

**State of Rhode Island and Providence Plantations  
Department of Business Regulation  
Division of Banking**

**Public Notice of Proposed Rule-Making**

**Banking Regulation 7**

**DERIVATIVE TRANSACTIONS IN LENDING LIMITS**

Pursuant to the provisions of R.I. Gen. Laws §§ 19-3-3, 19-4-16, 42-14-17, and 42-35-1 *et seq.*, the Banking Division of the Department of Business Regulation (“Department”) hereby gives notice of its intent to adopt Banking Regulation 7 entitled *Derivative Transactions in Lending Limits* (“BR 7”).

The purpose of BR 7 is to provide clarification, pursuant to Section 611 of the Dodd-Frank Act, that under R.I. Gen. Laws § 19-3-3, any Rhode Island state-chartered Financial Institution that engages in derivative transactions is required to take into consideration credit exposure to derivative transactions with respect to the lending limits in R.I. Gen. Laws § 19-3-3 and any other relevant applicable lending limits in Title 19 or Federal law.<sup>1</sup>

BR 7 is available for public inspection at [www.dbr.ri.gov](http://www.dbr.ri.gov) or in person at the Department of Business Regulation, 1511 Pontiac Avenue, Building 68-1, Cranston, RI 02920 or requested by email to: Neena Sinha Savage at [NSSVG1@dbr.ri.gov](mailto:NSSVG1@dbr.ri.gov) or by calling Neena Sinha Savage at (401) 462-9540.

In the development of the proposed adoption of BR 7 consideration was given to: (1) alternative approaches; (2) overlap or duplication with other statutory and regulatory

---

<sup>1</sup> Section 611 of the Dodd-Frank Act amended the Federal Deposit Insurance Act to provide that a state chartered bank may engage in a derivative transaction only if the law with respect to lending limits of the State in which the State bank is chartered takes into consideration credit exposure to derivative transactions. R.I. Gen. Laws § 19-3-3(b) states that:

To the extent that a deposit taking institution regulated by the federal office of thrift supervision [now a part of the Office of Comptroller of Currency (“OCC”)] and insured by the federal deposit insurance corporation is expressly permitted to make loans that would exceed the limitations set forth in this section, the lending limitations of the office of thrift supervision shall apply. Nothing herein shall limit the department of business regulation from taking any action it deems appropriate to maintain appropriate safety and soundness standards relative to any loan or loans made by any financial institutions.

Therefore, R.I. Gen. Law § 19-3-3(b) expressly allows the Department to incorporate and apply, to the extent applicable to Rhode Island lending limits, the OCC’s Interim Final Rule entitled *Lending Limits*, effective on July 21, 2012 to Rhode Island chartered banks. The OCC Interim Final Rule implements Section 610 of the Dodd-Frank Act to provide that the “loans and extensions of credit” includes any credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between a national bank and the person. Banking Regulation 7 incorporates the requirements of the OCC’s Interim Final Rule pertaining to calculation of “credit exposure” arising from a “derivative transaction.”

provisions; and (3) significant economic impact on small business. No alternative approach, duplication, or overlap was identified based upon available information.

All interested parties are invited to submit written or oral comments concerning the proposed regulations by to Neena Sinha Savage, Department of Business Regulation, 1511 Pontiac Avenue, Building 68-1, Cranston, RI 02920, or by email to: NSSVG1@dbr.ri.gov. A public hearing to consider the proposed adoption shall be held on **December 10, 2012 at 9:30 a.m.** at 1511 Pontiac Avenue, Building 68-1, Cranston, RI 02920 at which time and place all persons interested therein will be heard. The room is accessible to the disabled and interpreter services for the hearing impaired will be provided if requested 48 hours prior to the hearing. Requests for this service can be made in writing or by calling (401) 462-9540 or TDD 711.

**STATE OF RHODE ISLAND  
DEPARTMENT OF BUSINESS REGULATION  
DIVISION OF BANKING  
1511 PONTIAC AVENUE  
CRANSTON, RI 02920**

**BANKING REGULATION 7**

**DERIVATIVE TRANSACTIONS IN LENDING LIMITS**

**TABLE OF CONTENTS**

<b>Section 1.</b>	<b>AUTHORITY</b>
<b>Section 2.</b>	<b>PURPOSE</b>
<b>Section 3.</b>	<b>SEVERABILITY</b>
<b>Section 4.</b>	<b>DEFINITIONS</b>
<b>Section 5.</b>	<b>CRITERIA FOR ENGAGING IN DERIVATIVE TRANSACTIONS</b>
<b>Section 6.</b>	<b>CRITERIA FOR EVALUATING CREDIT EXPOSURE</b>
<b>Section 7.</b>	<b>CREDIT UNIONS</b>
<b>Section 8.</b>	<b>EFFECTIVE DATE</b>

**Section 1. AUTHORITY**

This Regulation (“Regulation”) is promulgated pursuant to the authority granted to the Department of Business Regulation (“Department”) by Title 19 of the Rhode Island General Laws, generally, and R.I. Gen. Laws §§ 19-3-3(b) and 19-4-16, specifically.

**Section 2. PURPOSE**

The purpose of this Regulation is to clarify that any Rhode Island state-chartered Financial Institution that engages in Derivative Transactions is required to take into consideration Credit Exposure to Derivative Transactions with respect to the lending limits in R.I. Gen. Laws § 19-3-3 and any other relevant applicable lending limits in Title 19 or Federal law.

**Section 3. SEVERABILITY**

If any provision of this Regulation or the application thereof to any Person or circumstance is held invalid or unconstitutional, the invalidity or unconstitutionality shall not affect other provisions or applications of this Regulation which can be given effect without the invalid or unconstitutional provision or application, and to this end the provisions of this Regulation are severable.

#### **Section 4. DEFINITIONS**

Unless otherwise provided by this Regulation or unless the context clearly requires otherwise, terms used in this Regulation shall have the same meaning as the terms defined in R.I. Gen. Laws § 19-1-1 or in any other relevant provision of Title 19 of the Rhode Island General Laws. All definitions herein may be superseded by applicable amendments by the Rhode Island Financial Institution's primary federal regulatory authority and any such amendment shall apply, as relevant and applicable, in that specific context.

- A. "Credit Exposure" (to a counterparty in connection with a Derivative Transaction) shall be determined based on an amount that the Financial Institution reasonably determines under the terms of the derivative or otherwise would be its loss were the counterparty to default on that date, taking into account any netting and collateral arrangements and any guarantees or other credit enhancements; provided, that the Financial Institution may elect to determine credit exposure on the basis of such other method of determining credit exposure as may be permitted by the Financial Institution's primary federal regulatory authority.
- B. "Director" means the Director of the Department or his or her designee
- C. "Derivative Transaction" shall include any transaction that is 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, indices, or other assets.
- D. "Financial Institution" means any entity, other than a credit union, duly organized under the laws of this state which has the statutory authority to accept money on deposit pursuant to title 19, including an entity which is prohibited from accepting deposits by its own by-laws or agreement to form; the term includes, but is not limited to banks, trust companies, savings banks, loan and investment banks and savings and loan associations.

#### **Section 5. CRITERIA FOR ENGAGING IN DERIVATIVE TRANSACTIONS**

- A. Notice
  - (i) Financial Institutions with no prior Derivative Transaction experience as of December 31, 2012 seeking to engage in Derivative Transactions for the first time after the effective date of this Regulation shall provide the Department written notice of that intention at least thirty (30) calendar days in advance of any binding contractual agreement and provide documentation that said Financial Institution is permitted

to engage in Derivative Transactions pursuant to the definition of “Eligible Contract Participant” in 7 U.S.C. § 1(a)(18).

(ii) Financial Institutions with prior experience in Derivative Transactions shall provide notice of said fact and include the approximate date that the Financial Institution began engaging in Derivative Transactions. Said Financial Institution shall immediately conduct the relevant Credit Exposure impact and analysis for the Department’s review during its next examination.

(iii) Should any Financial Institution’s lending limit be exceeded by its participation in Derivative Transactions, said Financial Institution shall immediately notify the Department in writing and prepare an analysis and corrective action remedying said issue.

B. A Financial Institution seeking to participate in or currently participating in Derivative Transactions must document in its files that it:

(i) is Well Capitalized in accordance with its Federal insurer’s standards and not subject to any written agreement, order, capital directive, or prompt corrective action, directive to meet and maintain a specific capital level for any capital measure and has an ability to absorb and/or mitigate any Credit Exposure indicated by such participation;

(ii) does not meet the definition of “Troubled condition” in 12 C.F.R. §371.2(f);

(iii) has a reasonable basis for engaging in the Derivative Transaction;

(iv) has an ability to manage and assess Credit Exposure; and,

(v) has effective internal controls to manage, monitor, and assess Credit Exposure.

C. Any Financial Institution that does not meet the conditions in Section 5 B (i)-(v) above may request written permission from the Department to engage in Derivative Transactions.

## **Section 6. CRITERIA FOR EVALUATING CREDIT EXPOSURE**

A. Rhode Island Financial Institutions shall comply with all requirements set forth in the Office of Comptroller of Currency’s (“OCC”) Final Interim Rule on Lending Limits 12 CFR Parts 32, 159 and 160 (Effective July 21, 2012) with respect to Credit Exposure caused by Derivative Transaction participation on relevant lending limits.

- B. Rhode Island Financial Institutions shall act cautiously, responsibly and consistent with safe and sound banking practices in any Derivative Transaction participation.

**Section 7. CREDIT UNIONS**

- A. While R.I. Gen. Laws § 19-5-15(2)(i) may be construed to allow Credit Unions to invest in Derivative Transactions, it is the Department's position that Rhode Island state-chartered Credit Unions are only permitted to participate in Derivative Transactions subject to the conditions in Subsections 7 B and C herein.

Subsections 5 and 6 herein do not apply to Rhode Island state-chartered Credit Unions.

- B. Before engaging in or taking any affirmative step toward participating in Derivative Transactions, Rhode Island state-chartered Credit Unions shall obtain a non-objection letter and/or written approval from the Department and National Credit Union Administration ("NCUA").
- C. If a Rhode Island state-chartered Credit Union obtains approval and/or non-objection to participation in Derivative Transactions from both the Department and the NCUA, the Department may impose appropriate conditions necessary to confirm the Credit Union's ability to manage, monitor, and assess Credit Exposure related to participation in Derivative Transactions and ensure the safety and soundness of the Credit Union.

**Section 8. EFFECTIVE DATE**

This Regulation is proposed to be effective on January 1, 2013.