

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 79-7

January 11, 1979

PROPOSED AMENDMENT TO REGULATION O

TO ALL MEMBER BANKS  
AND BANK HOLDING COMPANIES IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System on December 28, 1978, issued a proposal to amend Regulation O (12 CFR Part 215), which governs loans by a member bank to its executive officers, to implement certain additional requirements imposed by the new section 22(h) of the Federal Reserve Act. Section 22(h) was recently enacted by Congress as a part of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (92 Stat. 3641). The new section, which becomes effective March 10, 1979, imposes certain requirements on loans by member banks to insiders or their related interests.

Enclosed is a copy of the Board's proposal and press release.

Interested persons are invited to submit relevant data, views, or comments in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received by January 29, 1979.

Any questions on the proposed amendment should be directed to Messrs. W. C. Reddick or Marvin McCoy of our Bank Supervision and Regulations Department, Ext. 6274.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

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Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-492-4403 (intrastate) and 1-800-527-4970 (interstate). For calls placed locally, please use 651 plus the extension referred to above.



# FEDERAL RESERVE

press release

For immediate release

December 28, 1978

The Federal Reserve Board today proposed regulatory rules to implement new legislation tightening restraints on lending by member banks to insiders. At the same time, the Board proposed simplification of Regulation O, which would be amended by the proposals.

The proposals, on which the Board requested comment by January 29, 1979, would carry out requirements of a new section of the Federal Reserve Act (Sec. 22(h)) included in the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

The new section of the Federal Reserve Act, which becomes effective March 10, 1979, imposes the following four requirements on loans by member banks to insiders or their related interests:

1. An aggregate lending limit of 10 percent of the bank's capital and surplus on loans to an insider (other than a director) and all related interests of the insider.
2. Prohibition of payment by the bank of an overdraft by an insider (other than a principal shareholder).
3. A requirement that every extension of credit by the bank to an insider or to an insider's related interest be made on substantially the same terms others would receive for a comparable transaction at the time, and that no unusual risk or other unfavorable factor be involved.
4. A requirement that every extension of credit by the bank to an insider or any related interest of the insider that would exceed \$25,000 in the aggregate be approved in advance by a majority of the bank's board of directors, with the interested party abstaining.

Insiders are defined as the executive officers, directors, and principal shareholders of a member bank and of any holding company affiliate. The related interests of insiders are companies and political or campaign committees controlled by or benefitting the insiders. These and other key terms are fully defined in the proposed regulation (Sections 215.2 and 215.3).

The Board's proposed revisions of Regulation O to implement the new Act would provide that:

The lending limit to insiders (other than directors) and their related interests would be 10 percent of the bank's capital and surplus as defined by the bank's supervisor.

The Comptroller of the Currency (supervisor of national banks) includes subordinated capital notes in capital and surplus, while the Board (supervisor of State chartered member banks) does not. The Board specifically requested comment on these definitions, which are under review by the agencies.

The 10 percent limit could be exceeded in the case of loans to executive officers for housing or educational purposes.

Any extension of credit to an insider outstanding on November 10, 1978 (the date of enactment of the Act) that, if it had been made after March 10, 1979 (the effective date of the Act), would exceed the 10 percent limit, would have to be brought into compliance by March 10, 1980. Two additional one-year extensions could be granted for good cause by the appropriate supervisor.

Extensions of credit made between November 10, 1978 and March 10, 1979 that would exceed the limit if made after March 10, 1979 would have to be brought into compliance by June 10, 1979. The Comptroller or the appropriate Federal Reserve Bank could extend this period, for good cause, until March 10, 1980.

Member banks would be required to maintain appropriate records of loans to insiders and to their related interests.

The Board's proposal is attached.

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## REGULATION O

(12 CFR 215)

As amended effective

### LOANS TO INSIDERS OF MEMBER BANKS

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#### SECTION 215.1 -- AUTHORITY, PURPOSE AND SCOPE

(a) Authority.

This Part is issued pursuant to sections 11(i), 22(g) and 22(h) of the Federal Reserve Act, as amended (12 U.S.C. 248(i), 375a, and \_\_\_\_\_).

(b) Purpose and Scope.

This Part relates to the extension of credit by a member bank to any executive officer, director, or principal shareholder of the member bank, its parent bank holding company, or the holding company's other subsidiaries ("insiders"). It also applies to the extension of credit by a member bank to (1) companies controlled by insiders or (2) political or campaign committees that benefit insiders or are controlled by them.

#### SECTION 215.2 -- DEFINITIONS

(a) "Executive officer" means an officer of a member bank who participates or has authority to participate, otherwise than in the capacity of a director, in major policy-making functions of the bank, regardless of whether: (1) the officer has an official title, (2) the title designates the officer an assistant, or (3) the officer is serving without salary

or other compensation.<sup>1/</sup> The chairman of the board, the president, every vice president, the cashier, secretary, and the treasurer of a member bank shall be deemed executive officers, unless any such officer is excluded, by resolution of the board of directors or by the bank's bylaws, from participation in major policy-making functions, other than in the capacity of a director of the bank, and such officer does not actually participate therein.

(b) "Insider" means an executive officer, director, or principal shareholder of: (1) the member bank, (2) its parent bank holding company (as defined in 12 U.S.C. 1841(a)), or (3) any other subsidiary of such parent bank holding company.

(c) The "lending limit" for member banks for purposes of section 215.4(c) of this Part shall be an amount equal to 10 percent of the bank's capital and unimpaired surplus as those terms are defined by its appropriate federal banking agency.

(d) "Member bank" means any banking institution that is a member of the Federal Reserve System.

(e) "Principal shareholder" means any individual or company (other than an insured bank) that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has power to vote more than 10 percent of any class of voting securities of a member bank. However, for the purposes of section 215.4(c) of this Part, where the member bank is located in a city, town, or village with less than 30,000 in population, this percentage shall be "more than 18 percent." For the purpose of this definition, shares held by any member of an individual's immediate family (as defined in section 206.2(k) of this chapter) shall be deemed to be held by the individual.

(f) "Related interest" means (1) any company (other than an insured bank) controlled by an insider or (2) any political or campaign committee, the funds or services of which will benefit an insider or that is controlled by an insider.

(g) "Company," "control," "overdraft," and "person" shall have the meaning provided in sections 22(h) (5) and (6) of the Federal Reserve Act, (12 U.S.C. \_\_\_\_\_).

### SECTION 215.3 -- EXTENSION OF CREDIT

(a) An extension of credit is the making or renewal of any loan or the extending of credit in any manner whatsoever, and includes:

<sup>1/</sup> The term is not intended to include persons who may have official titles and may exercise a certain measure of discretion in the performance of their duties, including discretion in the making of loans, but who do not participate in the determination of major policies of the bank and whose decisions are circumscribed by policy standards fixed by the top management of the bank. For example, the term would not include a manager or assistant manager of a branch of a bank unless he participates, or is authorized to participate, in major policy-making functions.

(1) any purchase of securities, other assets, or obligations under repurchase agreement;

(2) any advance by means of an overdraft, cash item, or otherwise;

(3) a standby letter of credit (or other similar arrangement however named or described) and an ineligible acceptance, as those terms are defined in section 208.8(d) of this chapter;

(4) the acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a person may be liable as maker, drawer, endorser, guarantor, or surety;

(5) the increase of an existing indebtedness, except on account of (a) accrued interest or (b) taxes, insurance, or other expenses incidental to the existing indebtedness and advanced by the bank for its own protection;

(6) any advance of unearned salary or other unearned compensation for periods in excess of 30 days; and

(7) any other transaction as a result of which a person becomes obligated to a bank, directly or indirectly by any means whatsoever, by reason of an endorsement on an obligation or otherwise, to pay money or its equivalent.

(b) Such terms, however, do not include:

(1) advances against accrued salary or other accrued compensation, or advances for the payment of authorized travel or other expenses incurred or to be incurred on behalf of the bank;

(2) the acquisition by a bank of any check deposited in or delivered to the bank in the usual course of business unless it results in the carrying of a cash item or the granting of an overdraft;

(3) the acquisition of any note, draft, bill of exchange, or other evidence of indebtedness (a) through a merger or consolidation of banks or a similar transaction by which a bank acquires assets and assumes liabilities of another bank or similar organization or (b) through foreclosure on collateral or similar proceeding for the protection of the bank;

(4) (a) the endorsement or guarantee for the protection of a member bank of any loan or other asset previously acquired by such bank in good faith or (b) any indebtedness for the purpose of protecting a member bank against loss or giving financial assistance to it; or



(5) indebtedness of \$5,000 or less arising by reason of any general arrangement under which a bank (a) acquires charge or time credit accounts or (b) makes payments to or on behalf of participants in a bank credit card plan, check credit plan, or similar plan, provided: (i) such indebtedness does not involve prior individual clearance or approval by the bank other than for the purposes of determining authority to participate in the arrangement and compliance with any dollar limit under the arrangement and (ii) such indebtedness is incurred under terms that are not more favorable than those offered to the general public.

#### SECTION 215.4 -- GENERAL PROHIBITIONS

(a) Terms and Creditworthiness. No member bank shall extend credit to any insider or to any related interest of such an insider unless the extension of credit: (1) is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions by the bank with other persons not associated with the bank and (2) does not involve more than the normal risk of repayment or present other unfavorable features.

(b) Prior Approval. No member bank shall extend credit or grant a line of credit to any insider or to any related interest of such an insider in an amount that, when aggregated with the amount of all other extensions of credit and lines of credit by the member bank to the insider and to all related interests of the insider, would exceed \$25,000 unless such an extension of credit or line of credit has been approved in advance by a majority of the bank's entire board of directors with the interested party abstaining from participating directly or indirectly in the voting.

(c) Aggregate Lending Limit. No member bank shall extend credit to any insider (other than a director) or to any related interest of such an insider in an amount that, when aggregated with the amount of all other extensions of credit by the member bank to the insider and to all related interests of the insider, would exceed the lending limit of the member bank as specified in section 215.2(c) of this Part. This lending limit shall not apply so as to prohibit a loan to an executive officer made pursuant to section 215.4(e) of this Part, where such loan, when aggregated with all other loans to the executive officer and the officer's related interests, does not exceed \$90,000.

(d) Overdrafts. No member bank shall pay an overdraft on an account of an insider (other than a principal shareholder) at such bank unless the draft is made (1) pursuant to an automatic transfer system or plan authorized under section 217.5(c) (2) of this chapter or (2) in accordance with a written preauthorized interest-bearing extension of credit that specifies a method of repayment.

(e) Extension of Credit to Executive Officers. No member bank shall extend credit to any of its own executive officers, and no executive officer of a member bank shall borrow from or otherwise become indebted to such bank, except in such amounts, for such purposes, and upon such conditions as are specified in section 22(g) of the Federal Reserve Act (12 U.S.C. 375a).

(f) Extension of Credit to Partnerships. No member bank shall extend credit to a partnership in which one or more executive officers of such bank are partners and, either individually or together, hold a majority interest except as provided in section 22(g) of the Federal Reserve Act (12 U.S. C. 375a).

SECTION 215.5 -- EXTENSIONS OF CREDIT OUTSTANDING ON MARCH 10, 1979

(a) Credit Extended Before November 10, 1978.

(1) Any extension of credit made by a member bank that was outstanding on November 10, 1978, and that would, if made after March 10, 1979, exceed the lending limit provided in section 215.4(c) of this Part shall be reduced in amount to comply with that lending limit on or before March 10, 1980, and shall only be renewed or extended after March 10, 1979, on terms that will bring such extension of credit into compliance with such lending limit on or before March 10, 1980.

(2) If a member bank is unable to bring any extension of credit outstanding on November 10, 1978, into compliance with the lending limit provided in section 215.4(c) of this Part on or before March 10, 1980, the member bank shall promptly report such fact to the Comptroller of the Currency, in the case of a national bank, or the appropriate Federal Reserve Bank, in the case of a State chartered member bank, together with an explanation of the reasons why the extension of credit could not be brought into compliance. The Comptroller or the Reserve Bank, as the case may be, is authorized to extend the March 10, 1980 date for compliance for not more than two additional one-year periods for good cause shown.

(b) Credit Extended After November 10, 1978.

(1) Any extension of credit made by a member bank between November 10, 1978 and March 10, 1979, that would, if made after March 10, 1979, exceed the lending limit provided in section 215.4(c) of this Part shall be reduced in amount to comply with that lending limit on or before June 10, 1979.

(2) If a member bank is unable to bring any extension of credit made between November 10, 1978 and March 10, 1979, into compliance with the lending limit provided in section 215.4(c) of this Part on or before June 10, 1979, the member bank shall promptly report such fact to the Comptroller of the Currency, in the case of a national bank, or the appropriate Federal Reserve Bank, in the case of a State chartered member bank, together with an explanation of the reasons why the extension of credit could not be brought into compliance. The Comptroller or the Reserve Bank, as the case may be, is authorized to extend the June 10, 1979 date for compliance until March 10, 1980 for good cause shown.



SECTION 215.6 -- RECORDS BY MEMBER BANKS

Every member bank shall maintain such records as are necessary to ensure its compliance with the requirements of this Part. Such records shall appropriately identify all insiders and their related interests and the amount and terms of each extension of credit by the member bank to such persons.

SECTION 215.7 -- REPORTS

Every member bank and every executive officer of a member bank shall file the reports required by section 22(g) of the Federal Reserve Act, 12 U.S.C. 375a.

SECTION 215.8 -- CIVIL PENALTIES

As specified in section 29 of the Federal Reserve Act (12 U.S.C. \_\_\_\_\_), any member bank that violates, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank who violates, any provision of this Part shall be subject to a civil penalty of not more than \$1,000 per day for each day during which such violation continues.

Board of Governors of the Federal Reserve System, December 27, 1978.

(signed) Theodore E. Allison

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Theodore E. Allison  
Secretary of the Board

(SIGNED)