BANK POLICY INSTITUTE

August 3, 2020

Via Electronic Mail

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Re: Activities and Operations of National Banks and Federal Savings Associations (Docket ID OCC-2020-0003; RIN 1557-AE74)

To Whom It May Concern:

The Bank Policy Institute[1] appreciates the opportunity to comment on the notice of proposed rulemaking by the Office of the Comptroller of the Currency seeking input on the OCC's regulations relating to the activities and operations of national banks and federal savings associations ("FSAs") in 12 C.F.R. part 7,[2] the stated intent of which is to clarify and codify recent OCC interpretations, integrate certain regulations for national banks and FSAs, update or eliminate outdated regulatory requirements that no longer reflect the modern financial system, and include other technical changes. BPI strongly supports these goals and many of the specific ways in which the OCC has proposed to bring greater certainty and predictability to part 7's activities framework. At the same time, we also believe there are a number of ways in which the proposal may be improved and strengthened by further streamlining unnecessary processes or burdens, clarifying certain conditions or requirements, or expressly addressing specific questions not resolved under the proposal. To that end, this letter includes a range of concrete

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 85 Fed. Reg. 40794 (July 7, 2020).

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suggestions intended to build upon and further the proposal's goal of clarifying and modernizing the OCC's permissible activities framework.[3]

A major theme that runs throughout our comments is the fact that, for national banks and FSAs to be able to innovate and operate in a highly competitive marketplace and respond to customer needs, they need to be able to understand the legal and policy framework under which they can operate. As a legal permissibility and policy matter, banks consider the parameters set out in statutes, regulations, and other sources, as appropriate, and then make a good faith determination whether such activity is permissible under applicable law such as the National Bank Act. Separately, banks must also make certain that the manner by which they execute and risk manage such activity is safe and sound, informed by their interactions with their OCC examination team. As we describe throughout this letter, clear rules around legal permissibility and, where necessary, the opportunity to consult with the OCC's legal and policy leadership to resolve any legal permissibility questions, in an efficient and transparent manner, serve the important purpose of fostering innovation, supporting bank compliance efforts, and ensuring a level playing field. They also serve to ensure that questions of safety and soundness, as overseen by examiners, remain separate and distinct from questions of legal permissibility, as established by law and regulation. Accordingly, we believe that the proposed rule, as refined by the suggestions we describe here, would serve the public interest by providing national banks and FSAs with more clear, consistent, and transparent rules relating to the parameters of bank-permissible activities.

The letter is structured as follows:

- Section I of this letter (pp. 3 to 6) provides an executive summary of our recommendations;
- Section II (pp. 7 to 16) provides our comments on the proposal as it relates to permissible derivatives activities;
- Section III (pp. 16 to 18) provides our comments on the proposal as it relates to payment system memberships;
- Section IV (pp. 18 to 26) provides our comments on the proposal as it relates to tax equity finance ("TEF") transactions;
- Section V (pp. 26 to 31) provides our comments on the proposal as it relates to corporate governance;
- Section VI (pp. 31 to 35) provides our comments on the proposal as it relates to other bank powers or operations topics; and
- Section VII (pp. 35 to 36) provides our comments on the proposal as it relates to COVID-19-related relief.

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3 We focus on aspects of the proposal with greatest relevance to a national bank with a holding company, and therefore have not addressed certain of the proposal's provisions on corporate governance, among others.

I. Executive Summary

Regarding permissible derivatives activities:

- The final rule should make clear that national banks may continue to rely on guidance that they have previously received regarding the permissibility of derivatives activities and need not provide notice under proposed new § 7.1030 to continue to engage in activities that were commenced under the prior interpretive and supervisory framework before the final rule became effective;

- Certain of the key definitions proposed for purposes of new § 7.1030 should be revised to align with OCC precedent and market practice:

  - The final rule should clarify the definition of "customer-driven" to reflect that such transactions may serve a customer directly or indirectly;

  - The final rule should adopt the broader concept of "appropriately hedged" rather than unnecessarily distinguishing between "perfectly-matched" and "portfolio-hedged"—however, if these terms are adopted, the final rule should make clear that they are together intended to cover all derivatives transactions the market risks of which are appropriately hedged, regardless of the technique employed to do so;

  - To the extent it is retained, the definition of "perfectly-matched" should be expanded to reflect the broad range of prudent market practices employed to offset risk;

  - The final rule should clarify that the definition of "underlying" should be construed broadly; and

  - There is no need for the final rule to define "derivative," but should it do so, the definition must be appropriately broad so as to avoid inadvertent exclusion of common derivative products;

- The proposed set of permissible derivatives transactions in § 7.1030(c) should be revised to provide for permissible physically-hedged derivatives activities that are cash-settled, as well as physically-settled;

- The notice requirements in § 7.1030(d) should be revised to ensure consistency in supervisory standards and to clarify that the proper role of supervisors in evaluating derivatives activities relates to consistently applying safety and soundness standards, not evaluating legal permissibility;

- The notice requirements also should not define categories of "underlying" by regulation, but rather should take a substantially more principles-based approach to determining when prior notice is required that looks primarily to the risk management implications and challenges of any potential new derivatives activity;

- No notice should be required under the final rule where a national bank engages in permissible derivatives activity that is hedged either (i) using mirrored transactions that involve no market risk or (ii) on a nearly perfected-matched basis that involve only de minimis residual market risk; and

- The final rule should provide greater clarity as to the scope and substance of any additional requirements imposed on physical hedging involving commodities, and should require that any physical hedge be "at least as effective as," not more effective than, a cash-settled hedge.

Regarding payment system memberships:

- The final rule should clarify the OCC's risk management expectations by incorporating the relevant factors in previous interpretive letters;

- A national bank or FSA that believes its open-ended liability is otherwise limited should not be required to obtain a legal opinion to that effect, and instead should be required to have a good faith, reasoned basis for making that determination;

- The definition of "operational loss" should be adopted largely as proposed, and cybersecurity breaches should be added to the list of examples; and

- The final rule should acknowledge that, notwithstanding the requirement that national banks and FSAs complete their risk assessment of the payment system before joining, certain key aspects of the national bank's or FSA's risk management processes may occur after joining.

Regarding TEF transactions:

- A national bank or FSA should not be required to obtain a legal opinion on the tax benefits of a TEF transaction, but rather should be required to have a good faith, reasoned basis for making that determination;

- Several of the criteria for the qualification of a TEF as a "functional equivalent of a loan" should be clarified:

  - The final rule should clarify that TEF investments may be retained for the duration needed to obtain the expected rate of return;

  - The final rule should clarify that the calculation on rate of return is the expected rate of return at the time that the investment is initially made; and

  - The final rule should clarify that customary protective rights and covenants are permitted and do not violate the "passive investor" requirement;

- The final rule should clarify that national banks and FSAs have appropriate flexibility in satisfying the requirement that they not control the sale of energy from a TEF project;

- The final rule should not impose a cap on TEF transactions by national banks and FSAs;

- The final rule should not require notice before a national bank or FSA engages in a TEF transaction;

- National banks and FSAs should be permitted to enter into the TEF transactions about which the OCC has requested comment;

- The final rule should not prescribe any particular contractual remedy for TEF transactions, but rather should allow national banks and FSAs the flexibility to choose the most appropriate remedies for a given transaction from among a range of permissible options; and

- The final rule should not prohibit national banks and FSAs from participating in fund-based TEF structures.

Regarding corporate governance:

- The OCC's form articles of association, bylaws, and other form documents should be reviewed to confirm that they are consistent with applicable federal banking statutes and regulations;

- We support the proposal to allow national banks to elect to follow the corporate governance provisions of the law of any state in which the main office or any branch of the bank is located, among other options;

- Section 7.2009 should be revised to allow national banks to adopt the quorum requirements of the law of the relevant state, the Delaware General Corporation Law, or the Model Business Corporation Act, as applicable;

- We generally support the OCC's reorganization of indemnification requirements and offer the following comments in particular:

    - The final rule should clarify how the OCC would evaluate whether indemnification payments to institution-affiliated parties ("IAPs") under redesignated § 7.2014(a) are "consistent with safety and soundness";

    - The final rule should confirm that the written agreement required under proposed § 7.2014(c) may include funds to cover expenses;

    - The final rule should not adopt the requirement from 12 C.F.R. § 145.121 that, in certain circumstances, a majority of the disinterested directors determine that the IAP was acting in good faith before the institution may indemnify the IAP; and

    - We support the OCC's proposal not to require 60-day notice to the OCC before a national bank or FSA makes an indemnification payment; and

- Section 7.2010 on directors' responsibilities should be revised to avoid suggesting that guidance has the force of law.

Regarding other bank powers or operations:

- The final rule should simplify the requirements for operating financial literacy programs.

- The examples of permissible finder activities should be revised to reflect how this authority is exercised in the modern financial system;

- We support the OCC's proposal that a national bank operating subsidiary facility is not a branch if it provides similar services on substantially similar terms and conditions to customers of unaffiliated entities, including unaffiliated banks, but suggest that this provision apply equally to facilities of the national bank itself;

- The final rule should clarify that it is not impermissible to perfect security interests by holding collateral stock as nominee;

- The final rule should clarify that a national bank's ability to hold or invest in a SBIC does not terminate if the SBIC surrenders its license during its wind-down period;

- The final rule should reinforce that the risk management considerations outlined for letters of credit and independent undertakings are not mandatory safety and soundness conditions by removing them from the text of the rule;

- The final rule should clarify that nothing in proposed § 7.1016 is meant to imply that other sections of part 7 do not apply equally to federal branches and agencies as to national banks and FSAs, consistent with the International Banking Act;

- We support the OCC's proposed updates to the types of emergency conditions that may result in the declaration of a legal holiday; and

- The final rule should affirm that national banks and FSAs have multiple sources of legal authority on which to rely in engaging in a particular activity, and need not meet the specific terms of part 7 where another authority is available, the conditions of which are met.

Regarding COVID-19-related relief:

- We encourage the OCC to codify additional ways in which filings and other procedures can be accomplished electronically; and

- The requirements for filing oaths of directors should be modernized.

II. Permissible Derivatives Activities

The proposal would establish a new section, § 7.1030, to specifically address derivatives activities that are permissible for national banks for the purposes of incorporating and streamlining the framework articulated for such activities in prior OCC interpretive letters. The stated intentions for these changes are to promote clarity and transparency, reduce compliance burden, and help ensure consistent practices across institutions when a national bank seeks to commence or expand derivatives activities.[4]

As a fundamental matter, we support the steps the OCC has taken to codify into formal regulation the complex legal analysis of bank-permissible derivatives activities that has been established over the course of over several decades of interpretive letters, as doing so will clarify and formalize the substantive elements of this framework and promote consistency and efficiency in its application. Such codification also presents a useful opportunity to appropriately distinguish between legal questions of permissibility under the National Bank Act and prudential questions of safety and soundness.

While we generally support the OCC's codification of permissible derivatives activities, there are several important aspects of proposed section 7.1030 that could be made more consistent with the existing scope and substance of OCC precedent as articulated in prior interpretive guidance. There are also several ways in which we believe that the administrative and procedural aspects of the proposal can be made less burdensome in practice. Accordingly, we provide below a range of suggestions for how the final rule might better align with existing precedent and streamline certain procedures.

We also note that, as the proposal acknowledges, the permissibility of derivatives activities has often been addressed in the past through interpretive letters and supervisory processes, pursuant to which many banks already engage in certain types of permissible derivatives activities. For that reason, it is important that the final rule make clear, either in the rule itself or the preamble, that national banks may continue to rely on guidance that they have previously received regarding the permissibility of derivatives activities, and need not provide notice under proposed new section 7.1030 to continue to engage in activities that were commenced under the prior interpretive and supervisory framework before the final rule became effective.

A. The key definitions proposed for purposes of new § 7.1030 should be revised to align with OCC precedent and market practice.

1. The final rule should clarify the definition of "customer-driven" to reflect that such transactions may serve a customer directly or indirectly.

The proposal would define "customer-driven" to mean "a transaction entered into for a customer's valid and independent business purpose (and a customer-driven transaction does not include a transaction the principal purpose of which is to deliver to a national bank assets that the national bank could not invest in directly)." The preamble to the proposed rule notes that, "[a] customer-driven transaction would not include a transaction entered into for the purpose of speculating in derivative, currency, commodity, or security prices."[5] We suggest several clarifications or revisions to

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4 Proposed rule at 40804.

5 *Id*.

improve this definition to better align it with existing OCC precedent and avoid any ambiguity in application.

First, the final rule similarly should affirm, consistent with existing OCC precedent, that transactions entered into for a customer's valid and independent business purpose are customer-driven, regardless of whether they serve that customer purpose directly or indirectly. In particular, it is critical that the final rule clarify that "customer-driven" derivatives activities continue to include the types of permissible derivatives transactions described in Interpretive Letter 1018.[6] Existing OCC precedent makes clear that such transactions are permissible for national banks, and the final rule should follow suit.

Second, the final rule should make clear that, while speculation cannot be the purpose for which the *national bank* enters into the transaction, no such limitation is imposed as to the purpose for which the *customer* enters into the transaction. Customers frequently enter into transactions for hedging or risk management purposes, but a significant amount of activity in the derivatives market is driven by institutional customers entering into transactions as part of an investment strategy, such as the diversification or rebalancing of an investment portfolio by an asset manager. In addition, even if a corporate customer enters into a derivative to hedge an asset or liability and later wishes to lift the hedge, it may choose to enter into an offsetting transaction that neutralizes the hedge instead of unwinding the hedge and incurring an early termination fee; the lifting of the hedge in this manner could be seen as speculative in nature to the extent the underlying asset or liability has now become unhedged. We strongly believe that this bank-purpose versus customer-purpose distinction is implicit in the proposal's policy rationale, but also believe express affirmation of this point would be helpful to remove any ambiguity otherwise raised by the proposal's preamble language regarding which party's purpose cannot be speculative, as any result to the contrary could negatively impact derivatives market participants.

Third, we note that there are a range of mechanisms by which a national bank may enter into a derivative transaction with a customer for the customer's valid and independent business purpose. For example, a national bank and its customer may elect to execute a trade on a purely "over-the-counter" basis. Alternatively, a national bank and its customer may elect to utilize a trading platform to execute their transaction. With that in mind, we ask that the OCC confirm our understanding that an otherwise bank-permissible derivative transaction entered into by a national bank as a financial intermediary would be viewed as "customer-driven," so long as the national bank and its customer have bilaterally negotiated and agreed to the terms of the transaction, regardless of the execution mechanism selected by the bank and its customer.

Lastly, the final rule should clarify that the parenthetical in the definition of "customer-driven"—i.e., that a customer-driven transaction does not include "a transaction the principal purpose of which is to deliver to a national bank assets that the national bank could not invest in directly"—should *not* be read to prohibit a transaction that is otherwise permitted under the rule, namely, physically-settled derivatives. This is implicit, as the principal purpose of such derivatives is financial intermediation and not the receipt of what is physically-settled, but explicit clarification would be helpful to avoid any ambiguity in the application of this restriction.

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6 OCC Interpretive Letter No. 1018 (Feb. 10, 2005).

2. The final rule should adopt the broader concept of "appropriately hedged" rather than unnecessarily distinguishing between "perfectly-matched" and "portfolio-hedged"; however, if these terms are adopted, the final rule should make clear that they are together intended to cover all derivatives transactions the market risks of which are appropriately hedged, regardless of the technique employed to do so.

The proposed rule would establish separate definitions of "perfectly-matched" and "portfolio-hedged." Although not explicit in the proposal, it appears that the primary function of each of these definitions is to create different categories of activity for purposes of the prior notice requirements proposed at § 7.1030(d),[7] as both terms are otherwise always used together, in the alternative, in the provisions of proposed § 7.1030(c). We are concerned that the use of this bifurcated definitional approach creates potential ambiguity as to whether there may be certain types of derivative transactions that, while appropriately hedged in some manner so as to offset the market risk of such transactions, may not fall within the respective technical definition, and thus would not be bank-permissible. For example, a derivative transaction that is physically hedged on an individual basis, such as a total return swap that is hedged via holding the underlying equity position, is clearly a permissible hedging technique under existing OCC precedent, but it is not entirely clear whether such hedging technique would be "perfectly-matched" or "portfolio-hedged" under the proposed definitions.

We do not believe any ambiguity in this area is intended, nor would it be consistent with existing OCC precedent and supervisory practice, which generally ultimately looks to the effectiveness of the hedging technique used and the bank's risk management capacity to execute that technique, as evaluated by supervisory review. We therefore believe it would be helpful for the final rule to utilize, in lieu of separate definitions for "perfectly-matched" and "portfolio-hedged," a single definition and concept—such as "appropriately hedged"—that more effectively captures the range of hedging techniques that national banks may employ, provided that they are consistent with safety and soundness and applicable guidance.[8] Adopting a more straightforward, uniform definitional approach would avoid the ambiguities and uncertainties associated with classifying any given hedging approach across separate defined types, while still ensuring that a key milestone of legally-permissible derivatives activity is met—appropriate and effective hedging. To the extent that the OCC is concerned that a material change in a national bank's approach and techniques for hedging necessitates separate prior notice and supervisory oversight, we note that this result is better accomplished through specific requirements to that end in the prior notice provisions of proposed § 7.1030, rather than in bifurcated definitions of "perfectly-matched" and "portfolio-hedged." To that end, we propose complementary changes to the proposed notice provisions below.

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[7] The preamble notes that, "Section 7.1030(d)(1) of the proposed rule would require a national bank to provide EIC notice prior to engaging in any of the derivatives hedging or financial intermediation activities described in § 7.1030(c)(2) through (5) for the first time. This notice requirement would apply, for example, if a bank has previously engaged in cash-settled derivatives with respect to a particular underlying as described in § 7.1030(c)(3) but seeks to begin physically settling transactions as described in § 7.1030(c)(4) or (5). Likewise, a national bank would need to provide notice prior to first engaging in derivatives hedging activities pursuant to § 7.1030(c)(2) or expanding the bank's derivatives hedging activities to include a new category of underlying." Proposed rule at 40808.

[8] By way of example, we note that this is the approach taken in the Volcker Rule, which does not bifurcate hedging activities as either "perfectly-matched" or "portfolio-hedged." There is no policy benefit to this bright-line distinction between hedging techniques.

If the final rule nonetheless maintains this distinction, it should expressly confirm that any derivative transaction the risks of which are appropriately offset, whatever the technique, will fall under one of these two definitions. The bifurcated definition of hedging techniques should thus not preclude any type of otherwise permissible hedging technique; for example, as discussed below, the total return swap transaction noted above should be permissible under the definition of "perfectly-matched." If a permissible hedging technique does not fall within this definition, then it should be assumed to fall within the definition of "portfolio-hedged."

3. To the extent it is retained, the definition of "perfectly-matched" should be expanded to reflect the broad range of prudent market practices employed to offset risk.

The proposal would define "perfectly-matched" as "two back-to-back derivatives transactions that offset risk with respect to all economic terms (e.g., amount, maturity, duration, and underlying)."

To the extent that this definition is retained, certain revisions are needed to appropriately reflect the broader range of effective alternatives for offsetting back-to-back transactions. First, this proposed definition should be revised to treat corresponding transactions as perfectly-matched hedges so long as they substantially offset risk with respect to all material terms, so as to make clear that differences between the transaction with little or no effect on market risk (e.g., different maturity dates between the customer derivative and the offsetting future, or different margin arrangements) do not bar the transactions from being treated as perfectly-matched. (To the extent there is any residual market risk, it would be de minimis and managed by the bank.) This change would better align proposed § 7.1030 with existing OCC precedent.[9] It would also better reflect standard market practices for perfectly-matched hedges, increase the flexibility of national banks to arrange for suitable hedges, and reduce the cost of doing so, without affecting safety and soundness.

Second, the definition should allow for *one or more* offsetting trades that result in a substantially market risk neutral position for a single derivative transaction, rather than a single offsetting transaction in all cases. For example, a national bank could be short a basket of securities in one total return swap and collectively be long the same basket in a group of total return swaps, each referencing one or more basket components. This, too, is consistent with OCC precedent,[10] and again would better reflect standard market practices and permit greater flexibility in implementing effective hedging strategies without undermining safety and soundness.[11]

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9 OCC Interpretive Letter No. 1033 (June 14, 2005) ("While the baskets created by the Bank to hedge its equity index swap activities do not exactly match the applicable underlying index, we find that the extent of the mismatch is so slight as to still fall within the scope and rationale of the OCC precedents cited in support of bank hedging activities. The baskets will be designed and weighted to closely track the performance of the applicable index, i.e., less than 1% deviation under several probable scenarios. Thus, the likely potential mismatch is de minimis. Based on this authority, we conclude a national bank may purchase a basket of equities that closely tracks but does not exactly replicate the performance of an equity index, with the approval of the Bank's EIC.")

10 *Id.* (concluding that offering equity index swaps and holding baskets of securities for hedging purposes is permissible for a national bank).

11 Should the final rule indicate or suggest that these types of hedging transactions do not constitute "perfectly-matched," it should, at a minimum, clarify that such transactions thus do qualify as "portfolio-hedged." We note that an alternative approach to making clear that the final rule permits the full range of permissible derivatives activities

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Third, the definition should be revised to make clear that a perfectly-matched derivative may be one the risk of which is substantially offset by a non-derivative position (e.g., by holding a physical position in the underlying as hedge), subject to applicable risk management guidance (e.g., Banking Circular 277 and the OCC Handbook on Risk Management of Financial Derivatives) and the restrictions on physical hedging involving commodities as discussed separately in section II.E below. This change would be consistent with existing OCC precedent,[12] and would again better reflect standard market practice, in which perfectly-matched transactions may be hedged via a non-derivative position, without undermining safety and soundness.[13]

4. The final rule should clarify that the definition of "underlying" should be construed broadly.

OCC interpretive letters have generally analyzed derivatives transactions based on the underlying reference asset, rate, obligation, index, etc. The OCC proposes to define "underlying" as the reference asset, rate, obligation, or index on which the payment obligation(s) between counterparties to a derivatives transaction is based. The OCC requests comment on whether the proposed definitions accurately reflect the terms used in OCC interpretive letters and whether this term would benefit from further clarification.

Although we have no specific concerns with the proposed definition of "underlying," we note that derivatives—as well as the assets and measures that function as their underlyings—have and continue to evolve over time. Accordingly, it would be useful for the OCC to affirm in the final rule that the proposed definition of "underlying" should be construed broadly and flexibly over time, so as not to inadvertently introduce ambiguity with respect to whether a particular asset or quantitative measure may constitute an underlying.

5. There is no need for the final rule to define "derivative," but should it do so, the definition must be appropriately broad so as to avoid inadvertent exclusion of common derivative products.

The OCC requests comment on whether it should include a definition of the term "derivative" in the final rule, whether a definition of this term would be necessary to appropriately scope the proposed provision, and whether any definition would be workable in practice. To the extent a definition is

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would be for the rule to include a new, additional definition for "individually-hedged" transactions, which would reflect traditional hedging methods that may otherwise fall between "perfectly-matched" and "portfolio-hedged." Just as a portfolio of transactions may be hedged based on net unmatched positions or exposures in the portfolio, an individual transaction may be hedged with one or more trades or positions acquired or maintained by a bank for the purpose of offsetting the market risk of that specific transaction even though the types of trades or positions and their terms may not match. Some banks not engaged in portfolio hedging may hedge in this manner—or even if they do, certain hedges may be acquired or maintained for specific transactions even though they may not be perfectly-matched. This definition would thus capture the example total return swap transaction noted above and ensure that part 7 does not arbitrarily and unnecessarily preclude certain important types of permissible hedging techniques.

12 OCC Interpretive Letter No. 1033 (June 14, 2005); OCC Interpretive Letter No. 935 (May 14, 2002); OCC Interpretive Letter No. 892 (Sept. 13, 2000).

13 As for the previous paragraph, should the final rule indicate or suggest that these types of hedging transactions do not constitute "perfectly-matched," it should, at a minimum, clarify that such transactions thus do qualify as "portfolio-hedged."

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necessary, the OCC suggests that "derivative" be defined as follows and requests comment on the definition: "a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indexes, or other assets, except a derivative does not include a: (1) Retail forex transaction, as defined in 12 C.F.R. § 48.2; (2) Security; (3) Loan or loan participation; (4) Deposit; (5) Banker's acceptance; or (6) Letter of credit."

As a general matter, we do not believe it is necessary to define "derivative," as there is generally a common understanding of the term, as reflected in existing precedent, regarding the breadth and scope of what may constitute a derivative transaction. Moreover, we are concerned that including a specific definition of this term in the final rule, such as the one on which the OCC seeks comment, could create unnecessary and inadvertent uncertainty and ambiguity as to whether some common derivatives are within the scope of the definition.[14]

To the extent that the final rule does include a definition, it is crucial that this definition be appropriately broad and dynamic, and include (*but not be limited to)* transactions that constitute derivative contracts under the risk-based capital rules, accounting standards, and other applicable frameworks. In this regard, we note that the specific definition on which the OCC has sought comment is highly problematic because it includes language that, by excluding certain enumerated transactions, would introduce unnecessary ambiguity as to the scope of bank-permissible derivative transactions. That exclusionary language should be removed for several reasons. First, as a general matter, national banks have clear and express authority elsewhere to engage in many of the transactions listed in the proposed exception language (e.g., loans, deposits, and letters of credit), and national banks need not rely on new proposed § 7.1030 to engage in such activities, such that their exclusion is superfluous. Second, the proposed exclusion of any "security" would be particularly problematic, as that term itself is susceptible to a range of different definitions for different purposes, and could be inappropriately construed to prohibit national banks from engaging in certain equity derivative transactions that have long been considered bank-permissible,[15] including those in which equity derivatives are held for hedging purposes consistent with existing OCC precedent (e.g., the use of futures for hedging purposes).[16] For that reason, should the final rule define the term, we strongly suggest that the phrase "except a derivative does not include a: (1) Retail forex transaction, as defined in 12 C.F.R. § 48.2; (2) Security; (3) Loan or loan participation; (4) Deposit; (5) Banker's acceptance; or (6) Letter of credit" be

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14 In this regard, we note the extraordinary complexity associated with attempts to definitively define derivative transactions in other contexts. *See, e.g.,* Commodity Futures Trading Commission and Securities and Exchange Commission, *Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012).

15 *See* OCC Interpretive Letter No. 949 (Sept. 19, 2002) (concluding that derivatives activities involving equity options and forwards are permissible for a national bank; also noting that the OCC has found that equity swaps and equity index swaps are bank permissible). We also note that, similarly, the absence of any reference to forwards in the definition on which the OCC has sought comment could also be inappropriately misconstrued as implying these are not bank-permissible derivatives, which would be inconsistent with existing OCC precedent. *See, e.g., id.*

16 OCC Interpretive Letter No. 937 (June 27, 2002); OCC Interpretive Letter No. 652 (Sept. 13, 1994). *See also* OCC Interpretive Letter 1037 (Aug. 9, 2005); OCC Interpretive Letter 961 (Mar. 17, 2003); OCC Interpretive Letter 896 (Aug. 21, 2000); and OCC Handbook, *Risk Management of Financial Derivatives* (Jan. 1997) at 75 (stating that national banks may enter into matched and unmatched equity and equity index swaps (equity derivative swaps) as agent or principal, and that a national bank may hedge risks arising from any unmatched equity derivative swaps by purchasing and selling exchange-traded futures and options, government securities, or forward contracts).

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struck, and replaced by language that, similar to the OCC's capital rules, makes clear that a "derivative" includes interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and similar instruments.[17]

B. The proposed set of permissible derivatives transactions in § 7.1030(c) should be revised to provide for permissible physically-hedged derivatives activities that are cash-settled, as well as physically-settled.

The proposal's relevant provision permitting certain types of physically-hedged derivatives transactions (prongs (c)(4) and (c)(5) of § 7.1030(c)) would only permit such transactions if they are physically-settled, with the consequence that derivatives transactions that are cash-settled but physically-hedged are not permitted. Consistent with prior precedent, the relevant prongs should be revised to clarify that physically-hedged derivatives may be *either* physically-settled *or* cash-settled.[18]

To the extent the final rule continues to differentiate between cash- and physically-settled trades, the final rule should also, consistent with OCC precedent, confirm that, where a national bank has a physically-settled trade the settlement of which it directs to an affiliate, the trade would be deemed to be cash-settled.[19] Indeed, many commodity derivatives by banks are structured essentially as financings—for example, a bank would enter into a derivative with a customer where the bank extends a cash "loan" via an upfront payment, and at a date in the future when the customer is scheduled to deliver that commodity to the bank, the bank offloads that commodity to a third party buyer or to an affiliate (under transitory title authority) to recover its cash payment (while maintaining legal rights to the commodity prior to settlement, effectively as a security interest).

C. The notice requirements in § 7.1030(d) should be revised to ensure consistency in supervisory standards and should not define categories of "underlying" by regulation, but rather should take a substantially more principles-based approach to determining when prior notice is required that looks primarily to the risk management implications and challenges of any potential new derivatives activity.

The proposed notice requirements should be revised in two key ways to improve consistency in supervisory standards among national banks, reduce regulatory burden, and better align the requirement with the purpose it serves, i.e., to facilitate new supervisory review of a bank's risk management and internal controls when the bank engages in new activities that pose materially new risk management considerations and challenges.

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17 *See* 12 C.F.R. § 3.2.

18 We note that one way in which this might be achieved would be to substantially simplify prongs (c)(3)-(c)(5) by (i) incorporating all relevant conditions applicable to those transactions that are physically-settled—i.e., the requirement that physical settlement either occur by transitory title transfer or subject to the conditions articled in (c)(5)—into a single subsection, similar to the structure by which the OCC has proposed to establish conditions for physically-hedging; and (ii) addressing any distinctions between such trades as they may be required for prior notice purposes in the prior notice provisions of the proposed rule.

19 OCC Interpretive Letter No. 949 (Sept. 19, 2002).

1. The regulation should be revised to clarify that the proper role of supervisors in evaluating derivatives activities relates to consistently applying safety and soundness standards, not evaluating legal permissibility.

Section 7.1030(d)(1) of the proposal would require a national bank to provide Examiner-in-Charge ("EIC") notice at least 30 days before engaging for the first time in any of the derivatives hedging or financial intermediation activities described in proposed § 7.1030(c)(2)-(5). For example, this notice requirement would apply if a national bank has previously engaged in cash-settled derivatives with respect to a particular underlying as described in § 7.1030(c)(3) but seeks to begin physically settling transactions as described in § 7.1030(c)(4) or (5), or if a national bank seeks to begin engaging in derivatives hedging activities pursuant to § 7.1030(c)(2) or to expand the national bank's derivatives hedging activities to include a new category of underlying.

As a general matter, we agree that safety and soundness review by OCC supervisory teams is important and appropriate with respect to derivatives activities. However, the final rule should revise this proposal in two ways to improve consistency and transparency in supervisory standards for permissible derivatives activities. First, the regulation should clearly distinguish between the legal permissibility of derivatives transactions (to be governed by § 7.1030 and the OCC's legal interpretations thereof) from firm-specific prudential concerns, to be reviewed by the EIC and supervisory team. Given that one goal of the proposal is to codify OCC interpretations on legal permissibility of derivatives transactions, there should not be idiosyncratic supervisory standards or procedures, or supervisory discretion employed, to evaluate the legal permissibility of national bank derivatives activities relative to any other permissible activity permitted under the National Bank Act; this should be answered by law and regulation alone, and such permissions should be transparent to banks.

Second, the regulation should require an EIC to consult with OCC leadership before raising any *categorical* safety and soundness concerns about an activity—that is, concerns that relate to the nature of the derivatives activity itself as distinct from concerns with a bank's specific risk management practices, which of course are appropriately the remit of the examiner. The final rule should clearly provide for consistent and uniform standards with respect to evaluating the safety and soundness of certain types of derivatives activities as a categorical matter, with the EIC and supervisory team focusing only on idiosyncratic, bank-specific aspects of the relevant activity. In addition to helping to ensure equal supervisory treatment and fair competition among national banks, and transparency as to what constitutes permissible bank activities as a legal and policy matter, this requirement would contribute to making derivatives activities more accessible to national banks, in turn making derivatives markets more liquid, resilient, and efficient.

2. The final rule should avoid defining categories of "underlying" by regulation, and instead prescribe clear principles to govern when and in what circumstances a national bank would be required to provide prior notice under proposed § 7.1030 that look primarily to the risk management implications of any proposed new activity.

In defining "new category of underlying," the OCC notes that prior OCC interpretations have addressed several categories of permissible underlyings for national bank derivatives transactions and requests comment on whether the regulation should list these categories. If the regulation were to list these categories, the OCC requests comment on whether the regulation should specify that any new derivatives activities not falling within one of the specified categories also requires notice.

We do not believe it is necessary to define such categories by rule, and indeed are concerned that doing so for purposes of determining when prior notice is required would misalign the notice process with the underlying policy goals that are intended to be served by the supervisory review of risk management and internal controls that is triggered by receipt of that notice. For that reason, we strongly suggest that the final rule take a substantially more principles-based approach to determining when prior notice is required that looks primarily to the risk management implications and challenges of any potential new derivatives activity. Specifically, the final rule should make clear that prior notice is required only when a national bank commences a new activity or modifies an existing activity that would expose the bank to, and require the bank to manage and control, a material and substantially new type of market risk. Such a principle would help to make clear that new or modified derivatives activities that pose new and novel market risk factors—such as expanding a bank's activities from oil-based to gas-based derivatives—would require prior new notice, but more minor changes in activity that involve substantially comparable types of market risk—such as expanding from corrugated cardboard-based derivatives to non-corrugated cardboard-based derivatives—would not.

D. No notice should be required under the final rule where a national bank engages in permissible derivatives activity that is hedged either (i) using mirrored transactions that involve no market risk or (ii) on a nearly perfected-matched basis that involves only de minimis residual market risk.

Consistent with the broader goal of aligning the notice process with the underlying policy goals that are intended to be served by the supervisory review of risk management and internal controls that is triggered by receipt of that notice, we believe that the proposed notice requirement is overly broad in two clear cases that would require a notice for derivative activities that pose little or no market risk to manage. First, where a national bank is engaged in derivatives activities that are hedged solely through fully offsetting mirrored transactions, the bank is not exposed to market risk that must be managed, such that no notice requirement should be imposed. Second, and similarly, where a national bank is engaged in derivatives activities on a nearly perfectly-matched basis, the bank is only exposed to de minimis residual market risk, such that no notice requirement should be imposed. In contrast, where a national bank is engaged in derivatives activities that are hedged on a portfolio basis pursuant to which the bank is actively managing an inventory of market risks, imposing a notice requirement is appropriate as it would facilitate supervisory review of a bank's risk management and internal controls in implementing that hedging strategy.

E. The final rule should provide greater clarity as to the scope and substance of any additional requirements imposed on physical hedging involving commodities.

The proposal would require that a national bank's physical position in a particular physical commodity (including, as applicable, delivery point, purity, grade, chemical composition, weight, and size) must not be more that 5 percent of the gross notional value of the national bank's derivatives that are in that particular physical commodity and allow for physical settlement within 30 days. Title to commodities acquired and immediately sold by a transitory title transfer would not count against the 5 percent limit. The OCC requests comment on whether the rule should reflect any additional standards regarding the underlyings that are permissible for financial intermediation in derivatives and how national banks may hedge these activities.

Although we acknowledge that these proposed restrictions on physical hedging commodities reflect certain existing OCC supervisory guidance, we note that the 5 percent limit is ambiguous and overly prescriptive in certain respects, and thus make three recommendations. First, we note that restricting a bank's "physical position in a particular physical commodity" at the level of granularity proposed (e.g., by delivery point, purity, grade, chemical composition, weight, and size) would create artificial distinctions between commodity contracts that are treated as largely equivalent to each other for financial risk management purposes and do not involve materially different types of market risk (e.g., physically-settled contracts on West Texas Intermediate and Brent crude oil), and thus could limit the ability of national banks to provide liquidity in newer and developing benchmarks. To better align the 5 percent limit with financial risk management practices, we recommend that this limit be calculated with respect to the principles-based approach to differentiating between market risk types described above in section II.C.2 of this letter (i.e., the denominator with respect to a given transaction would include all transactions that implicate substantially equivalent market risk). Second, the OCC should expressly confirm that the 5 percent limit is intended to be calculated in the same manner described in OCC Bulletin 2015-35.[20] Third, and in connection with that confirmation, we believe that it would be helpful if the OCC provided greater clarity and specificity regarding the derivatives that are included in the 5 percent test's denominator because they "allow for physical settlement within 30 days." For example, it would be helpful if the OCC would confirm that the denominator includes derivatives that require or permit (e.g., because the bank has the right to terminate and settle the transaction prior to maturity) physical settlement within 30 days of any date of determination.

In addition to the above restrictions on a national bank's physical position in a particular physical commodity, the proposal would require that the physical position must "more effectively" reduce risk than a cash-settled hedge referencing the same commodity. This proposed effectiveness standard for physical hedging is not consistent with existing OCC precedent in a range of cases, and we are concerned that it could give rise to inappropriate "second-guessing" of a bank's risk management choices when hedging. For that reason, we suggest that the final rule instead require that any physical hedge be "at least as effective as" a cash-settled hedge, with an individual bank's risk management approach to evaluating and determining hedge effectiveness subject to examiner oversight as part of the notice process.

III. Payment System Memberships

To provide additional clarity to national banks and FSAs, the OCC proposes to add a new § 7.1026 to part 7 that is intended to codify the current process for joining a payment system. While we strongly support codification and simplification of prior OCC interpretive letters and precedent on this point, several changes to proposed § 7.1026 would provide greater certainty and reduce regulatory burden for national banks and FSAs that wish to join a payment system, as described below.

A. The final rule should clarify the OCC's risk management expectations by incorporating the relevant factors in previous interpretive letters.

The proposal would require a national bank or FSA to notify the appropriate OCC supervisory office if its ongoing risk management identifies a safety and soundness concern, such as a material change to the national bank's or FSA's liability or indemnification responsibilities, as soon as that concern is identified, and to take appropriate actions to remediate the risk. The OCC requests comment on whether to include any of the risk remediation criteria outlined in OCC Interpretive Letter 1140 and

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[20] OCC Bulletin 2015-35, "Quantitative Limits on Physical Commodity Transactions" (Aug. 4, 2015), https://www.occ.treas.gov/news-issuances/bulletins/2015/bulletin-2015-35.html.

OCC Banking Circular 235 related to the analysis of (i) the payment system and its membership criteria and (ii) criteria for an effective risk management program to the safety and soundness requirements in proposed § 7.1026(e).

We generally support the proposed ongoing risk management requirements, which would codify a regime that we believe is appropriate, but request that the final rule be revised to include the standards of risk management analysis outlined in Interpretive Letter 1140 and modified by Interpretive Letter 1157. These interpretive letters helpfully describe the OCC's view on the characteristics of an effective risk management analysis of a payment system and its membership criteria. It would be beneficial if the final rule established the relevant standard at the level of detail addressed in these letters and, in particular, if it described the most important factors in Interpretive Letter 1140 under particular circumstances.[21]

B. A national bank or FSA that believes its open-ended liability is otherwise limited should not be required to obtain a legal opinion to that effect, and instead should be required to have a good faith, reasoned basis for making that determination.

The proposal would require that a national bank or FSA that believes its open-ended liability is otherwise limited (e.g., by negotiated agreements or laws of an appropriate jurisdiction) may consider its liability to be limited if, before joining the payment system, the national bank or FSA obtains an independent legal opinion. The proposal would require that this legal opinion describe how the payment system allocates liability for operational losses and conclude that the potential liability for operational losses for the national bank or FSA is limited to specific and appropriate limits that do not exceed the lower of (i) the legal lending limit under 12 C.F.R. § 32 or (ii) the limit set for the national bank or FSA by the OCC.

A formal legal opinion, whether from an in-house attorney or from an outside law firm, is not appropriate or necessary in all cases of considering whether liability is open-ended. Rather, national banks and FSAs employ a range of approaches to evaluating the operational risks of joining payment systems, and the complexity and magnitude of the underlying analysis may vary widely depending on the nature of the payment system. Similarly, national banks and FSAs may employ a range of approaches in procuring legal advice concerning their liability under a payment system, and the scope and substance of the legal issues involved may vary substantially across different payments systems and circumstances, such that it would be both unnecessary and inappropriate to impose by regulation a single, prescriptive mandate as to how this legal advice should be procured and memorialized. For this reason, a national bank or FSA should have the flexibility to conduct this analysis in an appropriate way, consistent with its risk management program and related policies, so long as it has a good faith, reasoned basis for concluding its open-ended liability is limited. Regardless of what level of legal diligence is required (i.e., independent opinion, good faith, reasoned basis, or some other standard), the final rule should also make clear that, once a bank has joined a payment system, it need only undertake that analysis and diligence again in cases where there is a material change to the liability or indemnification provisions applicable to the bank under that payment system.

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[21] This clarity would be particularly helpful given that there may be some ambiguity in the application of these factors resulting from Interpretive Letter 1157, which states in a footnote that "banks may continue to consult IL No. 1140 to inform the risk analyses and controls" and that the "criteria identified in IL No. 1140 for an effective risk management program for payment system activities may be instructive." OCC Interpretive Letter No. 1157 (Nov. 12, 2017).

C. The definition of "operational loss" should be adopted largely as proposed, and cybersecurity breaches should be added to the list of examples.

The OCC proposes to define "operational loss" as a charge resulting from sources other than defaults by other members of the payment system. Examples of these operational losses, which are listed in OCC Interpretive Letter 1140, would be losses that are due to employee misconduct, fraud, misjudgment, or human error; management failure; information systems failures; disruptions from internal or external events that result in the degradation or failure of services provided by the payment system; or payment or settlement delays, constrained liquidity, contagious disruptions, and resulting litigation.

We generally support the proposed definition of "operational loss," because it aligns with OCC precedent and notes that the types of operational loss cited are simply examples. This flexibility will allow national banks and FSAs to evaluate operational loss in the way that is most appropriate given the circumstances of a particular payments system. We also suggest, however, that the final rule clarify that cybersecurity-related losses would fall within the definition of "operational loss" for this purpose.

D. The final rule should acknowledge that, notwithstanding the requirement that national banks and FSAs complete their risk assessment of the payment system before joining, certain key aspects of the national bank's or FSA's risk management processes may occur after joining (e.g., testing of payment system IT to which it only has access after joining).

The proposal would require a national bank or FSA, prior to joining a payment system, (i) to identify and evaluate the risks posed by membership in the payment system, taking into account whether the liability of the national bank or FSA is limited; and (ii) to ensure that it can measure, monitor, and control these identified risks.

While we strongly agree that an appropriate risk assessment of the payment system prior to joining that system is important, we note that risk assessment and management is a continuing process, and in some cases key aspects of a bank's risk management processes may necessarily occur after it has joined the system—for example, final testing of the payment system's IT systems, to which the bank may only have access after joining, but before live transactions are processed. It would thus be helpful for the final rule to acknowledge that certain key aspects of a bank's risk assessment of payments system membership may occur after it has joined the system.

IV. Tax Equity Finance Transactions

The OCC proposes to codify in part 7 its interpretations permitting a national bank or FSA to engage in TEF transactions. We generally support the OCC's proposal, which would provide greater clarity on the regulatory requirements for these transactions, subject to several key recommendations intended to clarify and simplify the framework and avoid unnecessary administrative burdens in applying it.

As an initial matter, it would be helpful if the final rule clarified that the authority to enter into a TEF transaction derives from 12 U.S.C. §§ 24(Seventh) and 1464 for, respectively, national banks and FSAs, and therefore that the provisions in part 7 on TEFs do not apply to tax credit investments that (i) national banks may enter into under their public welfare investment authority in 12 U.S.C. § 24(Eleventh) and part 24 or (ii) FSAs may enter into under 12 U.S.C. § 160.30.[22]

A. Several of the criteria for the qualification of a TEF as a "functional equivalent of a loan" should be clarified, and a legal opinion should not be required.

In the proposal, a TEF transaction would qualify as the functional equivalent of a loan, and therefore be permissible for a national bank or FSA (subject to other conditions in the proposal), if it meets enumerated requirements that derive from OCC interpretations: (i) the structure of the transaction is necessary for making the tax credits and other tax benefits available to the national bank or FSA; (ii) the transaction is of limited tenure and is not indefinite, though it permits a national bank or FSA to retain the limited investment interest required by law to obtain continuing tax benefits; (iii) the tax benefits and other payments received by the national bank or FSA from the transaction repay the investment and provide the expected rate of return; (iv) the national bank or FSA does not rely on appreciation of value in the project or property rights underlying the project for repayment; (v) the national bank or FSA uses underwriting and credit approval criteria and standards that are substantially equivalent to the underwriting and credit approval criteria and standards used for a traditional commercial loan; (vi) the national bank or FSA is a passive investor in the transaction and is unable to direct the affairs of the project company; and (vii) the national bank or FSA appropriately accounts for the transaction initially and on an ongoing basis and has documented contemporaneously its accounting assessment and conclusion.

1. A national bank or FSA should not be required to obtain a legal opinion on the tax benefits of a TEF transaction, but rather should be required to have a good faith, reasoned basis for making that determination.

In connection with the requirement that the structure of the transaction is necessary to make the tax benefits available, the OCC has requested comment on whether national banks or FSAs routinely obtain legal opinions regarding the availability of tax credits in connection with these types of finance transactions.

Such a legal opinion should not be required, because although national banks have developed appropriate processes to evaluate the tax treatment of TEF transactions and generally obtain opinions from outside tax counsel as to the effectiveness of the structure in making tax credits available to the national bank or FSA, it is not market practice to obtain a legal opinion that says that a TEF structure is *necessary* in order for the tax credits to be availed. The word "necessary" implies that this is the only available structure that can be utilized for all such transactions. The proposal should recognize that national banks and FSAs employ a range of approaches to evaluating the tax benefits of TEF transactions and instead require that national banks and FSAs conduct a reasoned analysis of the availability of tax credits in connection with a TEF transaction. This approach would more effectively balance regulatory burden with safety and soundness.

2. The final rule should clarify that TEF investments may be retained for the duration needed to obtain the expected rate of return.

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22 *See also* OTS Op. Ch. Couns. (May 10, 1995) (Community Development Investments). We also note that FSA service corporations may enter into TEF transactions as a community or public welfare investment under 12 C.F.R. § 5.59.

The final rule should clarify that its proposed requirement that a TEF investment be "of limited tenure" and "not indefinite" would be construed in a manner consistent with market practices for such investments, pursuant to which national banks and FSAs may retain an investment interest in a TEF transaction (i) for the duration necessary to receive the tax benefits or (ii) for the amount of time needed to repay the investment and provide the expected rate of return, which in some cases may be longer than the period for which tax benefits are available. The latter may be necessary based on the anticipated facts and circumstances of the TEF transaction at origination, or may become necessary over the life of the transaction—for example, if a project underperforms relative to its expected rate of return, a national bank or FSA may need to retain its limited investment interest for longer than planned when initially making the investment in order to achieve the expected rate of return.

Accordingly, the final rule should clarify in the preamble that national banks or FSAs have the flexibility needed to hold a TEF investment not only to obtain the tax benefits of the transaction, but also to repay the investment and achieve the expected rate of return, taking into account the performance of the TEF investment over time.[23] The final rule also should clarify that, to the extent the national bank or FSA would exit the TEF investment by selling it to a third party, a reasonable amount of time is necessary to effect this transaction; allowing the national bank or FSA too little time may effectively force the institution to sell the investment at a lower price than would otherwise be obtained. Moreover, the rule set forth in the preamble noting that the limited tenure requirement discussed above may be satisfied if the project sponsor has an option to purchase the national bank's or FSA's interest at or near fair market value should be expanded to make clear that a purchase option price that additionally includes an amount necessary for the national bank or FSA to achieve its expected rate of return also satisfies such requirement, as this is consistent with market practice in many TEF transactions.

3. The final rule should clarify that the calculation on rate of return is the expected rate of return at the time that the investment is initially made.

The final rule should expressly confirm that the relevant expected rate of return for purposes of the proposal is the expected rate of return at the time that the investment is made, and therefore that the permissibility of the transaction is not re-evaluated over the course of the investment. As a general matter, the legal permissibility of the transaction should not hinge on the performance of the project or portfolio or on the success or failure of the transaction—e.g., whether the tax benefits and other payments received by the national bank or FSA from the transaction have provided the expected rate of return at the time that the national bank or FSA exits the transaction or at any other time during the life of the investment. This requirement should be modified in the final rule to clarify that it applies only at the time that the national bank or FSA enters into the transaction. The final rule could refer to the expected rate of return at original underwriting, consistent with Interpretive Letter 1139.[24]

4. The final rule should clarify that customary protective rights and covenants are permitted and do not violate the "passive investor" requirement.

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23 For the avoidance of doubt, as discussed further in this paragraph, there will be a period of time once the expected rate of return is achieved that is required to confirm the expected return has been achieved and for the sale of the TEF investment or for the sponsor purchase option to become available. The national bank or FSA would need to continue to hold its TEF investment to account for such items.

24 OCC Interpretive Letter No. 1139 (Nov. 13, 2013).

Although we do not object to the proposed "passive investor" requirement in principle, it should be revised or clarified so as to make clear that a national bank or FSA may retain customary protective rights and covenants without violating this requirement. Specifically, the proposal should allow national banks and FSAs to hold the type of rights previously permitted in TEF investments, which are intended to allow the passive investor to protect its investment despite not being involved in the day-to-day management or operations of the project and therefore are consistent with safety and soundness. In the past, the OCC has permitted the documents governing national bank TEF transactions to contain many of the same terms, conditions, and covenants typically found in lending and lease financing transactions, such as conditions precedent to the national bank funding the project pertaining to the mitigation of risks; covenants requiring the company and the other investors in the company to provide the national bank with customary financial information; restrictions on the company with respect to the incurrence of liens and additional debt, merger, consolidation, or divesting of assets; and other covenants restricting the company from taking certain actions.[25] As with loans and other extensions of credit generally, and loans similar in scope and size to TEF transactions specifically, these customary rights and covenants promote safety and soundness by allowing the national bank or FSA to mitigate its risk. It follows that these protections should be permissible for TEF transactions.[26]

B. The final rule should provide greater flexibility for national banks and FSAs to meet the requirement that they not control the sale of energy from a TEF project, and there should not be a cap on or notice requirement for TEF transactions.

Proposed § 7.1025(d) would provide that a national bank or FSA only could engage in TEF transactions if it meets four additional criteria; we discuss the first three of these in greater detail in this section. The final rule should grant national banks and FSAs appropriate flexibility in meeting the first criterion, which is that they not control the sale of energy from the project. In addition, both the second proposed criterion (which would impose a cap on TEF transactions) and the third (which would require notice for each TEF project) should be removed because they are neither appropriate nor necessary.

We also note that, as an initial matter, the fourth criterion would require that the national bank or FSA is able to "identify, measure, monitor, and control the associated risks of its TEF transaction activities individually and as a whole on an ongoing basis to ensure that such activities are conducted in a safe and sound manner." To avoid any ambiguity regardless of the appropriately passive nature of a

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25 *See* OCC Interpretive Letter No. 1048 (Dec. 21, 2005) and OCC Interpretive Letter No. 1139 (Nov. 13, 2013).

26 We note that such permissible rights and covenants would include, but not be limited to, those identified under the Federal Reserve's rules implementing the Gramm-Leach-Bliley Act's merchant banking authority as types of covenants or other provisions that do not constitute "routinely managing or operating" a company. These rules permit a financial holding company investor to obtain covenants or other written agreements with a portfolio company that restrict the ability of the portfolio company, or require the portfolio company to consult with or obtain the approval of the financial holding company, to take actions outside of the ordinary course of the business of the portfolio company. *See* 12 U.S.C. § 1843(k)(4)(H); 12 C.F.R. §§ 225.170-177 and part 1500. Among other examples, under these rules, the financial holding company may restrict the ability of the portfolio company to alter its capital structure through the issuance, redemption, authorization, or sale of any equity or debt securities; create, incur, assume, guarantee, refinance, or prepay any indebtedness outside the ordinary course of business of the portfolio company; hire, remove, or replace any or all of the executive officers of the portfolio company; or alter significantly the business strategy or operations of the portfolio company such as, for example, by entering or discontinuing a significant line of business, or altering significantly the tax, cash management, dividend, or hedging policies of the portfolio company. *See* Federal Reserve Board Interpretive Letter from J. Virgil Mattingly, General Counsel of the Federal Reserve Board, to Peter T. Grauer, 2001 WL 35988616 (Dec. 21, 2001).

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national bank's or FSA's investment, it would be helpful if the final rule eliminated the word "control," or otherwise acknowledged that the use of that term is not meant in any way to suggest that national banks and FSAs should have anything more than the limited control over TEF transaction activities that is consistent with the passive nature of these investments. The word "control" could be read to imply that national banks or FSAs can restructure or otherwise direct the transaction, but national banks and FSAs of course would only be permitted to have the types of consent rights and other protections discussed above in section IV.A.4.

1. The final rule should clarify that national banks and FSAs have appropriate flexibility in satisfying the requirement that they not control the sale of energy from a TEF project.

The first of these four criteria is that the national bank or FSA cannot control the sale of energy, if any, from the project. The preamble to the proposal notes that, to satisfy this requirement, a national bank or FSA could enter into a long-term contract with creditworthy counterparties to sell energy from the project, as articulated in OCC Interpretive Letter 1139,[27] or have the project sponsor bear responsibility for selling generated power into the energy market so long as those sales are stabilized by a hedge contract that provides reasonable price and cash flow certainty, as articulated in OCC Interpretive Letter 1141.

The final rule should confirm that national banks and FSAs may make TEF investments in which the underlying project(s) may enter into *any* type of contract for the sale of energy for the time period necessary to obtain the expected rate of return at the time that the investment is made, and that "reasonable . . . cash flow certainty" is expected consistent with safe and sound banking practices. This may include arrangements (e.g., structural priorities) that have the effect of mitigating the exposure or otherwise providing cash flow certainty. An actual long-term contract or hedge need not and should not be required if the national bank or FSA has otherwise determined that exposure to cash flow certainty has been adequately mitigated. Such a results-oriented approach would provide national banks and FSAs with greater flexibility in determining how best to obtain reasonable cash flow certainty without undermining the safety and soundness of the activity nor the legal and policy principles that underlie the bar on controlling the sale of energy from a TEF project. Additionally, as discussed further below, the final rule should confirm that contracts for the sale of energy can be entered into with an affiliate(s) of the national bank or FSA participating in the TEF transaction, so long as such contracts are consistent with the requirements above and do not create negative tax consequences.

In addition, in certain TEF transactions, we note that tax benefits may be lost if the project company sells electricity to certain categories of taxpayers or parties related to the project company. The final rules should clarify that the right of a national bank or FSA to prohibit such sales does not constitute inappropriate control of the right to sell power from the project for this purpose. The final rules should also recognize that the TEF project may sell a portion of the electricity that it generates into the merchant market, and not pursuant to a power purchase agreement or a hedge contract. A national bank or FSA should be permitted to invest in such projects as long as it has reasonably determined that

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[27] We note that, consistent with Interpretive Letter 1139, it is generally the underlying project that enters into such a contract, and not the national bank or FSA that has invested in that project. Accordingly, we suggest the relevant language of the proposal be revised to avoid any ambiguity in this regard.

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any merchant sales by the project company contribute favorably to the overall financial health of the project company.

Lastly, the final rule should codify OCC Interpretive Letter 1141 and explicitly confirm that the project company's hedging counterparty need not be an unaffiliated third party, but may also be the national bank or FSA, or an affiliate of the national bank or FSA.[28] This clarification would preserve the existing flexibility provided to national banks and FSAs to achieve cash flow predictability when determining how best to avoid controlling the sale of energy from a TEF project, aligning the final rule with existing OCC precedent.

2. The final rule should not impose a cap on TEF transactions by national banks and FSAs.

The second of the four criteria is that the national bank or FSA must limit the total dollar amount of TEF transactions to no more than five percent of its capital and surplus unless the OCC determines, by written approval of a written request by the national bank or FSA to exceed the five percent limit, that a higher aggregate limit will not pose an unreasonable risk to the national bank or FSA and that the TEF transactions in the national bank's or FSA's portfolio will not be conducted in an unsafe or unsound manner. The section further requires that in no case may a national bank's or FSA's total dollar amount of TEF transactions exceed fifteen percent of its capital and surplus. The OCC requests comment on whether the final rule should use an alternate measure when calculating the aggregate investment limit and whether the proposed five percent aggregate investment limit is appropriate.

Although the OCC has imposed capital-and-surplus-based limits on certain subsets of TEF transactions in the past, the proposed caps on all TEF transactions as a class is neither necessary nor consistent with existing OCC precedent. TEF transactions do not pose any type of concentration or similar risk that differs from that posed by other types of lending exposures. Accordingly, TEF transactions are and should continue to be subject to the limits set forth in 12 C.F.R. part 32, which are appropriate and adequate to any concentration or similar risks presented by TEF transactions.[29]

We also note that, in addition to generally applicable lending limits, large national banks are subject to the OCC's Heightened Standards, which imposes the requirement that the institution's risk governance framework include concentration risk limits.[30] Thus, any large national bank with a significant TEF portfolio is already required to identify, measure, monitor, and control any concentrations of risk arising from these transactions. This analysis is more sophisticated and targeted than a simple cap on investment—it may evaluate, for example, risks in the TEF portfolio related to

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[28] OCC Interpretive Letter No. 1141 (April 22, 2014) (permitting a renewable wind facility to sell its energy into the local electricity market, and to protect against power price volatility using a hedge contract with an unaffiliated third party).

[29] *See, e.g.,* Interpretive Letter No. 1139 (Nov. 13, 2013) (noting that the national bank would include the proposed TEF financing in the calculation of its legal lending limits).

[30] 12 C.F.R. part 30, appendix D.I.

(continued…)

geography or sector—and thus provides an existing and more nuanced approach to managing the risks of TEF transactions in the aggregate.[31]

3. The final rule should not require notice before a national bank or FSA engages in a TEF transaction.

The third of the four criteria is that the national bank or FSA must provide written notification to the OCC prior to engaging in each TEF transaction, which notification must include the national bank's or FSA's evaluation of the risks posed by the transaction. This requirement is not necessary, and would impose significant regulatory burdens without providing much, if any, offsetting benefit. The EIC and supervisory team already have full access to information about, and the documentation for, each TEF transaction entered into by a national bank or FSA. Further, the proposal would require, consistent with risk governance principles generally, that the national bank or FSA can identify, measure, monitor, and control the associated risks of its TEF transaction activities individually and as a whole on an ongoing basis to ensure that it conducts such activities in a safe and sound manner. (We have separately commented above on the use of the term "control" in this proposed requirement.) To assess compliance with this requirement, the EIC and supervisory team may review the institution's risk management activities with respect to individual TEF transactions and the TEF portfolio generally at any time. In addition, TEF transactions contain many of the same terms, conditions, and covenants typically found in lending and lease financing transactions—but no prior notice is required for loans generally, of course, and such transaction-by-transaction notice would impose meaningful burdens with little corresponding benefit. For these reasons, the proposal's prior notice requirement should not be adopted in the final rule.

If the OCC nonetheless determines that some form of notice is required, given the arguments above and the minimal benefit of providing separate notices for each successive TEF investment, we suggest that the final rule require notice only when a national bank or FSA first commences the activity of engaging in TEF transactions, and that such notice be made on an after-the-fact basis and need not include an evaluation of risks related to TEFs generally or any TEF investment specifically. This approach would be consistent with the procedures by which qualifying national banks may provide notice to the OCC that they have established or acquired an operating subsidiary, performed a new activity in an existing operating subsidiary, or made a non-controlling equity investment. After-the-fact notice would alert the EIC and supervisory team to the commencement of TEF transactions; supervisors could then elect to review the relevant documentation and risk management activities as and when they saw fit.

C. National banks and FSAs should be permitted to enter into the TEF transactions about which the OCC has requested comment.

The OCC requests comment on whether the final rule should prohibit a national bank or FSA from entering into TEF transactions for projects involving residential installation TEF transactions not involving utility-scale standalone power-generation facilities. The OCC also requests comment on

[31] Finally, another constraint on TEF transactions is the availability of tax credits and other tax benefits, which are the basis for structuring the transaction as a TEF, as well as bank earnings, which are needed to take advantage of those tax benefits.

(continued…)

whether the final rule should permit national banks or FSAs to invest in TEF transactions involving detached single-family residences, multi-family residences, or non-utility commercial buildings.

There are no compelling policy or legal reasons that national banks and FSAs should be prohibited from investing in these types of TEF transactions, as such projects would not generate greater risk than other types of TEF transactions,[32] nor do they raise any different or additional questions as to legal permissibility. As is consistent with permissible loans and leases, national banks should be permitted to determine what constitutes an appropriate transaction regardless of the end-user segment (e.g., utility, municipality, residential, community solar, commercial and industrial, hedge, etc.). For these reasons, the final rule should not prohibit such types of TEF transactions and instead should affirm longstanding OCC precedent that the legal permissibility of a TEF transaction is agnostic as to end-user segment and underlying asset.

In addition, we urge the OCC to confirm that there is no prohibition on, and that tax credit availability would not be affected by, national banks funding a portion of their TEF investment during late stage construction if required to qualify for the tax benefits and adequate protections are in place.

D. The final rule should not prescribe any particular contractual remedy for TEF transactions, but rather should allow national banks and FSAs the flexibility to choose the most appropriate remedies for a given transaction from among a range of permissible options.

The OCC requests comment on whether national banks and FSAs should have other contractual remedies available before entering into a TEF transaction. For example, the OCC requests comment on whether the final rule should require national banks or FSAs to have the option to replace the sponsor or manager of a project under certain conditions or be required to have indemnifications for breaches of tax representations or other legal risks. In the alternative, the OCC requests comment on whether the final rule should require a project sponsor or the sponsor's parent to make or guarantee such an indemnification.

The final rule should permit national banks and FSAs to obtain these contractual remedies (e.g., removal of manager, indemnification, and parent guarantees) as and when they determine doing so is appropriate as a risk management matter, but should not mandate these remedies in all cases. As discussed further in section IV.A.4 above, customary protective covenants like those noted here are important risk management tools and should be expressly permitted. However, mandating certain remedies, rather than permitting them, would create an overly-rigid framework that might constrain a national bank's or FSA's ability to negotiate with counterparties to obtain a final outcome that, in its totality, best manages the specific risks of that transaction. Certain mandated remedies may also hamper the tax and accounting treatments that are necessary for these transactions to work. The national bank or FSA is best positioned to determine which investor protections are appropriate for a given transaction, and their value as a risk mitigant relative to all other terms of the transaction—for example, an indemnification may be the most effective remedy in one transaction, while the right to remove executive management is more effective in another. Moreover, in many TEF transactions the remedies available to the tax equity party must be limited in certain circumstances to ensure that the TEF transaction is respected as an equity investment for tax purposes. Therefore, it is important that

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32 Indeed, these transactions are likely to be significantly smaller in size and to be aggregated into a diversified portfolio, thereby further mitigating risk.

the national bank or FSA have flexibility to structure remedies in a manner appropriate to ensure that the TEF transaction will be respected for tax purposes as contemplated by TEF transaction structures. For these reasons, the final rule should permit, but not require, national banks and FSAs to obtain these types of contractual protections.

E. The final rule should not prohibit national banks and FSAs from participating in fund-based TEF structures.

The OCC also requests comment on whether national banks and FSAs are currently participating in TEF transactions through fund-based structures, and, if not, whether national banks and FSAs wish to participate in TEF transactions through fund-based structures. The OCC also requests comment on whether there are additional issues related to fund-based structures and whether the final rule should include additional safeguards related to fund-based structures.

Prohibiting any particular TEF structure that is not otherwise inconsistent with the rule is neither necessary nor appropriate in light of the dynamic nature of the marketplace for TEF transactions and the tax credit regimes that underlie them, which continue to evolve. Similarly, as with other types of functional lending activities, national banks and FSAs may choose to participate in TEF transactions through a range of structures (e.g., by arranging or participating in TEF transactions along with other investors in a manner akin to traditional syndicated lending structures). In addition, and again as with other forms of functional lending, the use of a range of structures may create benefits (e.g., risk mitigation, diversification of investments, and efficiency of deal sourcing and negotiation) without introducing any incremental safety and soundness risks. For these reasons, we do not believe there is any compelling reason to prohibit or otherwise limit any specific structure through which a national bank or FSA may make a TEF investment that is otherwise consistent with the rule.

V. Corporate Governance

The OCC proposes to update and modernize § 7.2000, which provides a regulatory framework for national bank corporate governance. The OCC notes in the preamble to the proposal that it proposes these changes to reduce burden, provide greater clarity, and modernize the national bank charter with respect to corporate governance provisions.[33] We are generally supportive of this aspect of the proposal, including the revision allowing national banks to elect to follow the corporate governance provisions of the law of any state in which the main office or any branch of the bank is located, and we provide below specific suggestions to improve the proposal as it relates to the OCC's form articles of association and bylaws, the indemnification of IAPs, and the existing § 7.2010 on directors' responsibilities.

A. The OCC's form articles of association and bylaws should be reviewed to confirm that they are consistent with applicable federal banking statutes and regulations.

The proposal would not substantively change § 7.2000(a), which provides that a national bank's articles of association and bylaws and the national bank's conduct of its corporate governance affairs must comply with applicable federal banking statutes and regulations, as well as safe and sound banking practices. We note, however, that the OCC's form articles of association and bylaws contain requirements that are *not* mandated by federal banking statutes and regulations. For example, the form

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[33] Proposed rule at 40809.

articles of association provide that the board of directors has the power to establish or change the location of a branch of the bank, which in turn suggests that the establishment or change of the location of a branch requires board approval; similarly, the OCC's branch application requires evidence of the board resolution approving details of the transaction. However, there is no statutory or regulatory requirement for board approval of the establishment or relocation of a branch (other than 12 U.S.C. § 30, which is only relevant to main office relocations).

The OCC's form articles of association and bylaws should be reviewed and revised to eliminate this and any other requirements that are not actually mandated by applicable federal banking statutes and regulations. First, this review would be particularly important because, in practice, these forms are viewed as requirements (e.g., national banks and FSAs may be asked to justify deviations from these form documents in the context of applications), which is inappropriate and unnecessary because there is no statutory or regulatory basis for the de facto requirement. Second, this review would be important because imposing such a requirement conflates the role of the board of directors and that of management. A central tenet of effective corporate governance is the distinction between, and complementary nature of, the board's responsibility for oversight of the business and affairs of the banking organization, and management's responsibility for the day-today operations of the organization. Blurring of this distinction detracts from effective governance by potentially reducing the board's ability to focus on its core oversight functions, impairing the board's ability to perform its critical oversight role objectively, and creating uncertainty as to roles and responsibilities. Accordingly, while it is of course entirely appropriate for the board to oversee material strategic initiatives affecting the bank's branch network, responsibility for the location of particular branches generally should be left to management, subject (as elsewhere) to the general oversight of the board. This is especially true for large banks, which may have thousands or hundreds of branches. The form articles of association, bylaws, and other OCC form documents should reflect that such delegation to management is not only permissible, but also appropriate.

B. We support the proposal to allow national banks to elect to follow the corporate governance provisions of the law of any state in which the main office or any branch of the bank is located, among other options.

The proposal would revise § 7.2000(b) so that, to the extent not inconsistent with applicable federal banking statutes or regulations, or bank safety and soundness, a national bank may elect to follow the corporate governance provisions of the law of any state in which the main office or any branch of the bank is located, the law of the state in which a holding company of the bank is incorporated, the Delaware General Corporation Law, or the Model Business Corporation Act. We support this aspect of the proposal, which would allow national banks additional flexibility to follow the corporate governance provisions that it deems appropriate and create greater parity amongst different national banks with respect to available corporate governance frameworks. In some cases, this change also would helpfully allow the holding company and the national bank to select the same underlying corporate law, which would lead to administrative and related efficiencies.

C. Section 7.2009 should be revised to allow national banks to adopt the quorum requirements of the law of the relevant state, the Delaware General Corporation Law, or the Model Business Corporation Act, as applicable.

Under this provision of part 7, a national bank must provide in its articles of association or bylaws that, for the transaction of business, a quorum of the board of directors is at least a majority of the entire board then in office and that a national bank director may not vote by proxy. The OCC does not propose to substantively revise this requirement.

The final rule should revise this provision to allow national banks to adopt the quorum requirements of the law of the relevant state, the Delaware General Corporation Law, or the Model Business Corporation Act, as applicable. For example, Delaware General Corporation Law provides that a quorum may not be less than 1/3 of the total number of directors.[34] This change would significantly improve the efficiency of board oversight of national banks by allowing boards to more flexibly convene a quorum, consistent with standard corporate practices, without undermining the effectiveness of national banks' corporate governance. The recent COVID-19 pandemic, which necessitated that bank boards act quickly, has demonstrated that this efficiency is both important and necessary under emergency circumstances. In addition, bank holding company boards generally have experience operating with the quorum requirements of Delaware General Corporation Law or other applicable state law, and the board members of the holding companies frequently overlap with or mirror those of their national banks; the quorum requirements between the two entities therefore should be standardized and aligned to the well-understood, and more efficient, state law standards.

D. We generally support the OCC's reorganization of indemnification requirements, but the final rule should not incorporate the disinterested director vote or 60-day notice requirements of 12 C.F.R. § 145.121.

The OCC proposes to revise and reorganize § 7.2014—which governs the indemnification of IAPs by national banks in cases involving an administrative proceeding or civil action initiated by a federal banking agency, as well as cases that do not involve a federal banking agency—and to incorporate FSAs into the reorganized § 7.2014. The OCC would then remove the parallel indemnification requirements for FSAs in § 145.121.

We support this reorganization, one benefit of which would be that holding companies and national banks could apply one approach to indemnification based on the applicable state law, but suggest that the final rule be revised in several ways. First, the final rule should clarify how the OCC will evaluate whether indemnification payments are consistent with "safety and soundness" and provide for an appropriate process prior to nullifying any indemnification payment under the redesignated § 7.2014(a). Second, the final rule should clarify that funds advanced pursuant to a written agreement may be used for expenses. Finally, the two indemnification provisions from § 145.121, which would require a vote of disinterested directors and 60-day notice to the OCC before a national bank or FSA makes an indemnification payment, should not be adopted.

1. The final rule should clarify how the OCC would evaluate whether indemnification payments to IAPs under redesignated § 7.2014(a) are "consistent with safety and soundness."

The proposal would provide that a national bank or FSA may indemnify an IAP for damages and expenses, including the advancement of expenses and legal fees, in accordance with the law of the state that the national bank or FSA has designated for its corporate governance, provided such payments are

[34] Del. Code tit. 8 § 141(b).

consistent with safe and sound banking practices. The requirement that such payments must be consistent with safe and sound banking practices is in the existing regulation.

We generally support the proposed indemnification changes to the revised § 7.2014(a), which would simplify the requirements, but the final rule should be revised in two ways. First, it would be helpful if the agency would provide further explanation of its standard for evaluating whether indemnification payments are "consistent with safety and soundness." For example, we request confirmation from the OCC that the types of indemnification permissible under Delaware General Corporation Law generally would be permissible for national banks and FSAs, except where such payment would introduce safety and soundness risk by measurably reducing bank capital and/or liquidity levels.[35] To that end, the final rule should provide examples of how the OCC would evaluate whether indemnification payments to IAPs under different circumstances are consistent with safety and soundness. Further explanation of the circumstances under which the OCC would not permit indemnification payments would allow national banks and FSAs greater certainty in making arrangements for such payments.

Second, the final rule should include a process for appealing the invalidation of indemnification payments or an indemnification agreement on safety and soundness grounds.[36] It would be inconsistent with basic due process principles and rights not to allow a hearing or similar procedure for these determinations, which could substantially affect the livelihood of bank IAPs, to be challenged. In light of bank supervisors' broad authority to make safety and soundness determinations, codification of the "safety and soundness" standard in OCC regulations without any procedural protections in place could act as a significant deterrent for the most qualified prospective directors from serving on national bank boards, in addition to denying due process to those IAPs already affiliated with national banks.

2. The final rule should confirm that the written agreement required under proposed § 7.2014(c) may include funds to cover expenses.

The proposed rule would require that, before advancing funds to an IAP, a national bank or FSA must obtain a written agreement that the IAP will reimburse the bank or FSA, as appropriate, for any portion of that indemnification payment that the IAP is ultimately found not to be entitled to under 12 U.S.C. § 1828(k) and its implementing regulations, except to the extent that the bank's or FSA's expenses have been reimbursed by an insurance policy or fidelity bond.

We request confirmation that the written agreement may provide for the reimbursement of expenses, in addition to damages and other costs. The proposed § 7.2014(c) implies that expenses may be covered by a written agreement, because it notes that the written agreement may cover any portion of the indemnification payment "except to the extent that the bank's or saving association's expenses have been reimbursed by an insurance policy or fidelity bond." Confirmation on this point would encourage qualified candidates to serve on the board of a national bank or FSA, for the reasons discussed throughout this section of the letter, and therefore enhance bank safety, soundness, and efficiency.

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35 Del. Code tit. 8 § 145.

36 One option would be to include this procedure within the OCC's existing Bank Appeals Process. *See* OCC, *Appeals Process for National Banks and Federal Savings Associations* (July 2015), https://occ.gov/publications-and-resources/publications/banker-education/files/pub-appeals-process-nat-banks-fed-savings-assoc.pdf.

3. The final rule should not adopt the requirement from 12 C.F.R. § 145.121 that, in certain circumstances, a majority of the disinterested directors determine that the IAP was acting in good faith before the institution may indemnify the IAP.

The OCC specifically requests comment on whether, instead of relying on state law, the final rule should include the requirement from 12 C.F.R. § 145.121 that, in the case of settlement, final judgment against the IAP, or final judgment in the IAP's favor other than on the merits, a majority of the disinterested directors determine that the IAP was acting in good faith before the institution may indemnify the IAP.

The final rule should not adopt this requirement from 12 C.F.R. § 145.121. This provision is generally more restrictive than typical state law and may discourage qualified candidates from serving on the board of a national bank or FSA. There is no compelling public interest served by subjecting national bank or FSA directors to greater risk of personal liability than directors of other corporations. Having the most qualified and dedicated directors serve on the boards of leading financial institutions greatly contributes to a safe, sound, and efficient banking system. Absent a conflicting compelling public interest, the part 7 indemnification provisions generally should encourage, not serve to discourage, persons with these qualifications and dedication from serving as directors on the board of national banks and FSAs. Accordingly, the final rule should not incorporate the requirement that, in the circumstances noted above, a majority of the disinterested directors determine that the IAP was acting in good faith before the institution may indemnify the IAP.

4. We support the OCC's proposal not to require 60-day notice to the OCC before a national bank or FSA makes an indemnification payment.

The OCC proposes to apply revised § 7.2014 to FSAs and to remove 12 C.F.R § 145.121, which governs the indemnification of directors, officers, and employees by FSAs. In making this change, the OCC does not propose to incorporate into § 7.2014 the provision in 12 C.F.R § 145.121 that requires a 60-day prior notice to the OCC before making an indemnification, because the OCC believes that it is burdensome and unnecessary. There is not currently such a requirement for national banks in § 7.2014. The OCC requests comment on whether the final rule should include this prior notice requirement and, if so, what benefits prior approval would provide that would outweigh any additional regulatory burden.

We support the OCC's proposal not to include this prior notice requirement, because the regulatory burden of such a notice would outweigh any benefit. National bank indemnification payments (for insured depository institutions) are already required to comply with the requirements of 12 U.S.C. § 1828(k) and its implementing regulations (12 C.F.R. part 359), in addition to the relevant provisions in part 7. Further requirements are not needed to address any gaps in the existing regulatory regime.

E. Section 7.2010 on directors' responsibilities should be revised to avoid suggesting that guidance has the force of law.

Although we do not have concerns with the general policy established by § 7.2010, we note that the reference to OCC guidance in the text of the rule creates ambiguity as to the legal status of any expectations articulated in such guidance; as the OCC has affirmed elsewhere, supervisory guidance does not have the force of law.[37] For this reason, we urge the OCC to strike the second sentence of § 7.2010 and, to the extent it wishes to establish any further specific binding legal standards in this regard, to do so through rules issued pursuant to notice-and-comment rulemaking.

VI. Other Bank Powers or Operations

A. The final rule should simplify the requirements for operating financial literacy programs.

Under the proposal, the OCC clarifies that a national bank may participate in a financial literacy program if the principal purpose of the program is to be educational for members of the community. The proposal further codifies prior OCC precedent permitting national banks to rely on the messenger services safe harbor under 12 C.F.R. § 7.1012(c)(2).[38] If the activity falls outside the safe harbor, the proposal provides that the OCC would consider whether the establishment and operation of a financial literacy program constitutes a branch under 12 U.S.C. § 36 on a case-by-case basis, considering the facts and circumstances.

We support the proposed expansion of the purpose of financial literacy programs to cover both school programs and other programs offered to the community. Financial literacy programs provide important services to the community and are extremely unlikely to result in the establishment and operation of a branch under 12 U.S.C. § 36. For this reason, we urge the OCC to further simplify the requirements for operating a financial literacy program. Toward this end, the final rule could incorporate the relevant standards for operating a financial literacy program within the messenger service safe harbor directly into the rule, *without* cross-referencing the messenger service rule.[39] The rule could also directly state that a bank employee may manage the financial literacy program or engage in other financial education activities, provided that the school or organization retains control over the program and over the premises or facilities at which the program is held. In this regard, it would be helpful if the rule also expressly permitted a bank employee to accept checks at a financial literacy program event, subject to certain safeguards to prevent operation of the program as a branch. For example, a school official could accept the checks and deposit them in a portable lockbox, which the branch employee could then be responsible for bringing to the branch. This would reduce the burdens placed on the school employee while not raising any undue concerns on operation of a branch within the meaning of 12 U.S.C. § 36, so long as the main purpose of the event is only educational for members of the community.

Lastly, the final rule should not include the relevant language in the proposal indicating that the OCC will consider the facts and circumstances on a case-by-case basis whether other financial literacy

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37 *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and OCC, *Interagency Statement Clarifying the Role of Supervisory Guidance* (Sept. 11, 2018), https://www.federalreserve.gov/supervisionreg/srletters/sr1805a1.pdf.

38 The proposal notes that the factor discussed in § 7.1012(c)(2)(i) of the third party messenger safe harbor can be met for purposes of the financial literacy program safe harbor if bank employee participation in the financial literacy program consists of managing the program or conducting or engaging in financial education activities. The school or other organization must "retain control" over the program and over the premises or facilities at which the program is held.

39 Likewise, we would recommend not referring to the messenger service safe harbor as a "test" given it does not involve the measurement, a rating, or other performance measure, and thus may impose unnecessary compliance and audit requirements on the operation of such programs.

programs outside of the safe harbor constitute a branch. This language could be read to suggest that a bank must submit a request for interpretive relief to the OCC before operating any financial literacy program outside the scope of the safe harbor and cannot exercise its own judgment in determining when further OCC guidance is required on whether an activity constitutes establishment and operation of a branch under 12 U.S.C. § 36.

B. The examples of permissible finder activities should be revised to reflect how this authority is exercised in the modern financial system.

The OCC proposes a technical change to its finder regulation at § 7.1002, which would revise its regulations by adding a new paragraph (8) to § 7.1002(b) that would cross-reference the permissible electronic finder activities listed in § 7.5002(a)(1). However, the proposal would not make substantive changes to this section on finder activities.

The final rule should expand the section on finder authority to reflect new examples of how national banks and FSAs have exercised this important authority since the regulation was last updated.[40] The final rule should add, for example, making or receiving a referral to or from a third party for a fee. In addition, the final rule should codify in the regulation previous interpretations that the sharing of revenue or profit alone in a referral relationship would not constitute a joint venture under state law if the parties, by the terms of their contract or based on other relevant factors, express their intent not to create a joint venture. Finally, the rule should provide that a finder may accept reasonable finder's fees. In the preamble or accompanying guidance, the final rule should confirm that a finder is not required to disclose the amount of fees collected or paid and that a finder may collect or pay as a finder's fee a share of revenue.

C. We support the OCC's proposal that a national bank operating subsidiary facility is not a branch if it provides similar services on substantially similar terms and conditions to customers of unaffiliated entities, including unaffiliated banks, but suggest that this provision apply equally to facilities of the national bank itself.

The proposal would revise § 7.1003 to provide that a national bank operating subsidiary may distribute loan proceeds from its own funds or bank funds directly to the borrower in person at offices the operating subsidiary established without violating 12 U.S.C. § 36, 12 U.S.C. § 81, and 12 C.F.R. § 5.30—i.e., without the facility being considered a branch—if the operating subsidiary provides similar services on substantially similar terms and conditions to customers of unaffiliated entities, including unaffiliated banks. We support this proposed change, which would increase flexibility for national banks to operate such facilities and therefore allow national banks to better serve the convenience and needs of their communities. However, we note that same logic applies equally to a facility of the national bank itself where it otherwise meets the terms of the proposal—that is, where that facility of the national bank provides similar loan disbursement services on substantially similar terms and conditions to customers of unaffiliated entities, including unaffiliated banks. For that reason, the proposed revision to

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40 As the OCC's part 7 advance notice of proposed rulemaking on national bank and FSA digital activities recognizes, electronic finder authority is an important authority for digital activities as well. 85 Fed. Reg. 40827 (July 7, 2020). We encourage the OCC to consider consolidating the finder authority in § 7.1002 and the electronic finder authority in § 7.5002.

§ 7.1003 should be broadened to apply equally to facilities of either the national bank or its operating subsidiary.

D. The final rule should clarify that it is not impermissible to perfect security interests by holding collateral stock as nominee.

Current § 7.1009 permits a national bank to transfer stock it has received as collateral for a loan into the bank's name as nominee. The proposal states that the OCC believes that this provision is unnecessary and proposes to delete it, because the OCC permits a bank to perfect its security interests in collateral under applicable state laws consistent with the Uniform Commercial Code, and recent versions of the Uniform Commercial Code provide other potentially less burdensome methods to perfect an interest in securities collateral such as by obtaining control over a brokerage account holding the stock.

The elimination of this section permitting national banks to hold collateral stock as nominee is potentially ambiguous, and could be read to suggest that banks must always instead follow less burdensome practices of perfecting security interests (i.e., that holding collateral stock as nominee is now effectively *impermissible*). However, there may be certain circumstances for a given financing in which holding collateral stock as nominee is relevant or necessary. Accordingly, the final rule should clarify that national banks may continue to hold collateral stock as nominee.

E. The final rule should clarify that a national bank's ability to hold or invest in a SBIC does not terminate if the SBIC surrenders its license during its wind-down period.

The proposal would revise § 7.1015 to provide that a national bank may invest in a SBIC or in any entity established solely to invest in SBICs, and that purchasing stock in a SBIC is one example of this type of investment. The OCC also proposes to revise § 7.1015 to clarify that a national bank or FSA may invest in a SBIC that is either (i) already organized and has obtained a license from the Small Business Administration, or (ii) in the process of being organized.

While we support this change, we believe that it would also be helpful to clarify that national banks also may *retain* investments in a SBIC that has surrendered its license to operate as a SBIC during its wind-down period so long as it does not make new investments (other than investments in cash equivalents). This change would align with the Volcker Rule implementing regulations, which exclude SBICs from the definition of "covered fund," and which were recently revised to make clear that this exclusion would continue to apply where a SBIC issuer has voluntarily surrendered its license to operate as an SBIC in accordance with 13 C.F.R. § 107.1900 and does not make new investments (other than investments in cash equivalents) after such voluntary surrender.[41] Introducing similar clarity and nuance into part 7 would provide certainty to banks wishing to invest in SBICs and would increase investment in small businesses.

F. The final rule should reinforce that the risk management considerations outlined for letters of credit and independent undertakings are not mandatory safety and soundness conditions by removing them from the text of the rule.

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[41] 85 Fed. Reg. 46422, 46435-46436 (July 31, 2020).

The OCC proposes to revise § 7.1016 to clarify that federal branches and agencies of foreign banks may issue letters of credit and other independent undertakings, consistent with the requirements outlined in that section. The OCC does not propose other substantive changes to the requirements for issuing letters of credit.

We appreciate the OCC affirming in the proposal that, consistent with existing precedent, there are certain risk management considerations that a national bank or FSA *should* take into account when issuing a letter of credit or entering into an independent undertaking, but need not consider as a matter of binding, legal mandate. However, to further reinforce that these considerations are not formal legal obligations, we suggest that they be struck from the text of regulation itself, so as to avoid any possibility that they will be misconstrued in practice as mandatory safety and soundness conditions.[42]

G. The final rule should clarify that nothing in proposed § 7.1016 is meant to imply that other sections of part 7 do not apply equally to federal branches and agencies as to national banks and FSAs, consistent with the International Banking Act.

The proposal would revise § 7.1016 to clarify that federal branches and agencies of foreign banks may issue letters of credit and other independent undertakings, consistent with the conditions outlined in that section. It also would revise § 7.3000 to apply the hours and closings regulations to federal branches and agencies of foreign banks.

Although we have no objection to this change in principle, the final rule should affirm that the reference to federal branches and agencies in proposed § 7.1016 in no way implies that the general principle of parity with national banks and FSAs, as established by the International Banking Act,[43] does not apply to the other sections within part 7.

H. We support the OCC's proposed updates to the types of emergency conditions that may result in the declaration of a legal holiday.

The OCC proposes a number of changes to clarify and update the emergency closing provisions of § 7.3000. The proposal would expand the types of emergency conditions listed in § 7.3000(b) under which the Comptroller may declare a legal holiday to include acts of nature or of man, other disasters, public health or safety emergencies, and cyber threats or other unauthorized intrusions (e.g., a pandemic, terrorism, or a cyber-attack on bank systems). The proposal also would allow national banks and FSAs to temporarily close offices in response to any of these emergency conditions, with notice provided to the OCC as soon as feasible after-the-fact.

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42 The OCC confirmed that these considerations are not mandated by regulation when revising the provision in 1996: "Several commenters objected to the word 'must' in proposed § 7.1016(b), as 'must' seemed to impose mandatory safety and soundness conditions on the issuance of independent undertakings. The final ruling changes references in § 7.1016(b) from 'must' to 'should,' consistent with former § 7.7016, to provide banks with added flexibility in structuring and entering into financing arrangements. Nonetheless, the OCC strongly urges national banks to evaluate these safety and soundness factors when issuing independent undertakings." 61 Fed. Reg. 4853 (Feb. 9, 1996).

43 12 U.S.C. § 3102(b); 12 C.F.R. § 28.13.

We support the proposed changes, which would allow the OCC, national banks, and FSAs greater flexibility to declare a legal holiday in the event that any of these emergency conditions occurs, which the recent COVID-19 pandemic has demonstrated is both important and necessary.

I. The final rule should affirm that national banks and FSAs have multiple sources of legal authority on which to rely in engaging in a particular activity, and need not meet the specific terms of part 7 where another authority is available, the conditions of which are met.

In some cases, national banks and FSAs have multiple authorities on which they can rely to establish the legal permissibility of the activity in which they propose to engage, and would look to such conditions as apply under those authorities. For example, as noted in section IV above, national banks have authority to enter into a TEF transaction under 12 U.S.C. § 24(Seventh) but the provisions in part 7 on TEFs do not apply to tax credit investments that national banks may enter into under their public welfare investment authority in 12 U.S.C. § 24(Eleventh) and 12 C.F.R. part 24. Reflecting this longstanding principle, the final rule should expressly acknowledge that national banks and FSAs have multiple sources of legal authority on which to rely in engaging in a particular activity, and need not meet the specific terms of part 7 where another authority is available, the conditions of which are met.

VII. COVID-19 Relief

The preamble to the proposal observes that the COVID-19 emergency has required banks in many cases to consider changes to the way they do business, which may potentially result in longer-term changes in industry practices. The OCC therefore requests comment on whether it should consider other amendments to part 7 to address issues that may have arisen due to the COVID-19 pandemic.

We commend the OCC for extending appropriate relief to national banks and FSAs during the COVID-19 pandemic, which has allowed national banks and FSAs to continue meeting the needs of their communities and providing essential financial services. In particular, we appreciate OCC relief permitting telephonic and electronic participation at board, shareholder, and member meetings and have supported the permanent codification of this relief.[44] We agree with the OCC that the COVID-19 emergency has required banks to consider changes to business practices and believe that the modernization of these practices should be reflected and codified in part 7, as well as elsewhere in OCC regulation and requirements.

A. We encourage the OCC to codify additional ways in which filings and other procedures can be accomplished electronically.

The flexibility for electronic filing that the OCC allowed in light of COVID-19, including as permitted in OCC Bulletin 2020-20, has substantially reduced regulatory burden without affecting safety

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[44] OCC Bulletin 2020-20, "Licensing Filings: Use of Electronic Methods for Submission of Licensing Filings" (March 20, 2020); *see* BPI, *Comment Letter on OCC Interim Final Rule (IFR) Regarding Director, Shareholder, and Member Meetings* (July 13, 2020), https://bpi.com/wp-content/uploads/2020/07/BPI-letter-OCC-IFR-on-telephonic-electronic-based-board-meetings-2020.07.13.pdf (concurring with the OCC's view that remote communications tools provide national banks with more flexibility in planning and holding director meetings; could permit greater director participation at these meetings for those participants not able to attend in person; and may reduce the costs, logistical constraints, and other burdens—as well as, in the current environment, health risks—associated with conducting in-person meetings).

and soundness. We encourage the OCC to advance additional ways in which filings and other procedures can be accomplished digitally and remotely, such as electronic fingerprinting, digital signatures, and virtual notarization. These changes may be more convenient, accurate, and efficient than existing requirements, and accordingly would reduce the regulatory burden associated with filings and other procedures. Electronic submission of filings and other materials therefore should be the default practice, except where there is a statutory or other compelling basis for requiring wet signatures, hard copies, and the like. To that end, the final rule should adopt the following change to the Oaths of Directors requirements in part 7.

1. The requirements for filing oaths of directors should be modernized.

Section 7.2008(c) requires that a national bank file the original executed oaths of directors with the appropriate OCC licensing office. In addition, § 7.2008(a) does not allow the notary administering the oath to be an officer of the bank.

Accordingly, the final rule should modernize this requirement in part 7 by (i) permitting the submission of copies of signed oaths, including electronic copies, rather than original hard copies as currently required; (ii) allowing the notary to be a bank officer; and (iii) as an alternative to notarization, allowing certification of the oaths by the Secretary or an Assistant Secretary of the national bank (or equivalent title, such as Corporate Secretary or Assistant Corporate Secretary), who should be able to validate the directors' identities and signatures and sign a single certificate as to the attached oaths as true and correct copies. Such changes would substantially reduce regulatory burden without affecting safety and soundness or the effectiveness of bank governance.

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If you have any questions, please contact the undersigned by phone at 646-736-3960 or by email at Gregg.Rozansky@bpi.com.

Respectfully submitted,

Gregg Rozansky

Gregg L. Rozansky
Senior Vice President, Senior Associate General Counsel
Bank Policy Institute

cc: Brian Brooks, Acting Comptroller of the Currency
Jonathan Gould, Senior Deputy Comptroller and Chief Counsel
(Office of the Comptroller of the Currency)

Mark E. Van Der Weide, General Counsel
Michael S. Gibson, Director, Division of Supervision and Regulation
(Board of Governors of the Federal Reserve System)

Nick Podsiadly, General Counsel
Doreen R. Eberley, Director, Division of Risk Management Supervision
(Federal Deposit Insurance Corporation)