safety and soundness at banks with larger portfolios by providing consistency with their accepted risk management practices that utilize internal models. In summary, neither the model nor the non-model approach is optimal for every bank, and one of the Rule's major attributes is its flexibility in permitting each bank to make the best choice for it.

We recognize that models can never be flawless, and credit exposure models should be eligible for use only after a rigorous review by both the appropriate Federal banking agency and the bank itself. Moreover, the continued validity of credit exposure models should likewise be subject to a rigorous and frequent review process by both the appropriate Federal banking agency and the bank.

Our letter also addresses several important issues and points of clarification, including some raised by the OCC's questions in its release accompanying the Rule (the "**Lending Limit Release**"), that, if not resolved appropriately, could significantly impair banks' ability to comply with the Rule. The attached **Appendix A** provides responses to a number of the questions raised by the OCC in the Lending Limit Release.

Executive Summary

One of the most pressing concerns we have is the date by which banks must be in compliance with the Rule. Our concern is a function of the volume of work that will need to be done in order for banks to ensure implementation and compliance with the Rule and with other recent rulemakings, as well as the fact that internal models are unlikely to be approved by January 1, 2013. As discussed below in Section I, we believe that an extension of the compliance date until October 1, 2013 is necessary and appropriate in order to give banks sufficient time to incorporate the Rule into bank systems and to develop necessary compliance programs and policies. This extension would also coordinate more closely with other rulemakings addressing similar matters (in particular, the single counterparty credit limit rules proposed by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**")).[5]

Another significant area of timing concern is the approval process for internal models. As discussed in Section II, we believe it is unlikely that banks planning to use any type of internal models would have their models approved and implemented by the current compliance date. Of particular concern, banks that plan to use non-advanced approaches internal models do not have sufficient guidance regarding the parameters for approval, the nature of the approval process or the timeframe in which approval is expected to occur. To the extent the compliance date is extended, this concern would be reduced; however, there still

[5] 77 Fed. Reg. 594 (January 5, 2012).

may be some banks that will not have an approved model by even an extended compliance date. The Rule is not clear as to what calculation regime would apply to banks in that situation. In Section II, we propose that the only practical approach in such circumstances is to permit banks to use, on a provisional basis, their existing models that are used for risk management and other purposes or use models that have been developed but are still in the process of being approved.

Although we believe strongly that the OCC has taken the correct approach in allowing banks to choose between a model and a non-model approach, we believe banks should be given additional flexibility as to which non-model approach they choose to apply. The non-model approaches specified in the Rule may be useful and appropriate for many banks, but for banks that are already using the Basel II A-IRB and current exposure methodology ("**CEM**") for calculating credit exposure, development and implementation of a new, non-model approach would add an unnecessary regulatory burden. As discussed in Section III, we believe the OCC should allow banks to choose this standardized approach as one of the permissible alternatives to using internal models. Also in Section III, we raise several concerns specific to banks planning to use a non-model approach.

With respect to central clearing parties ("**CCPs**"), as discussed in Section IV, we believe that the Rule's approach of including exposures to all CCPs within the definition of credit exposure runs counter to the objective of encouraging the use of CCPs. We believe that, at the very least, the Rule should be modified to exclude exposures to "eligible" CCPs from the lending limit. The OCC would have the authority to define what CCPs are "eligible." By excluding exposures from CCPs (or "eligible" CCPs), the OCC would further incentivize banks to move trading activities into CCPs. This is consistent with the notion throughout Dodd-Frank that trading activities of banks should be conducted through CCPs.

In Sections V and VI (and in other points throughout the letter), we have raised a number of discrete but important concerns that we believe could have serious impacts on banks and could potentially result in market disruptions or reduced credit availability, if not resolved appropriately.

I. Extension of Compliance Date

The Associations and their members appreciate that the OCC has recognized that compliance with Section 610 of Dodd-Frank (and the Rule) by July 21, 2012 was not practical and, accordingly, has provided a temporary extension, until January 1, 2013, of the date by which banks must be in compliance with the provisions of the revised lending limits related to calculating credit exposure arising from derivative and securities financing transactions. We are concerned, however, that the extension will still not give banks sufficient time to develop systems and compliance programs and policies to implement the Rule by January 1, 2013. For example, at some banks, credit approval processes will require adjustments to incorporate credit exposure from derivative and securities financing transactions with that of "traditional" extensions of credit. Credit authorities and exception tracking, which currently may be a separate process for derivative transactions, will need to be combined with the processes for calculating credit exposures from traditional loans and extensions of credit. Internal credit limit policies will need to be adjusted accordingly. Training for credit-related bank personnel will also need to occur. Systems will need to be modified to support the requirements of the Rule, and changes to systems in the fourth quarter of 2012 will be hampered by routine, year-end technology freezes (which limit changes that can be made to bank systems to reduce risk to year-end reporting and processing).

This concern is compounded by the fact that banks and bank holding companies are already devoting significant time, resources and systems changes to comply with a number of rulemakings required by Dodd-Frank. We expect that the time and resource pressures on bank compliance and systems development teams will only increase in the coming months as they develop the numerous systems and programs needed to implement the requirements of the large volume of such rulemakings (with a number of required rulemakings still to be finalized and others still to be introduced). Indeed, just the calculation of "credit exposure" arising from derivatives and securities financing transactions will require significant systems and compliance program development to implement the various, and potentially divergent, regimes that have been proposed for measuring such exposure, including, among others, the Rule and the Federal Reserve's single counterparty credit limits rules (which have not yet been finalized). Moreover, as discussed in this letter, there are certain aspects of the Rule that require additional clarification, and banks will not have a clear picture of what compliance systems, programs and policies need to be developed until those clarifications are made. Because these concerns apply to all banks, there should be a single effective date for all banks as a matter of competitive fairness.

There is an additional concern for banks planning to develop their own internal models ("**Alternative Internal Models**") to measure exposure arising from derivative and securities financing transactions, other than internal models developed (or in the process of development) by some banks to comply with the Federal banking agencies' advanced approaches risk-based capital rules[6] ("**Advanced Approaches Models**"). A bank would use Alternative Internal Models when it chooses to use an internal model approach but is either not eligible for or does not plan to use Advanced Approaches Models. In order to use Alternative Internal Models, a bank is required to seek the approval of its appropriate Federal banking agency under Sections 32.9(b)(1)(i)(C) and 32.9(c)(1)(i) of the Rule. Such banks may have only begun the process of developing Alternative Internal Models when the Rule was promulgated.

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[6] Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule, Joint Notice of Proposed Rulemaking, June 7, 2012 (available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20120607a3.pdf).

Not only will development, testing and implementation of Alternative Internal Models itself require time, but, as discussed in Section II.B below, the Rule provides little guidance regarding the OCC's expectations for Alternative Internal Models and the nature and timeframe for the model approval process. For these reasons and others discussed below, we believe it is unlikely that banks that plan to use an internal model approach (whether Advanced Approaches Models or Alternative Internal Models) will have received approval to use those models by the January 1, 2013 compliance date. We do not believe the regulatory objectives of the Rule would be well served by retaining a compliance date that is not practical for a large number of banks.

The Associations, therefore, urge the OCC to extend the compliance date until October 1, 2013, at the earliest. October 1, 2013 is the effective date specified by the Federal Reserve in its proposed single counterparty credit limits rules.[7] Given the overlap in subject matter, we believe it is appropriate from a bank implementation standpoint that the Rule be coordinated with the single counterparty credit limit rules. We have advocated that the Federal Reserve extend the October 1, 2013 effective date for the proposed rules governing single counterparty party credit limits[8] and believe that, if the Federal Reserve grants such a request, the OCC should consider further extending the compliance date of the Rule to coordinate with the implementation of the single counterparty credit limits.[9]

Extending the compliance date until October 1, 2013 should have little effect on the achievement of the regulatory objectives of Section 610 of Dodd-Frank. As the OCC notes in the Lending Limit Release, even prior to the compliance date of the Rule, the OCC has full authority to address, on a case-by-case basis and through its existing safety and soundness authority, credit exposures that present undue concentrations.[10] We believe that, through this supervisory role, the OCC would be able to oversee the appropriate management of derivative and securities financing risks.

II. Model Approaches

The Associations acknowledge and appreciate that, in allowing banks to use regulator-approved internal models for measuring credit exposures, the OCC has recognized

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7 Section 252.91(a)(2) of the proposed rule (77 Fed. Reg. 594, 649 (January 5, 2012)).

8 Comment letter submitted by the Associations (and other associations) to the Federal Reserve on April 27, 2012, regarding the proposed rules implementing Sections 165 and 166 of Dodd-Frank (the "**165/166 Comment Letter**") (available at http://www.theclearinghouse.org/index.html?f=073837).

9 If a compliance date of October 1, 2013 (which we believe is appropriate and even necessary) is not acceptable to the OCC, the Associations would appreciate the opportunity to discuss an alternative date.

10 77 Fed. Reg. 37265, 37274 (June 21, 2012).

that a one-size-fits-all approach will not be appropriate for all banks and, indeed, may actually run counter to achieving regulatory objectives of safety and soundness, market stability and credit availability. We believe that additional clarity on certain aspects of the Rule related to internal models would enhance banks' ability to comply with the Rule.

A. The OCC should clarify that approval by the appropriate Federal banking agency for an Advanced Approaches Model bank to exit parallel run constitutes "approval" of those models for purposes of the Rule.

Banks that are developing Advanced Approaches Models to comply with the Federal banking agencies' advanced approaches risk-based capital rules will likely use those same Advanced Approaches Models to comply with the Rule. With respect to Advanced Approaches Models, the Rule uses the phrase "approved by the appropriate Federal banking agency." We understand that the Federal banking agencies generally will not "approve" any particular model as such, but will instead approve a bank's exit from parallel run.[11] We believe, but would ask the OCC to confirm, that, once a bank has received approval to exit parallel run, its Advanced Approaches Models will be "approved" for purposes of the Rule.

B. The OCC should clarify its expectations, and its approval process, for Alternative Internal Models.

As noted above, we believe that an internal model approach is the most appropriate way for a number of banks to calculate credit exposure. We appreciate that the Rule recognizes that this principle applies not just to "advanced approaches" banks but also permits banks that are not eligible to use, or do not plan to use, Advanced Approaches Models to develop Alternative Internal Models.

The Rule, however, does not provide guidance as to what Alternative Internal Model approaches would be expected or would be acceptable, describing them only as "another appropriate model approved by the appropriate Federal banking agency" that is not an Advanced Approaches Model.[12] Although we recognize that a variety of different model approaches may be appropriate and that it would be difficult to specify in advance which may qualify, from a planning perspective, a bank needs to know whether its proposed Alternative Internal Model would be of a type that is likely to be acceptable to the OCC and also the likely duration of the approval process. As a preliminary matter, additional information as to the

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[11] See, e.g., 12 C.F.R. Part 3, Appendix C, Section 21 ("Qualification Requirements"). During the parallel run period, a bank must calculate and report to its Federal banking regulator its risk-based capital ratios under both the general risk-based capital rules (12 C.F.R. Part 3, Appendix A for national banks) and the risk-based capital rules implementing the Federal banking agencies' advanced approaches risk-based capital rules.

[12] 77 Fed. Reg. 37265, 37268 (June 21, 2012).

expected standards for Alternative Internal Models would be helpful to enable banks to start planning for and implementing new compliance regimes. The OCC could provide guidance in the near term on an informal basis through its supervision staff to those banks that are more likely to rely on a model approach because of the volume of derivatives or securities financing transactions in which they engage. This near-term guidance is important because banks that plan to use Alternative Internal Models will need to begin work on those models as soon as possible. These banks will be subject to the same compliance date as the date for banks that have been developing Advanced Approaches Models for some time and the date for banks that plan to use the Rule-defined calculation methods that they can begin implementing more promptly (although, given the clarifications required, banks planning to use the non-model approaches specified in the Rule will not have full clarity until after the Rule is revised).

The Rule also does not provide specific guidance regarding the approval process associated with Alternative Internal Models. This is also important for banks in planning implementation timelines and resource allocation. We request that the OCC clarify the nature of the approval process and the expected timeframe to receive approval.

C. The OCC should coordinate with other Federal banking agencies to ensure such agencies will be in a position to approve Alternative Internal Models.

The Lending Limit Release specifically notes that, in addition to national banks, the Rule also applies to state-chartered savings associations (whose models would be approved by the Federal Deposit Insurance Corporation). Although not mentioned in the Lending Limit Release, state-licensed branches of foreign banking organizations ("**FBOs**") will also be subject to the Rule.[13] By its terms, the Rule requires a state-licensed branch of a FBO to seek approval from the Federal Reserve (as its "appropriate federal banking agency") for any Alternative Internal Models it seeks to use. Although we have requested that the OCC clarify its expectations, and the nature of its approval process, for Alternative Internal Models, we also believe it is important that the OCC coordinate with other Federal banking agencies to ensure that these agencies will be in a position to approve Alternative Internal Models for the banks or branches of FBOs they regulate. This is of particular importance to the extent the OCC's guidance in this area is informal. We do not believe that this requires that the agencies agree on "joint" guidance or that the OCC delay adoption of a final Rule, but we do believe that there is value in inter-agency consultation to harmonize general approaches. This way, national banks, federal- and state-chartered savings banks and federally and state- licensed branches of FBOs could all expect to approach the Alternative Internal Models approval process on a similar footing.

[13] State-licensed branches of FBOs are subject to the same lending limits applicable to federally-licensed branches of FBOs, which are themselves subject to the national bank lending limits (12 U.S.C. §§ 3102(b), 3105(h)(2)).

D. In the event a bank's models are not yet approved (or approved and not yet implemented) by the compliance date of the Rule, the OCC should approve, on a provisional basis, a bank's calculation of credit exposure using existing internal models, or, if appropriate in the specific case, models that are in the process of being approved, to comply with the Rule.

In addition to the impracticality of implementation that all banks face with a January 1, 2013 compliance date, we believe it is likely that many banks planning to use internal model approaches will not have an approved and implemented model by January 2013.[14] We expect that an extension of the compliance date of the Rule until at least October 1, 2013, as requested above, would significantly improve the likelihood that a bank planning to use internal models will have an approved model by that date. Otherwise, the flexible approach that the OCC has taken in allowing the use of approved internal models could be thwarted by the fact that internal models are not likely to be developed or approved before the Rule would take effect.

The Rule does not explain what credit exposure calculation regime will apply to a bank that is still in the process of developing or receiving approval for a model for any part of its business (or that has received approval but needs additional time to determine that its compliance program and policies have been satisfactorily implemented) on the compliance date. As a result, regardless of whether or the extent to which the compliance date is extended, the OCC should clarify what credit exposure calculation method would apply to these banks. We urge the OCC to amend the Rule to provide that, on a provisional basis, a bank that plans to use internal models may calculate credit exposure for derivative and securities financing activities using the bank's existing models that are used for risk management or similar purposes, with which a bank's appropriate Federal banking agency would already be familiar. As an alternative, and if appropriate in the specific case, a bank could use models that are in the process of being approved under the Rule by the appropriate Federal banking agency.

Although a bank that does not yet have an approved internal model on the compliance date could, theoretically, implement one of the non-model methods provided in the Rule (the Conversion Factor Matrix Method ("**CFMM**") or the Remaining Maturity Method ("**RMM**") for derivative transactions or the Non-Model Method for securities financing transactions), we do not believe it would be a beneficial use of resources for banks to develop an entirely different approach on a short-term, interim basis. These banks would need to

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[14] We understand, for example, that most advanced approaches banks will not have received approval to exit parallel run by January 1, 2013. For a non-advanced approaches bank, even if such a bank could develop Alternative Internal Models quickly, it seems unlikely that the OCC would have sufficient time to review, suggest changes to and finally approve Alternative Internal Models by January 1, 2013. This is particularly true if approval of Alternative Internal Models will require the development of models significantly different from those models a bank currently uses for risk management or similar purposes today.

devote time and resources to developing systems to comply with the Rule's non-model alternatives, which would be used only briefly, at the same time that they are developing or are in the processing of receiving approval for their internal models (whether Advanced Approaches Models or Alternative Internal Models). Even more serious than the inefficiencies involved in implementing a merely temporary compliance program is the fact that the non-model approaches in the Rule generally overstate risk and are, therefore, not appropriate for banks with large portfolios, which need to be able to use more risk-sensitive measures of credit exposure in order to avoid curtailing their existing operations.[15] As a result, it is unlikely that banks that engage in a significant volume of derivative and securities financing transactions could continue to conduct this business at their current levels in compliance with the Rule, or would be required to reduce loans or other credit exposures, if required to use a non-model approach.[16] As such, it would not be practical or appropriate to attempt to apply non-model approaches on an interim basis to a bank that is actively involved in implementing, and planning to use, an internal model approach.

As with the extension of the compliance date, approving banks' use on a temporary basis of existing models or models that are in the process of being approved in these circumstances should have minimal, if any, impact on achieving the objectives of Section 610 of Dodd-Frank. Banks using models provisionally would still be subject to the lending limit, with the only question being the calculation regime. We believe that the OCC has ample safety and soundness authority to monitor banks' compliance with the lending limit in these circumstances. If the compliance date is extended until October 1, 2013, we expect the number of banks needing this provisional approval to be small.

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[15] As just one example, it does not appear the non-model approaches allow for netting of transactions with a counterparty. This key example also illustrates why the internal model approach is appropriate for some banks, but not for others. For a bank with a large derivatives operation, recognition of netting is essential to evaluate (and not overstate) actual credit exposure. For a bank with a smaller derivatives book, the issue of netting will be inconsequential. There are, of course, other reasons why the non-model approaches would not be appropriate for some banks.

[16] The Clearing House recently completed an industry study which examined the potential effects of implementing the Federal Reserve's proposal for measuring credit exposure (which generally utilizes a CEM approach) in the context of single counterparty credit limits. Even though CEM allows partial recognition of netting, that study demonstrated that applying such a non-model approach would be expected to result in serious disruptions to banks' existing activities and in reduced liquidity for participants (including regional and community financial institutions) in derivatives and securities financing markets. We would expect that similar effects should be expected were banks with large portfolios required to implement non-model approaches, even temporarily (Single Counterparty Credit Limits: The Clearing House Industry Study, July 2012 (available at http://www.theclearinghouse.org/index.html?f=074112)).

E. Banks should be permitted to apply different calculation methods based on transaction or product type, and the Rule should provide guidance with respect to transitioning between methods.

The Rule, as written, appears to require a bank to choose a single method that it will use to calculate credit exposure for all types of derivative transactions. Likewise, a bank must choose a single method for calculating credit exposure for all types of securities financing transactions. In addition, the Rule does not specifically provide that a bank may change from one method to another (for example, from RMM to a models-based method), even in the event of a change in the bank's business operations.

We believe that banks should be permitted to apply more than one method across their derivative activities and more than one method across their securities financing activities. This kind of flexibility is not designed to, and should not, permit banks to select the most favorable method available at any given time. Rather, some banks may have a heavy focus on only one type of transaction or one product that would warrant the development of a model for that transaction or product, but its other, less significant activities may not warrant development of a model and could be calculated using a less sophisticated approach. For example, a bank may engage in a significant amount of interest rate derivatives but have limited activity in equity derivatives. In such a case, developing a model for equity derivatives may be unnecessary and costly. Developing a model to measure exposures from transactions that a bank does not enter into on a regular basis would impose an unnecessary regulatory burden, especially when other alternatives could be used to measure such exposures effectively in these limited circumstances. A bank that chooses to use multiple approaches could be required to justify its rationale for doing so.

We also believe that the OCC should set forth guidance for banks that wish to change to a different method, such as any pre-clearances the OCC would require and the establishment of appropriate transition periods, as appropriate. We would expect that such changes would be infrequent and would occur primarily when growth or a reduction in the level of a bank's activities or a new product set makes one method better suited to those specific activities.

III. Non-Model Approaches

A. The OCC should permit certain alternative approaches to calculating credit exposures arising under derivative and securities financing transactions.

The Associations believe that certain alternative approaches to measuring credit exposure should be permissible for banks that choose to use them, whether permanently or provisionally. We request that banks be permitted to measure credit exposure for derivative and securities financing activities as they would for purposes of measuring counterparty credit risk for such transactions under a non-model approach permitted under the appropriate Federal banking agencies' capital rules implementing the Basel II A-IRB approach ("**Basel II A-IRB Rules**").[17]

In particular, this would mean that a bank already using CEM for capital purposes (in Section 32(c)(5)-(7) of the Basel II A-IRB Rules) could use CEM to measure exposure from derivative transactions as an additional option to the proposed RMM and CFMM approaches.[18] Although CEM is an overly conservative measure of exposure, a bank that accepts CEM's limitations and chooses to use CEM, whether as an interim approach before developing its own internal models or permanently, should be permitted do to so under the Rule.[19] For securities financing transactions, banks could use the collateral haircut approach in Section 32(b)(2) of the Basel II A-IRB Rules, using standard supervisory haircuts or, if approved in accordance with the Basel II A-IRB Rules, a bank's own internal estimates.

This approach would have the advantage of relying on calculation methodologies that are already used in another regulatory context and are familiar to both banks and the Federal banking agencies, thereby minimizing the regulatory burden associated with implementing the Rule. These methodologies are also included in the Federal banking agencies' proposal to implement the Basel II standardized approach[20] and, therefore, are likely to be available to all banks when that rulemaking is finalized.

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[17] 12 C.F.R. Part 3, Appendix C for national banks, 12 C.F.R. Part 167, Appendix C for Federal savings associations, and 12 C.F.R. Part 390 subpart Z, Appendix A for state savings associations.

[18] As discussed below, the major advantage of CEM in this context is that banks are already using it and will not need to expend the time and resources required to develop compliance systems and programs for a new non-model approach, such as RMM and CFMM. Additionally, CEM is relatively more risk-sensitive than RMM and CFMM because it at least allows for partial recognition of netting and collateral, whereas RMM and CFMM ignore both. If the OCC accepts our proposal in Section III.B (below), however, each of RMM, CFMM and CEM would permit full recognition of netting and collateral.

[19] In the 165/166 Comment Letter, we noted many of the limitations and the overly conservative nature of CEM from a risk measurement perspective. Given those aspects of CEM, we continue to believe that it should not be imposed as a *mandatory* approach to calculating credit exposure, but we believe that, in the context of the Rule, which permits banks to select different options for calculating credit exposure, CEM should be one of those acceptable options, especially because this approach may be used by some banks for the purposes of Section 165 of Dodd-Frank even if the Federal Reserve does not retain it as the only permissible approach for calculating credit exposure.

[20] Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, Joint Notice of Proposed Rulemaking, June 7, 2012. (available at http://www.federalreserve.gov/aboutthefed/boardmeetings/standardized_approach_FR_final_draft_20120607.pdf).

The options discussed above should also be available to banks that, as discussed in Section II.E above, may not use internal models across all types of their derivative or securities financing transactions.

B. Banks using non-model approaches, such as RMM or CFMM (or CEM, if adopted), should be permitted to recognize netting and collateral in measuring credit exposure.

Unlike the internal model approaches, the Rule does not explicitly provide that banks using non-model approaches will be permitted to net transactions under a qualifying master netting agreement and recognize collateral in measuring credit exposure. We believe that, from an economic perspective, it is appropriate for netting and collateral to be recognized as reducing credit exposure, regardless of whether a model or non-model approach is taken. This would apply to RMM and CFMM, as well as to CEM if adopted as we have requested in Section III.A. It has been a long-standing regulatory practice to recognize the beneficial effects of netting and collateral in reducing credit exposure as reflected in the bank capital rules, payment system risk reduction efforts and the current lending limit rules. Netting procedures reduce risk where they are valid and legally binding. We are not aware of any reason why that principle should not prevail in the non-model approaches of the Rule.

Further, we believe that because the non-model approaches are generally conservative, the absence of the recognition of netting and collateral is unnecessarily punitive. We do not believe that recognition of netting and collateral would result in undue complexity, as both calculations could be integrated efficiently and effectively into a non-model approach, including RMM and CFMM.

Finally, any form of acceptable collateral should be recognized under the Rule. Banks post many types of collateral in connection with derivatives transactions, including cash and agency and government securities. As long as the collateral is permissible and appropriate under a valid and legally enforceable derivatives agreement, such collateral should be recognized under the Rule as an offset to credit exposure.[21]

C. The potential future exposure for amortizing interest rate swaps under RMM and CFMM should be changed to reflect amortization.

Some interest rate swaps are amortizing swaps where the risk associated with the swap is reduced as the counterparty pays down its obligation. The tables provided under

[21] We note that the quality of collateral is already taken into account through haircuts in connection with the derivatives transaction itself and other regulatory requirements.

the Rule for RMM and CFMM, however, treat amortizing swaps the same as non-amortizing swaps so that the calculation results in the same predictive exposure for both types of swaps.

For example:

- Swap 1: $10MM, non-amortizing, 5 year remaining maturity, assume current MV=$0
- Swap 2: $10MM, fully amortizing, 5 year remaining maturity, assume current MV=$0

In this example, the underlying risk of Swap 2 is approximately half of that of Swap 1 because, due to amortization, the average life of Swap 2 is 2.55 years compared to 5 years for Swap 1. Given this result, we believe that amortizing swaps should receive a lower potential future exposure factor measurement to reflect the difference in the underlying risk of the transaction.

We believe this can be addressed by permitting banks to use one of two alternative methods for calculating exposures for amortizing swaps under CFMM and RMM. A bank could choose between these alternatives for calculating amortizing swaps based on the bank's access to the necessary data.

1) Average Notional Amount:

   a. CFMM: The credit exposure calculation would include the average notional amount of the transaction at inception.
   b. RMM: The calculation would use the average remaining notional amount of the transaction.

2) Weighted Average Life ("**WAL**") (replacing the number of years to the contractual maturity date in the calculation with the WAL of the trade in years):

   a. CFMM: The formula would incorporate the original WAL.
   b. RMM: The formula would use the remaining WAL.

D. Derivative transactions calculated using RMM and CEM (assuming CEM is allowed as an alternative approach) should be treated as "nonconforming" if credit exposure arising from a derivative transaction increases after execution of the transaction.

We believe the OCC should treat post-transaction execution changes in credit exposure that cause a bank to exceed the relevant lending limit as an instance of nonconformance rather than as a violation. Section 32.6, as amended by the Rule, implements this approach for banks using the internal model approach, but this treatment appears not to apply to banks using RMM, even though credit exposure can also increase under RMM after execution as a result of the transaction being marked-to-market. Banks choosing to use RMM, therefore, could face violations of the lending limit due to increases in credit exposure post-execution, while banks using internal models, in similar circumstances, would only face an instance of non-conformance with an opportunity to correct the nonconformance before it is deemed a violation. To the extent CEM is permitted as an alternative calculation methodology, the same post-execution increase in credit exposure could occur.

In sum, we believe that the OCC should clarify the Rule so that post-execution credit exposure increases under RMM and CEM will be treated similarly to those calculated under the internal model approach. We see no reason that similar instances of unintentionally exceeding the lending limit should be treated differently based on the approach taken to calculate credit exposure, and that, in all cases, an increase in exposure due to exogenous market events should not be treated as a violation.

IV. Calculating Exposures to Central Clearing Parties

Under the Rule, exposures to CCPs would be considered "exposures" subject to the lending limit. One of the key elements of Dodd-Frank is the requirement that most OTC derivative transactions be cleared through a regulated CCP. CCPs will be subject to substantial regulation and, in appropriate cases, the Financial Stability Oversight Council has the authority to designate a CCP as a "systemically important" financial market utility subject to heightened supervision and prudential and risk management standards.[22] All CCPs will be required to develop systems and procedures intended to address member failures, market crises and operational failures and to manage exposures. Because Dodd-Frank has mandated that many derivative transactions be migrated to CCPs, and those CCPs will be highly regulated, we believe it is appropriate that exposures to CCPs not be subject to the lending limit.

Indeed, this may be the only practical result. Because so few CCPs will exist, at least initially, subjecting exposures to CCPs to the lending limit could prevent the CCPs from functioning as intended by Dodd-Frank or prevent some banks from being able to engage in certain types of transactions altogether and thereby limit their ability to provide customers with a full range of products. As a way to mitigate risk arising from the exclusion of exposures to CCPs, the OCC could limit the exclusion to only "eligible" CCPs, under appropriate standards as determined by the OCC, and could adjust the exclusion, as necessary, as the CCP market develops.[23]

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[22] For example, the Financial Stability Oversight Council recently designated both Chicago Mercantile Exchange, Inc. and ICE Clear Credit LLC (IntercontinentalExchange), among others, as "systemically important" financial market utilities.

[23] The Basel Committee on Banking Supervision recently released an interim framework for determining bank capital requirements for exposures to central counterparties. In the press release accompanying the framework, the Basel Committee acknowledged the importance of designing rules to incentivize and increase the use of CCPs ("Capitalisation of bank exposure to central counterparties," July 25, 2012 (available at http://www.bis.org/press/p120725a.htm)). The framework also affords preferential capital treatment for

Given the policy issue of encouraging the use of CCPs and the fact that the CCP market is in the early stages of development, we believe that it would be premature for contributions to a CCP's guaranty default fund to be subject to the lending limits rules. We believe that in order to appropriately address whether, and the extent to which, such contributions should be covered, additional discussion and observation is required. We urge the OCC, therefore, to delay its decision of whether, and to what extent, to cover contributions to a CCP's guaranty default fund under the Rule until after this process is complete.

V. Coordination with Existing Lending Limit Regulations

A. The "direct benefit test," in the context of derivative and securities financing transactions, should be limited by its terms to situations of evasion.

Section 32.5 of the current lending limit rules includes a "direct benefit test," which provides that "the proceeds of a loan or extension of credit to a borrower will be deemed to be used for the direct benefit of another person and will be attributed to the other person when the proceeds, or assets purchased with the proceeds, are transferred to another person…."[24] Section 32.5 also includes a specific exception for bona fide arm's-length transactions where proceeds are used to acquire property, goods, or services. Under the Rule, this section will apply to derivative and securities financing transactions. A primary goal of the direct benefit test is to prevent evasion of the lending limit.[25]

In the context of a typical lending transaction, tracing the proceeds of a loan and determining for whose benefit the loan is made can often be a difficult exercise. In the context of derivative and securities financing transactions, those difficulties would be compounded. In the case of derivative transactions, a bank's counterparty may be simultaneously entering into a back-to-back transaction with another party, and that transaction would not necessarily be disclosed to the bank. In the case of securities financing transactions, a counterparty may be acting as an agent or other intermediary in the transaction and may transfer the securities or transaction proceeds to a third party. These practices are customary in these markets and have no evasion objectives. The direct benefit would be difficult to monitor in these circumstances

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exposures to "qualifying" CCPs that are regulated in a manner consistent with the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions' Principles for Financial Market Infrastructures. See Basel Committee on Banking Supervision, Capital requirements for bank exposures to central counterparties (July 2012) (available at http://www.bis.org/publ/bcbs227.pdf).

24 12 C.F.R. § 32.5.

25 See, e.g., OCC Interpretive Letter, August 25, 1986 (1986 W.L. 85036) ("The traditional parameters of the 'direct benefit' test essentially focus on whether a person is borrowing in a nominal capacity for a third party or is borrowing to purchase goods or services from the third party for adequate consideration.").

and would likely require significant changes to market practices or revisions to standard documentation to implement. Moreover, from the bank's perspective, the actual credit exposure is to its counterparty and not some third (and quite possibly unknown) party.

We urge the OCC to confirm that, with respect to derivative and securities financing transactions, the direct benefit test would be limited by its terms to situations of evasion.

B. The Rule should clarify that securities lending transactions secured by federal and state (or political subdivision) obligations or a segregated deposit account should receive the same treatment as "cash collateralized" transactions.

Under the Rule, to the extent a bank receives cash collateral in a securities lending transaction, the exposure is calculated as the market value of the securities lent less any cash received from the counterparty.[26] Under the current lending limit regulations, to the extent loans are secured by general obligations of the United States or a state (or political subdivision thereof) or a segregated deposit account, those loans are exempt from the lending limit.[27] The Associations believe that the OCC should permit all Type I Securities (but at the very least, consistent with the existing lending limit rules, general obligations of the United States or a state (or political subdivision thereof) or a segregated deposit account) to receive the same treatment as cash under the Rule to reduce credit exposure in a securities lending transaction.

VI. Other Specific Concerns.

A. Option contracts (i.e., foreign exchange options, commodity options or interest rate caps and floors) that have been sold by a bank have no ongoing credit exposure beyond settlement and should not be considered "exposures" under the Rule.

Many banks engage in the business of selling options, including foreign exchange options, commodity options and interest rate caps and floors, to customers and counterparties. In most circumstances these options are paid for at settlement. When an option is paid-up, there is no further performance obligation by the counterparty and no further credit exposure. Because there is no resulting credit exposure, we believe that the OCC should clarify that the Rule does not require a bank to calculate the exposure for such paid-for options.

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[26] Section 32.9(c)(1)(ii)(D)(1) of the Rule.

[27] 12 C.F.R. §§ 32.3(c)(3), (5) and (6).

B. Effective margining arrangements should not be limited to arrangements that require full collateralization over a specified dollar threshold for banks using internal models.

The Rule requires that a bank have in place an effective margining agreement that requires full collateralization of the bank's net credit exposure above $1 million on a daily basis in order for the bank to use an internal model approach to calculate credit derivatives exposure. We believe the selection of a $1 million threshold is unnecessary (and, based on our experience, somewhat arbitrary) because an effective model should take into account whatever threshold is applicable for a particular margining agreement.

C. Banks should be permitted to use credit protection to reduce all types of credit exposure, including traditional loans and derivative credit exposure.

Banks purchase credit protection (e.g., default or total return swaps on individual transactions or a pool) to reduce the risk associated with all types of credit exposures to a borrower, such as traditional loans and lines of credit.[28] This is a well-accepted risk management technique and is recognized in the Comptroller's Handbook on Concentrations of

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[28] The definition of "eligible credit derivative" in Section 32.2(m) of the Rule includes only single-name credit derivatives and standard, non-tranched index credit derivatives. Particularly in light of this definition, we believe the Rule is not at all clear as to whether and how credit exposures arising from tranched index credit derivatives would be covered under the Rule. For example, Section 32.9(b)(2)(ii) of the Rule requires banks to use "notional value" to calculate credit exposure on protection sold, but there are several different notional amounts identified in standard, tranched index CDS documentation, and none of these can reasonably be understood as a proxy for credit exposure. If the OCC does intend to cover such exposures in the Rule, we believe that additional opportunity for comment on this area is needed.

Moreover, in such a case, the definition of "eligible credit derivative" should be amended to allow banks, at a minimum, to purchase credit protection using standard tranched index credit derivatives in addition to standard non-tranched index credit derivatives. As both tranched and non-tranched index CDS are highly standardized, rely on the same triggering events for payments and calculate payments from the protection provider on the basis of the same auction-determined prices, we can see no reason that a bank's ability to reduce its exposure under the Rule should be limited to only one type of index credit derivative.

In addition, the OCC should carefully consider the treatment of sovereign and municipal CDS under Section 32.2(m) of the Rule, particularly the application of the requirement of Section 32.3(m)(3)(ii) regarding bankruptcy, insolvency or inability of the obligor on the reference exposure to pay its debts. Because bankruptcy and insolvency regimes generally do not exist for these types of reference exposures, standard 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 a receiver, nonetheless bind the holders of the sovereign or municipal debt to changes in principal, interest or similar economic terms of the debt. We believe that the OCC should clarify that contractual terms covering restructurings of this nature would satisfy the requirement of Section 32.3(m)(3)(ii).

Credit as a "useful" strategy for managing credit concentration risk.[29] We believe that where the protection contract maturity is as long as the maturity of the other exposure, protection purchased from an eligible protection provider should be permitted to be used to reduce all types of credit exposure under the Rule. Use of credit protection should adhere to bank guidelines that are designed to ensure that the extent of credit risk mitigation is applied and measured in a prudent and consistent manner. In addition, in order for an eligible credit derivative to qualify as a reduction of a credit exposure, both the reference obligation and the hedged asset must have been issued by the same reference entity (or by affiliates which, from an economic and legal standpoint, can reasonably be considered to be the same entity for these purposes). The reference obligation of the credit derivative must be *pari passu,* or junior to, the hedged asset.

D. If a banking agency mandates the use of a particular method for measuring credit exposure, that requirement should only apply prospectively to ensure greater certainty regarding a bank's compliance with the Rule.

Sections 32.9(b)(3) and 32.9(c)(2) of the Rule provide that a banking agency may require a national bank or savings association to use a particular method to calculate credit exposure if the agency finds that the method is necessary to promote safety and soundness. Unless such a requirement were to apply only prospectively and not, in effect, retroactively, considerable uncertainty about the extent of a bank's compliance would be created as loans and extensions of credit that were within the lending limit when made using a particular method of calculation could subsequently be thrust into non-compliance by a later required change in calculation method. To reduce this uncertainty, we believe that mandated use of a particular method should be phased in over a period of time based on discussions between the bank and its examination staff. In addition, we believe that the OCC should set forth the factors that it might use in exercising the authority to mandate the use of a particular method. Such factors could be included in published guidance to the Rule.

E. The OCC should clarify that "repurchase agreement" and "reverse repurchase agreement" as used in the definition of "securities financing transaction" are limited to transactions in securities.

Section 610 of Dodd-Frank requires the OCC to include credit exposure from a "repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction." Section 32.2(aa), as amended by the Rule, creates a definition of "securities financing transaction" that incorporates each of the foregoing types of transactions. Those transactions, however, are not individually defined. We believe it would be beneficial, and consistent with the intent of the Rule, if the OCC were to clarify that

[29] See Comptroller's Handbook, Concentrations of Credit, December 2011, p. 13.

"repurchase agreement" and "reverse repurchase agreement" under the definition of "securities financing transaction" are limited to transactions in securities. The existing lending limit rule already covers exposures from the discount of negotiable or nonnegotiable installment consumer paper that carries a full recourse endorsement or unconditional guarantee by the person selling the paper (whether in the form of a repurchase agreement or otherwise).[30] This makes sense because the bank is in the position of lender in these transactions. It is unnecessary to cover repurchase agreements (where the bank is in the position of borrower) other than in the context of securities repurchase agreements where there is concern regarding the fluctuation in the value of securities over the life of the transaction.

F. The OCC should specify how credit exposure would be calculated when more than one type of securities collateral is provided in a securities financing transaction.

The Rule's Non-Model Method for calculating credit exposure for securities financing transactions when the transactions are collateralized with securities assumes that only one type of securities collateral will be provided for a particular financing transaction. Under the Rule, the credit exposure in this case is calculated at the higher of the two haircuts associated with the two securities (i.e., the borrowed securities and the pledge securities). Although it is not uncommon for several different types of non-cash collateral to be allocated to a particular transaction, the Rule does not specify how credit exposure would be calculated if multiple types of non-cash collateral were used. We request that the OCC provide a formula or other procedure that specifies how credit exposure should be calculated when numerous types of collateral, in different amounts, with different haircuts, are used and how non-cash collateral should be allocated in such transactions. We also request that additional opportunity for comment be provided with respect to any such formula or procedures, once they are proposed.

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[30] 12 C.F.R. § 32.3(b)(2)(i).

In conclusion, the Associations appreciate the OCC's issuance of an interim final rule that allows for flexibility and recognizes the importance of models for many banks. We believe that, with the adjustments and clarifications discussed above, the Rule would be strengthened while minimizing negative consequences or potential issues with respect to banks' ability to comply with the Rule.

If you have any questions or need further information, please contact (i) at The Clearing House, John Court (e-mail: John.Court@theclearinghouse.org, telephone number: (202) 649-4628); (ii) at ABA, Beth Knickerbocker (e-mail: bknicker@aba.com, telephone: number: (202) 663-5042); and (iii) at The Roundtable, Richard Whiting (e-mail: rich@fsround.org, telephone number: (202) 589-2413).

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The Clearing House Association

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House's web page at www.theclearinghouse.org.

American Bankers Association

The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees. See the ABA's web page at www.aba.com.

The Financial Services Roundtable

The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine and account directly for $92.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

Appendix A

Responses to Certain Specific Questions Raised in the Lending Limit Release

Question 3: Are these terms adequately defined? Are there other terms we should define in part 32 to help implement section 610 of the Dodd-Frank Act?

Response: See Section VI.E of the Comment Letter.

Question 4: Is the requirement to use the same method when calculating credit exposure for all non-credit derivative transactions appropriate? Should institutions be allowed to use a different method for different types of transactions or for the same transaction type but different parties?

Response: As set forth in Section II.E of the Comment Letter, we believe that more flexibility is appropriate.

Question 5: Would it be more appropriate to require that national banks and savings associations use other models instead of the one included in part 3?

Response: Section 32(d) of the advanced approaches risk-based capital rules permits advanced approaches banks to develop Advanced Approaches Models to determine exposure at default for counterparty credit risk from OTC derivative transactions, as well as from securities financing transactions. As drafted, the Rule permits banks to use models developed under Section 32(d) *only* for measuring credit exposure from securities financing transactions and not for credit exposure from derivative transactions, which, under the current Rule, must be measured under models developed for purposes of Section 53 of the advanced approaches risk-based capital rules. The Associations believe that it would be appropriate to permit banks to use the Advanced Approaches Models that banks may develop pursuant to Section 32(d) for calculating credit exposure from derivative transactions.

Question 8: Should protection purchased from eligible protection providers by way of eligible credit derivatives be allowed to reduce other exposures under the lending limit, for example, loans traditionally covered by the lending limit and counterparty credit exposure arising from financial derivatives, at least where the protection contract maturity is as long as the maturity of the other exposure?

Response: As set forth in Section VI.C of the Comment Letter, we believe banks should be permitted to use credit protection to reduce all types of credit exposure, including traditional loans and derivative credit exposure.

Question 9: Has the OCC properly reflected the different derivative transactions undertaken by community, mid-size, and large institutions for purposes of application of the lending limits? Does the rule adequately capture the actual risks of these transactions?

Response: We believe the answer to both questions is largely in the affirmative. As markets develop and the OCC and the industry gain experience with application of the Rule to credit exposures from CDS, however, we believe the OCC should consider other appropriate methodologies for measuring the credit exposure to the underlying reference asset on a CDS sold (e.g., exposure at default).

Question 10: Is the requirement to use the same method to calculate credit exposure for all securities financing transactions appropriate? Should institutions be allowed to use a different method for different types of securities financing transactions, or for the same transaction type but different parties?

Response: See Section II.E of the Comment Letter and Question 4 above.

Question 12: Has the OCC properly accounted for the different securities financing transactions in institutions of different size and complexity? Does the rule adequately capture the actual risks of these transactions?

Response: See Sections III.A and VI.F of the Comment Letter.

Question 13: Please comment on the provision that provides the OCC and FDIC with authority to require modeling. Is this discretion appropriately described?

Response: See Section VI.D of the Comment Letter.

Question 15: The interim final rule does not address the applicability of the lending limit rules to a national bank's or savings association's contingent obligation under derivative clearinghouse rules to advance funds to a clearinghouse guaranty fund. Please comment on whether and to what extent part 32 should apply to these obligations and if applicable, how the credit exposure of these obligations should be measured.

Response: See Section IV of the Comment Letter.

Question 16: Should the lending limit calculation rules set forth at § 32.4 or the combination rules set forth at § 32.5 be adjusted or changed in any way given the addition of credit exposures arising from derivative and securities financing transactions to part 32 as new categories of extensions of credit?

Response: See Section V.A of the Comment Letter.