FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS 75222

May 15, 1992

**Notice 92-43**

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

## SUBJECT

**Final Amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks) and Regulation Y (Bank Holding Companies and Change in Bank Control)**

## DETAILS

The Federal Reserve Board has adopted final amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks) and Regulation Y (Bank Holding Companies and Change in Bank Control). These amendments conform the regulations to Section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

The most significant changes required by Section 306 include a new aggregate lending limit on the total amount of credit a bank may extend to its insiders and their related interests as a class. In general, this limit is equal to the bank's unimpaired capital and unimpaired surplus if the bank's total deposits are $100 million more. This limit is 200% of a bank's unimpaired capital and unimpaired surplus if the bank's total deposits are under $100 million. In addition, the same lending limit applicable to executive officers and principal shareholders and their related interests will now apply to extensions of credit to directors and their related interests.

Section 306 also changes the definition of principal shareholder. Formerly, a principal shareholder was any person who owned or controlled more than 10 percent of a class of the voting shares of a bank, except for banks located in communities with populations of less than 30,000, in which case the amount was 18 percent. The 10 percent definition now applies to all banks, regardless of the size of the community where the bank is located.

## ATTACHMENT

A copy of the Board's notice (Federal Reserve System Docket No. R-0747) is attached.

## MORE INFORMATION

For more information, please contact Jane Anne Schmoker at (214) 651-6228. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

Robert D. McTeer, Jr.

## FEDERAL RESERVE SYSTEM

## 12 CFR Parts 215 and 225

**[Regulations O and Y; Docket No. R-0747]**

## Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies and Change in Bank Control

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

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**SUMMARY:** The Board is adopting revisions to Regulations O and Y to conform the regulations to the amendments to § 22(h) of the Federal Reserve Act (12 U.S.C. 375b) made by § 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (''FDICIA''). As amended by § 306, § 22(h) establishes a limit on the total amount a bank may lend to its executive officers, directors, and principal shareholders, and the related interests of those persons. Section 22(h), as amended, also subjects extensions of credit to directors and their related interests to the same lending limit that applies currently to executive officers and principal shareholders and their related interests under § 22(h). *See* 12 CFR 215.4(c). The final rule amends Regulation O to implement these amendments.

The final rule also amends Regulations O and Y to implement a reporting requirement required by § 306 that relates to certain credit extended to executive officers and principal shareholders of certain banks and bank holding companies. In addition, the final rule makes limited technical revisions to Regulation O to conform the regulation to § 306 and to correct existing ambiguities.

**EFFECTIVE DATE:** Effective June 15, 1992.

**FOR FURTHER INFORMATION CONTACT:** Andrew Karp, Attorney (202/452-3554), Legal Division; Stephen M. Lovette, Manager (202/452-3622), or William G. Spaniel, Senior Financial Analyst (202/452-3469), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551.

**SUPPLEMENTARY INFORMATION:** Section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) restricts the amount and terms of extensions of credit from a bank to its executive officers, directors and principal shareholders (collectively, ''insiders'') and to any company or political campaign controlled by an insider (''related interests''). The Board promulgated Regulation O in 1978 to implement this statute. In general, § 22(h):

1. Requires a bank's board of directors to approve any extension of credit to an insider or a related interest in excess of a threshold amount (generally

the higher of $25,000 or five percent of the bank's capital and unimpaired surplus, up to $500,000);

2. Prohibits any extension of credit on preferential terms;

3. Limits the amount a bank may lend to each of its executive officers and principal shareholders and their related interests;[1] and

4. Prohibits the payment by a bank of an overdraft of an executive officer or director on an account at the bank.[2]

On December 19, 1991, the President signed into law the Federal Deposit Insurance Corporation Improvement Act of 1991 (''FDICIA'').[3] Section 306 of the FDICIA amends § 22(h) of the Federal Reserve Act. On February 20, 1992, the Board published for comment proposed revisions to Regulation O to implement the amendments of § 22(h) of the Federal Reserve Act made by FDICIA. The comment period expired on March 23, 1992. The FDICIA amendments take effect May 18, 1992.

Section 306 of FDICIA replaces the language of § 22(h) with the provisions of the Board's Regulation O. Section 306 also makes a number of substantive modifications to § 22(h). The most significant changes required by the provisions of FDICIA are as follows:

1. *New Aggregate Lending Limit.* Section 306 establishes a limit on the total amount a bank may lend in the aggregate to its insiders and their related interests as a class. In general, this limit is equal to the bank's unimpaired capital and unimpaired surplus.

2. *Lending Limit for Directors and Related Interests.* Section 306 extends to loans to directors (and their related interests) the same lending limit currently applicable to executive officers and principal shareholders (and their related interests) under § 22(h).[4] Previously, § 22(h) did not limit the amount directors and their related interests could borrow from their banks.

3. *Credit Standards.* Section 306 adds a requirement that, when lending to an insider, a bank must follow credit underwriting procedures that are ''not less

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[1] This amount is 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured. In calculating this limit, all of the bank's loans to the insider and the insider's related interests are aggregated. This lending limit is subject to the exceptions set forth in § 5200 of the Revised Statutes (12 U.S.C. 84). These exceptions generally provide higher or no lending limits for loans secured by various kinds of obligations. Thus, for example, loans secured by obligations fully guaranteed by the United States are not subject to a lending limit.

[2] The overdraft prohibition does not apply to principal shareholders, unless the principal shareholder is also an executive officer or director. The prohibition also does not apply to the related interests of an executive officer or director. In addition, the prohibition does not apply to inadvertent overdrafts, as defined in Regulation O.

[3] Pub. L. No. 102-242, 105 Stat. 2236 (1991).

[4] See note 1, *supra*.

stringent than those applicable to comparable transactions by the bank with [persons outside the bank]."

4. *Definition of Principal Shareholder.* Section 306 tightens the definition of principal shareholder for banks located in small communities. Formerly, § 22(h) defined a principal shareholder as a person who owned or controlled more than 10 percent of a class of the voting shares of a bank, except for banks located in communities with populations of less than 30,000, in which case the amount was 18 percent. The 10 percent definition now applies to all banks, regardless of the size of the community where the bank is located.

5. *Definition of Member Bank.* Section 306 redefines the term "member bank" for the purposes of § 22(h) to include any subsidiary of the member bank, clarifying that an extension of credit from a subsidiary of a member bank is subject to the same insider restrictions as an extension of credit from the member bank itself.

6. *Coverage of All Companies That Own Banks.* Section 306 amends § 22(h) to cover all companies that own banks, regardless of whether the company is technically a bank holding company.

7. *Prohibition on Knowing Receipt of Unauthorized Extensions of Credit.* Section 306 amends § 22(h) to prohibit insiders from knowingly receiving (or knowingly permitting their related interests to receive) any extension of credit not authorized by § 22(h).

8. *Reporting Requirement for Certain Credit.* Section 306 requires executive officers and directors of member banks and bank holding companies without publicly traded stock to report to their institutions annually the outstanding amount of any credit that is secured by shares of the insider's institution.

9. *Definitions.* Section 306 defines the terms "company," "control," "executive officer," "extension of credit," "related interest," and "subsidiary." Each definition is consistent with the corresponding definitions in current Regulation O.

The final rule adopted by the Board implements these statutory requirements and contains several technical revisions, discussed below, to conform Regulation O with § 306 and to correct existing ambiguities.

The proposal the Board published for comment sought only to implement the FDICIA amendments. The proposal did not modify the regulation where the statutory amendments track the present regulatory language.[5] The Board did not

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[5] Thus, for example, the existing regulatory definitions of "control," "executive officer," "extension of credit," "overdraft" and "related interest" remain unchanged, as the new statutory definitions are fully consistent with the present regulatory definitions.

request comment on existing features of Regulation O, except as necessary to implement the FDICIA amendments.[6]

The Board received 268 written comments in response to notice of the proposal. Community or independent banks submitted the majority of comments. Other commenters included several large banks and bank holding companies, individual bank directors, numerous state and national banking trade associations, several state banking superintendents, and four Federal Reserve Banks.

*Discussion of Issues*

1. *Lending limit applicable to individual directors.* The preponderance of the commenters, including community banks, state and national independent bankers' trade associations, and certain state banking supervisors, objected to the FDICIA requirement that the Regulation O individual lending limit be applied to loans to directors. These commenters observed that directors of community banks frequently control substantial local business enterprises, especially in small or rural communities. In this regard, the commenters stated, such directors provide to bank management important expertise and valuable credit and deposit relationships. The commenters asserted nearly unanimously that application of the Regulation O lending limit to directors would curtail the ability of banks to serve the credit needs of their directors (and the directors' related interests). The commenters concluded that the limit will force directors or prospective directors to choose between retaining or accepting a directorship and maintaining a customer relationship with the bank, thereby in turn depriving banks of either informed leadership or valuable customer relationships.

The final rule implements the director lending limit as proposed. FDICIA requires that the Board apply this limit to extensions of credit to directors and their related interests and gives the Board no discretion in applying this aspect of the statute. It should be noted, however, that directors and their related interests generally have long been subject to similar borrowing constraints by reason of the concentration of credit rules under the National Bank Act and state laws. *See, e.g.*, 12 U.S.C. 84; 12 CFR part 32. The § 22(h) lending limit incorporates the limits and exceptions of the concentration of credit rules under the National Bank Act. Thus, the § 22(h) lending limit generally permits each individual director and his or her related interests to borrow in aggregate amounts the equivalent of up to 15 percent of the bank's unimpaired capital and unimpaired surplus on an unsecured basis and an additional 10 percent on a secured basis. The exceptions provide higher limits for, or exclude from limitation altogether, various credit transactions, such as extensions of credit secured by obligations of the United States or guaranteed by a Federal agency, extensions of credit secured by bills of lading or warehouse receipts covering readily marketable staples, and extensions of credit secured by livestock or dairy cattle.

2. *Limit on Aggregate Lending to Insiders.* As amended by FDICIA, § 22(h) establishes a limit on the total amount a member bank may lend to its insiders

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[6] The final rule amends the Board's Regulation Y to implement a loan reporting requirement created by the FDICIA that applies to executive officers and directors of certain bank holding companies.

and their related interests as a class. The statute generally restricts that amount to an amount that is no greater than the bank's unimpaired capital and unimpaired surplus. The Board is authorized, however, to set a more stringent general limit. The statute permits the Board to make an exception to this limit only for banks with deposits of less than $100 million and only if the Board determines that the exception would be "important to avoid constricting the availability of credit in small communities or to attract directors to such banks."[7] The statute provides that the higher limit for banks with deposits of less than $100 million may not exceed 200 percent of the bank's unimpaired capital and unimpaired surplus.

The legislative history of FDICIA indicates that the aggregate limit was adopted in response to the significant insider lending at Madison National Bank and other failed institutions.[8] In this respect, the aggregate limit was designed as a prophylactic measure to limit the risks to the deposit insurance system of large concentrations of credit to institution insiders.

The final rule's general limit—100 percent of the member bank's unimpaired capital and unimpaired surplus—is the same as provided in the statute.[9] The Board requested specific comment regarding whether to provide an exception to the general limit for banks with deposits of under $100 million. The Board also requested comment on whether a 100 percent limit as applied to small banks would unduly restrict credit or limit the availability of directors. In connection with these requests, the Board requested that commenters supply specific data as to the effect of the aggregate limit.

The great preponderance of commenters, including community banks and bank trade associations, opposed the aggregate limit in principle. Every commenter that referred to the Board's discretion to make exceptions to the general limit for small banks urged the Board to raise that limit to 200 percent of unimpaired capital and unimpaired surplus for small banks. These commenters included community banks, larger banks, the American Bankers Association, and the Independent Bankers Association of America.

The commenters argued the same points discussed above with respect to the director lending limit. Commenters argued nearly unanimously that the aggregate limit, like the application of the director lending limit, would inhibit unduly the ability of community banks to serve the credit needs of their directors and the related interests of the directors. As a result, commenters contended, directors will be forced to choose between retaining a directorship or maintaining a customer relationship with the bank, thereby depriving the bank of either informed leadership or valuable customer relationships. Apart from anecdotal

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[7] Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 306(d), 105 Stat. 2236, 2358 (1991).

[8] *See* S. Rep. No. 167, 102nd Cong., 1st Sess. 55 (1991).

[9] Under Regulation O, unimpaired capital and unimpaired surplus is the sum of (1) total equity capital as reported on the bank's most recent report of condition; (2) any subordinated notes and debentures approved as an addition to the bank's capital structure by the appropriate federal banking agency; and (3) any valuation reserves created by charges to the bank's income. Total equity capital includes retained earnings. *See* 12 CFR 215.2(h).

evidence, commenters did not provide specific information regarding the amount of lending by banks to their directors and related interests, or other specific information that would allow the Board to determine the effect of the aggregate limit on the availability of credit and directors.[10]

In light of the great concern evidenced by the comments of small banks, the Board has determined that an exception to the general aggregate lending limit for small banks is important to avoid constricting the availability of credit or directors in small communities. Accordingly, the Board has determined to exercise its discretion under FDICIA to permit small banks (*i.e.*, banks with total deposits under $100 million) to establish a higher aggregate lending limit for loans to executive officers, directors, and principal shareholders, and their related interests, where the board of directors of the bank has determined, based on its experience with loans to such persons and related interests, that a higher aggregate lending limit is consistent with prudent, safe, and sound banking practices. This higher limit must be considered and established by the bank's board of directors by resolution, and may not exceed a maximum amount of 200 percent of the bank's unimpaired capital and unimpaired surplus.

The Board has determined to permit small banks to establish this higher aggregate limit for a one-year period that will expire May 18, 1993. This one-year period will enable the Board, in consultation with the other federal banking agencies, to collect specific data on the lending practices of banks to insiders, including directors, in order to analyze the effect of a limitation on this lending on the ability of banks to attract qualified directors and to serve the credit needs of local communities. The Board will then revisit the issue of an appropriate limit for small banks.

3. *Bank Holding Company Indebtedness under the Aggregate Limit.*

A. *Section 23A.* Three larger holding companies commented that the application of the aggregate lending limit to transactions with holding company affiliates that are also covered by § 23A of the Federal Reserve Act[11] may produce inconsistent results. Under § 23A, a member bank's transactions with any one affiliate are limited to 10 percent of the bank's capital and surplus; an aggregate 20 percent limit applies to transactions with all affiliates.[12] However, several types of transactions that present little or no risk to the bank are excluded from the quantitative limits of § 23A. These transactions include loans that are fully secured by (i) the obligations of the United States or certain Federal agencies or (ii) segregated, earmarked deposit accounts.

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[10] Two community bank commenters submitted data regarding the percentage of capital and surplus represented by loans to directors or to other insiders. One demonstrated that loans to insiders, including directors, exceeded 100 percent of unimpaired capital and surplus. The second questioned the necessity of any limit, on the basis that its loans to insiders, including directors, fell far short of 100 percent.

[11] 12 U.S.C. 371c.

[12] Section 23A also applies qualitative restrictions to such transactions. For example, the transactions must be on terms and conditions that are consistent with safe and sound banking practices, and the member bank may not purchase low-quality assets from its affiliates.

The FDICIA aggregate lending limit does not provide for any exemptions. Three commenters observed that inclusion under the aggregate lending limit of holding company indebtedness, including indebtedness exempt from the quantitative limits of § 23A, could render unavailable a significant portion of the aggregate lending limit.

The commenters suggested that the Board address this problem by excluding from the FDICIA aggregate lending limit extensions of credit to parent holding companies and their non-bank subsidiaries.[13] These transactions would continue to be subject to the requirements of § 23A.

The Board declined to adopt this suggestion. The FDICIA aggregate lending limit by its terms applies to all extensions of credit by a bank to principal shareholders and their related interests, thereby covering extensions of credit to parent holding companies and the companies they control. The FDICIA aggregate limit provides no exclusion for loans to a parent holding company or its non-bank affiliates. In addition, unlike § 23A, § 22(h) does not provide the Board general exemptive authority. Thus, the statute requires that bank extensions of credit to parent holding companies and non-bank affiliates count toward the aggregate lending limit.

The Board intends to propose legislation to cure the inconsistent treatment of certain transactions under § 22(h) (as amended by § 306) and § 23A. In this respect, the Board believes that the best approach would be to exclude loans to parent holding companies and their non-bank affiliates from § 22(h) altogether on the basis that such transactions are controlled adequately by § 23A, which regulates comprehensively inter-affiliate transactions.

B. *National Bank Act.* One commenter requested that the Board exclude from the aggregate lending limit any loan subject to the exceptions provided under the concentration of credit rules of the National Bank Act.[14] For the reasons discussed with respect to § 23A, the Board declined to implement such an exemption. To address the problem of inconsistent treatment, the Board intends to propose legislation to grant to the Board specific authority to define exclusions from the § 22(h) definition of extension of credit. On the basis of such authority, the Board could revise Regulation O to exclude from the aggregate lending limit certain transactions that present little or no risk to the bank, including transactions that are exempt under the National Bank Act or § 23A.

4. *Definition of the term "member bank" to include any subsidiary of the member bank.* As amended by § 306, § 22(h) defines the term "member bank" specifically to include any subsidiary of the member bank. The definition is designed to codify Board policy that an extension of credit made by a subsidiary of a bank is considered to have been made by the bank itself. The purpose of the policy is to ensure that an extension of credit from a subsidiary of a member

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[13] Under existing law and regulations, member bank extensions of credit to affiliated banks are exempt in many respects from the coverage of both Regulation O and § 23A.

[14] 12 U.S.C. 84; 12 CFR part 32.

bank is subject to the same insider restrictions as an extension credit from the member bank itself.[15]

Two commenters asserted that the definition would have the additional effect of constituting executive officers and directors of subsidiaries of banks as executive officers and directors of the parent bank. As a result, the commenters contended, extensions of credit to insiders of the subsidiaries of banks would become subject to requirements of Regulation O, including the aggregate lending limit.[16]

The commenters argued that the statutory amendment of the term member bank to include subsidiaries of the bank nullifies the regulatory distinction between insiders of subsidiaries of the bank and insiders of a bank or its parent and non-bank affiliates. The commenters urged the Board to clarify that Regulation O does not cover insiders of subsidiaries of banks (unless they are also insiders of the bank or its parent or non-bank affiliates).

The final rule retains the proposed definition of member bank, which specifically includes any subsidiary of the member bank. Prior to the enactment of FDICIA, Regulation O did not reach the insiders of such subsidiaries, unless an insider actually participated in the major policy-making functions of the bank.[17] Accordingly, the Board believes that the inclusion of subsidiary in the term member bank is not intended to modify the existing policy that Regulation O does not reach the insiders of subsidiaries of banks (unless an insider is a bank director or actually participates in major policy-making functions at the bank).

5. *Elimination of higher control threshold for principal shareholders of banks located in small communities.* Prior to the enactment of FDICIA, § 22(h) defined a principal shareholder as a person who owns or controls more than 10 percent of a class of the voting shares of a bank, except for banks located in communities with populations of less than 30,000, in which case the amount was 18 percent. FDICIA eliminated the exception for banks located in small communities. As a result, the 10 percent definition now applies to all banks, regardless of the size of the community where the bank is located.

Several commenters objected to this statutory modification and urged the Board to preserve the exception. Because the Board has no discretion in the application of this statutory provision, the final rule eliminates the 18 percent exception.

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[15] *See* 138 Cong. Record S2059, S2077 (daily ed. February 21, 1992) (Statement of Sen. Riegle).

[16] The commenters observed that such a result appears to conflict with an existing provision of Regulation O, which excludes subsidiaries of banks from the definition of subsidiary. *See* 12 CFR 215.2(n). An effect of this exclusion has been to remove the insiders of subsidiaries of banks from the requirements of Regulation O.

[17] This is so because under § 215.2(n) of Regulation O subsidiaries of banks are not considered to be parent holding company subsidiaries.

6. *Coverage of all companies that own banks.* Prior to the enactment of FDICIA, § 22(h) deemed insiders of bank holding companies to be insiders of the bank holding companies' subsidiary banks. This provision reflected the statutory presumption that insiders of the parent holding company are involved necessarily in the major decisions of bank subsidiaries. Section 306 amended § 22(h) in several places by replacing the term bank holding company with the term company. This change was intended to ensure that insiders of holding companies that are not technical bank holding companies are treated in the same manner as insiders of bank holding companies.[18]

One commenter, a law firm representing diversified financial holding companies, argued that this revision would work an especial hardship on such companies. The commenter asserted that, in contrast to the insiders of bank holding companies, many insiders of diversified financial holding companies have no responsibility for, or influence over, the operations of subsidiary banks. Instead, responsibility for subsidiary banks typically devolves to a small, readily identifiable group, with most insiders responsible for the company's primary business lines, such as manufacturing, retail sales, or insurance. Therefore, the commenter contended, the regulation as proposed would serve no purpose to the extent it would constitute as insiders persons who have no ability to influence the operations of subsidiary banks. The commenter suggested that Board revise Regulation O to implement a method to exclude from coverage insiders of diversified parent holding companies who do not supervise subsidiary banks.

The final rule does not include such an exclusion. As amended by § 306, § 22(h) presumes that insiders of parent holding companies exercise sufficient influence over subsidiary banks to be deemed bank insiders. In addition, FDICIA amended § 22(h) specifically to treat in the same fashion insiders of all companies that own banks—whether or not the company is technically a bank holding company. As noted above, the Board has no discretion to exclude such insiders from the coverage of § 22(h). Accordingly, the Board believes that implementation of the suggested exclusion would not be consistent with the terms of § 306.

7. *Prohibition on knowing receipt of any extension of credit not authorized by § 22(h).* Section 306 amended § 22(h) to prohibit an insider from knowingly receiving an extension of credit not authorized by § 22(h). Several commenters requested that the Board refine the prohibition by including in Regulation O a provision permitting insiders to rely in good faith on a bank's statement that an extension of credit is authorized by § 22(h).

This prohibition applies only to knowing receipt of unauthorized extensions of credit. The Board believes that the reference to knowing receipt adequately protects insiders in the circumstances cited by the proponents of the good faith reliance safe-harbor.

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[18] *See* 138 Cong. Rec. S2059, S2077 (daily ed. February 21, 1992) (Statement of Sen. Riegle).

8. *Grandfathering provision.* FDICIA provides that amendments made by § 306 do not affect the validity of any extension of credit or other transaction lawfully entered into on or before the effective date of the FDICIA amendments. The effective date of the amendments relating to § 22(h) is the earlier of (i) the date on which the required revisions to Regulation O become effective or (ii) 150 days after the date of enactment of the FDICIA. Accordingly, May 18, 1992 is the effective date of the statutory provisions.

Several commenters sought guidance as to the effect of this statutory provision. The provision applies to the newly limited loans to directors and the aggregated loans to insiders. As applied to both categories, the provision requires that banks and insiders comply prospectively after the effective date of the statute (May 18, 1992). Extensions of credit made before the effective date are not required to comply with the single borrower limit made applicable to directors and their related interests or with the aggregate limit on loans to insiders and their related interests contained in Regulation O. All extensions of credit made after the effective date (*i.e.*, made after May 18, 1992) must comply with all of the provisions of the statute and Regulation O. Banks would not be authorized to extend further credit in amounts that, when aggregated with outstanding loans to insiders, would exceed either limit.

9. *General review of Regulation O.* The Independent Bankers Association of America requested that, within a year of the promulgation of this final rule, the Board review Regulation O in its entirety, including aspects of the regulation on which the Board did not seek comment in connection with the amendments discussed above. FDICIA mandates that the federal banking agencies conduct general reviews of the regulations implemented under the statutes they administer.[19] Accordingly, the Board will review Regulation O in its entirety and the effect of the regulation on bank operations and consider any modifications that are shown by experience to be necessary or appropriate to carry out the intent of Congress in this area or to prevent evasions of §§ 22(g) and 22(h).

10. *Technical revisions.* The final rule also contains several technical revisions to conform the Regulation O with § 306 and to correct existing ambiguities. In this respect, for example, the final rule:

(1) Modifies the requirement that member bank loans to executive officers be "made subject to the condition that the extension of credit will, at the option of the member bank, become due and payable" to clarify that the condition must be in writing.

(2) Replaces the term "bank" with the term "insured depository institution" where appropriate to reflect statutory usage.

(3) Provides a dedicated definition of the term "foreign bank" that is the same as the existing definition that is provided in the definition of "member bank."

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[19] Federal Deposit Insurance Corporation Improvement Act of 1991, § 221, 105 Stat. 2236, 2305 (1991).

(4) Replaces the term ''capital stock'' with the term ''unimpaired capital'' where appropriate to reflect statutory usage.

(5) Adds a date specification to the calculation of valuation reserves for purposes of determining a member bank's unimpaired capital and unimpaired surplus under Regulation O.

(6) Clarifies the definition of extension of credit on which a party may be liable.

**Section-By-Section Analysis:**

The following describes the final rule's amendments of Regulation O.

**Section 215.1(a)**: The final rule adds a reference to FDICIA.

**Section 215.2(a)**: The final rule replaces the term ''bank'' with the term ''depository institution'' to reflect statutory usage.

**Sections 215.2(c) and (d) and 215.4(c); and redesignated section 215.2(b)**: The final rule replaces the term ''bank holding company'' with the term ''company'' and removes the reference to the statutory definition of bank holding company.

**Sections 215.2(e) through (l)**: The final rule redesignates these paragraphs as paragraphs (g) through (n) to accommodate new paragraphs (e) and (f) of § 215.2.

**Section 215.2(e)**: The final rule creates a new paragraph (e) that relocates the existing Regulation O definition of the term ''foreign bank.'' The definition, which remains unchanged, was previously a parenthetical part of the Regulation O definition of ''member bank.''

**Section 215.2(f)**: The final rule creates a new paragraph (f) that defines the term ''insider.''

**Redesignated section 215.2(h)**: The final rule replaces the regulatory term ''capital stock'' with the statutory term ''unimpaired capital'' and adds a date specification to the definition of valuation reserves for the purposes of calculating a member bank's capital.

**Redesignated section 215.2(i)**: The final rule defines the term ''member bank'' to include any subsidiary of the member bank.

**Redesignated section 215.2(l)**: The final rule replaces the phrase ''an individual or company'' with the term ''person'' to reflect statutory usage. The final rule also strikes the sentence that implemented the control standard for determining ''principal shareholder'' of member banks located in communities with populations of less than 30,000 persons.

**Redesignated section 215.2(m)**: The final rule adds the phrase ''of a person'' to the definition of ''related interest'' to reflect statutory usage.

**Section 215.3(a)(4)**: The final rule replaces the term ''person'' with the term ''insider'' to clarify that the definition applies when the party liable is a bank insider.

**Section 215.3(a)(8)**: The final rule adds the term ''similar'' to reflect statutory usage.

**Section 215.3(b)(2) and (b)(5)**: The final rule modifies the regulatory references to conform with the reorganized regulation.

**Section 215.4(a)(1)**: The final rule adds to the existing qualitative requirements the new requirement that, in extending credit to an insider, a member bank follow credit underwriting procedures no less stringent than those prevailing for comparable transactions with non-insiders. In addition, the proposal proposed to replace the term ''repayment'' with the term ''default.'' The final rule retains the term ''repayment.''

**Sections 215.4(b)(2) and (3)**: The final rule reorganizes § 215.4 by redesignating existing paragraphs (b)(2) and (b)(3) of § 215.4 as paragraphs (b)(3) and (b)(4) to accommodate new paragraph (b)(2).

**Section 215.4(b)(2)**: The final rule reorganizes § 215.4 by creating a new paragraph (b)(2) to contain the existing $500,000 limitation. The limitation provision is not modified substantively.

**Section 215.4(c)**: The final rule adds the term ''directors'' to the list of persons subject to the lending limit. This reflects the FDICIA amendment of § 22(h) that extends to loans to directors the § 22(h) lending limit.

**Section 215.4(d)**: The final rule redesignates existing paragraph (d) as paragraph (e) to accommodate new paragraph (d). New paragraph (d) implements the aggregate limit on extensions of credit to all insiders as a class mandated by FDICIA.

**Section 215.5(a), footnote 4**: The final rule strikes the first sentence to reflect the FDICIA revisions that amend § 22(g) of the Federal Reserve Act to cover non-member insured banks. The final rule also modifies regulatory references to conform them with the reorganized regulation.

**Section 215.5(c)(2)**: The proposal proposed to add the phrase ''the primary'' to clarify that the amount limit under this paragraph applies only to an executive officer's primary residence. The final rule does not add the term ''primary.''

**Section 215.5(d)**: The final rule adds the phrase ''in writing'' after the term ''condition'' to clarify that the condition required by this paragraph must be in writing. The proposed rule also proposed to add the term ''corresponding'' before the phrase ''category of credit.'' The final rule does not add the term ''corresponding.''

**Sections 215.6 through 215.10**: The final rule redesignates these sections as §§ 215.7 through 215.11 to accommodate new § 215.6.

**Section 215.6**: The final rule creates a new § 215.6 that implements FDICIA revisions to § 22(h) that prohibit an insider from knowingly receiving (or knowingly permitting the insider's related interest from receiving) an extension of credit that is not authorized under Regulation O.

**Section 215.11**: The final rule redesignates § 215.11 as § 215.13 and adds a new § 215.12 to implement the FDICIA requirement that executive officers and directors of certain member banks report certain credits to the board of directors of the executive officer's or director's member bank.

**Redesignated section 215.9**: The proposal proposed to add the term ''corresponding'' before the phrase ''category of credit'' in redesignated § 215.9. The final rule does not add term ''corresponding.''

**Redesignated section 215.13**: The final rule amends this section to refer to the appropriate civil penalty provisions of the Federal Reserve Act.

The following describes the final rule's amendment of Regulation Y.

**Section 225.4(f)**: The final rule adds a new paragraph (f) to implement the FDICIA requirement that executive officers and directors of certain bank holding companies report certain credits to the board of directors of the executive officer's or director's bank holding company.

**Regulatory Flexibility Act Analysis**

The final rule implements additional restrictions on member banks' lending to their executive officers, directors, and principal shareholders that are required by § 306 of the FDICIA. The final rule also adds reporting requirements mandated by FDICIA that relate to certain credit to executive officers and directors of certain banks and bank holding companies.

The Board expects that these statutorily mandated requirements, such as the aggregate lending limit, will impose costs on banking organizations, including small banking organizations. As authorized by FDICIA, however, the Board has determined to permit banks with total deposits of less than $100 million to establish a higher aggregate lending limit (not to exceed two times the bank's unimpaired capital and unimpaired surplus) under certain circumstances. The Board has determined to permit the higher limit for a one-year period in order to enable the Board to collect data for the purpose of assessing the effect of the aggregate lending limit on the ability of small banks to attract directors and to lend.

The final rule does not establish any new substantive, procedural, or reporting requirements that are not required by FDICIA, with the exception of a submission required of small banks that establish higher aggregate lending limits authorized by the regulation. The final rule requires that such small banks submit to the appropriate federal banking agency and to the Board of Governors the resolution that records the board of directors' decision, including a statement of the bank's lending to its insiders as a percentage of the bank's unimpaired capital and unimpaired surplus.

**List of Subjects**

*12 CFR Part 215*

Credit, Federal Reserve System, Reporting and recordkeeping requirements, Security measures.

*12 CFR Part 225*

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this rule, and pursuant to the Board's authority under §§ 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. 375a and 375b), § 5(b) of the Bank Holding Company Act (12 U.S.C. 1844(b)), and § 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102-242, 105 Stat. 2236 (1991)), the Board is amending 12 CFR part 215 subpart A, and 12 CFR part 225 subpart A as follows:

## PART 215—LOANS TO EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL SHAREHOLDERS OF MEMBER BANKS

### Subpart A—Loans by Member Banks to Their Executive Officers, Directors, and Principal Shareholders

1. The authority citation for part 215 is amended to read as follows:

**Authority**: Secs. 11(i), 22(g) and 22(h), Federal Reserve Act (12 U.S.C. 248(i), 375a, 375(b)(7)), 12 U.S.C. 1817(k)(3) and 1972(2)(F)(vi), and sec. 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No 102-242, 105 Stat. 2236 (1991)).

2. In part 215, the footnotes are redesignated as shown below:

| Section and paragraph | Current Number | New number |
|---|---|---|
| § 215.4(c) ..... | 3 | removed |
| § 215.4(e) ..... | 4 | 3 |
| § 215.5(a) ..... | 5 | 4 |
| § 215.9 ..... | 6 | 5 |
| § 215.10 ..... | 7 | 6 |
| § 215.11(a) ..... | 8 | 7 |
| § 215.11(b) ..... | 9 | 8 |

3. 12 CFR 215.1 is amended by revising paragraph (a) to read as follows:

**Authority**: This subpart is issued pursuant to sections 11(i), 22(g), and 22(h) of the Federal Reserve Act (12 U.S.C. 248(i), 375a, and 375b), 12 U.S.C. 1817(k)(3), and section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102-242, 105 Stat. 2236 (1991).

4. 12 CFR 215.2 is amended by revising paragraphs (a), (c), and (d), redesignating paragraphs (e) through (l) as paragraphs (g) through (n), adding new paragraphs (e) and (f), and revising redesignated paragraphs (d), (h), (i), (l), and (m) to read as follows:

**§ 215.2 Definitions.**

* * * * *

(a) *Company* means any corporation, partnership, trust (business or otherwise), association, joint venture, pool syndicate, sole proprietorship, unincorporated organization, or any other form of business entity not specifically listed herein. However, the term does not include:

(1) An insured depository institution (as defined in 12 U.S.C. 1813) or

(2) A corporation the majority of the shares of which are owned by the United States or by any State.

* * * * *

(c) *Director of a member bank* includes:

(1) Any director of a member bank, whether or not receiving compensation,

(2) Any director of a company of which the member bank is a subsidiary, and

(3) Any director of any other subsidiary of that company. An advisory director is not considered a director if the advisory director

(i) Is not elected by the shareholders of the company or bank,

(ii) Is not authorized to vote on matters before the board of directors, and

(iii) Provides solely general policy advice to the board of directors.

(d) *Executive officer* of a company or bank means a person who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions of the company or bank, whether or not:

(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.[1] The chairman of the board, the president, every vice president, the cashier, the secretary, and the treasurer of a company or bank are considered executive officers, unless

(i) The officer is excluded, by resolution of the board of directors or by the bylaws of the bank or company, from participation (other than in the capacity of a director) in major policymaking functions of the bank or company, and

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[1] 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 or company and whose decisions are limited by policy standards fixed by the senior management of the bank or company. For example, the term does not include a manager or assistant manager of a branch of a bank unless that individual participates, or is authorized to participate, in major policymaking functions of the bank or company.

(ii) The officer does not actually participate therein.

For the purpose of §§ 215.4 and 215.8 of this part, an executive officer of a member bank includes an executive officer of:

(A) A company of which the member bank is a subsidiary, and

(B) Any other subsidiary of that company, unless the executive officer of the subsidiary

(*1*) Is excluded (by name or by title) from participation in major policymaking functions of the member bank by resolutions of the boards of directors of both the subsidiary and the member bank, and

(*2*) Does not actually participate in such major policymaking functions.

* * * * *

(e) *Foreign bank* has the meaning given in 12 U.S.C. 3101(7).

(f) *Insider* means an executive officer, director, or principal shareholder, and includes any related interest of such a person.

* * * * *

(h) The *lending limit* for a member bank is an amount equal to the limit of loans to a single borrower established by § 5200 of the Revised Statutes,[2] 12 U.S.C. 84.

This amount is 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured, and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the loan. The lending limit also includes any higher amounts that are permitted by § 5200 of the Revised Statutes for the types of obligations listed therein as exceptions to the limit. A member bank's unimpaired capital and unimpaired surplus equals the sum of

(1) The ''total equity capital'' of the member bank reported on its most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3),

(2) Any subordinated notes and debentures approved as an addition to the member bank's capital structure by the appropriate federal banking agency, and

(3) Any valuation reserves created by charges to the member bank's income reported on its most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3).

(i) *Member bank* means any banking institution that is a member of the Federal Reserve System, including any subsidiary of a member bank. The term

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[2] Where State law establishes a lending limit for a state member bank that is lower than the amount permitted in § 5200 of the Revised Statutes, the lending limit established by applicable State laws shall be the lending limit for the state member bank.

does not include any foreign bank that maintains a branch in the United States, whether or not the branch is insured (within the meaning of 12 U.S.C. 1813(s)) and regardless of the operation of 12 U.S.C. 1813(h) and 12 U.S.C. 1828(j)(2).

* * * * *

(l) *Principal shareholder* means a person (other than an insured bank) that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank or company. Shares owned or controlled by a member of an individual's immediate family are considered to be held by the individual. A principal shareholder of a member bank includes:

(1) A principal shareholder of a company of which the member bank is a subsidiary, and

(2) A principal shareholder of any other subsidiary of that company.

(m) *Related interest* of a person means:

(1) A company that is controlled by that person, or

(2) A political or campaign committee that is controlled by that person or the funds or services of which will benefit that person.

* * * * *

5. 12 CFR 215.3 is amended by revising paragraphs (a)(4), (a)(8), (b)(2) and (b)(5) to read as follows:

**§ 215.3 Extension of Credit.**

(a) * * *

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

* * * * *

(8) Any other similar transaction as a result of which a person becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

* * * * *

(b) * * *

(2) A receipt by a bank of a check deposited in or delivered to the bank in the usual course of business unless it results in the carrying of a cash item for or the granting of an overdraft (other than an inadvertent overdraft in a limited amount that is promptly repaid, as described in § 215(4)(e) of this part);

* * * * *

(5) Indebtedness of $5,000 or less arising by reason of any general arrangement by which a bank:

(i) Acquires charge or time credit accounts or

(ii) Makes payments to or on behalf of participants in a bank credit card plan, check credit plan, interest bearing overdraft credit plan of the type specified in § 215.4(e) of this part, or similar open end credit plan:

* * * * *

6. 12 CFR 215.4 is amended by revising paragraphs (a), (b) and (c), redesignating paragraphs (b)(2) and (b)(3) as paragraphs (b)(3) and (b)(4), respectively, adding a new paragraph (b)(2), redesignating paragraph (d) as paragraph (e), and adding a new paragraph (d) to read as follows:

**§ 215.4 General Prohibitions.**

(a) * * *

(1) Is made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this part and who are not employed by the bank, and

(2) * * *

(b) *Prior approval.* (1) No member bank may extend credit (which term includes granting a line of credit) to any of its executive officers, directors, or principal shareholders or to any related interest of that person in an amount that, when aggregated with the amount of all other extensions of credit to that person and to all related interests of that person, exceeds the higher of $25,000 or 5 percent of the member bank's unimpaired capital and unimpaired surplus, unless:

(i) The extension of credit has been approved in advance by a majority of the entire board of directors of that bank, and

(ii) The interested party has abstained from participating directly or indirectly in the voting.

(2) In no event may a member bank extend credit to any one of its executive officers, directors, or principal shareholders, or to any related interest of that person, in an amount that, when aggregated with all other extensions of credit to that person, and all related interests of that person, exceeds $500,000, except by complying with the requirements of this paragraph.

(3) * * *

(4) * * *

(c) *Lending limit.* No member bank may extend credit to any of its executive officers, directors, or principal shareholders or to any related interest of that person in an amount that, when aggregated with the amount of all other extensions of credit by the member bank to that person and to all related interests of that person, exceeds the lending limit of the member bank specified in § 215.2(h) of this part. This prohibition does not apply to an extension of credit

by a member bank to a company of which the member bank is a subsidiary or to any other subsidiary of that company.

(d) *Aggregate lending limit.*

(1) *General limit.* A member bank may not extend credit to any insider unless the extension of credit is in an amount that, when aggregated with the amount of all outstanding extensions of credit by that bank to all of its insiders, does not exceed the bank's unimpaired capital and unimpaired surplus (as defined in § 215.2(h) of this part).

(2) *Member banks with deposits of less than $100,000,000.* A member bank with deposits of less than $100,000,000 may by resolution of its board of directors increase the general limit specified in paragraph (d)(1) of this section for the one-year period ending May 18, 1993, to a level not to exceed two times the bank's unimpaired capital and unimpaired surplus, if:

(i) The board of directors determines that such higher limit is consistent with prudent, safe, and sound banking practices in light of the bank's experience in lending to its insiders and is necessary to attract or retain directors or to prevent restricting the availability of credit in small communities;

(ii) The resolution sets forth the facts and reasoning on which the board of directors bases the finding, including the amount of the bank's lending to its insiders as a percentage of the bank's unimpaired capital and unimpaired surplus as of the date of the resolution;

(iii) The bank has submitted the resolution to the appropriate Federal banking agency (as defined in 12 U.S.C. 1813(q)) with a copy to the Board of Governors; and

(iv) The bank meets or exceeds, on a fully-phased in basis, all applicable capital requirements established by the appropriate Federal banking agency.

(e) * * *

7. 12 CFR 215.5 is amended by revising redesignated footnote 4 in paragraphs (a) and (d) to read as follows:

**§ 215.5 Additional restrictions on loans to executive officers of member banks.**

(a) * * *[4]

* * * * *

(d) Any extension of credit by a member bank to any of its executive officers shall be:

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[4] Sections 215.5, 215.9, and 215.10 of this part implement § 22(g) of the Federal Reserve Act. For the purposes of those sections, an executive officer of a member bank does not include an executive officer of a bank holding company of which the member bank is a subsidiary or any other subsidiary of that bank holding company.

(1) Promptly reported to the member bank's board of directors;

(2) In compliance with the requirements of § 215.4(a) of this part;

(3) Preceded by the submission of a detailed current financial statement of the executive officer; and

(4) Made subject to the condition in writing that the extension of credit will, at the option of the member bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in paragraph (c) of this section.

8. 12 CFR 215.11 is redesignated as § 215.13, §§ 215.6 through 215.10 are redesignated as 12 CFR 215.7 through 215.11, respectively, and a new § 215.6 is added to read as follows:

**§ 215.6 Prohibition on knowingly receiving unauthorized extension of credit.**

No executive officer, director, or principal shareholder of a member bank shall knowingly receive (or knowingly permit any of that person's related interests to receive) from a member bank, directly or indirectly, any extension of credit not authorized under this part.

9. A new 12 CFR 215.12 is added to read as follows:

**§ 215.12 Reporting requirement for credit secured by certain bank stock.**

Each executive officer or director of a member bank the shares of which are not publicly traded shall report annually to the board of directors of the member bank the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the member bank.

10. Redesignated 12 CFR 215.13 is amended to read as follows:

**§ 215.13 Civil penalties.**

Any member bank, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank, that violates any provision of this subpart (other than § 215.11) is subject to civil penalties as specified in § 29 of the Federal Reserve Act (12 U.S.C. 504).

## PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority for part 225 is amended to read as follows:

**Authority**: 12 U.S.C. 1817(j)(13), 1818, 1831(i), 1843(c)(8), 1844(b), 3106, 3108, 3907, 3909, 3310, and 3331-3351, and sec. 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102-242, 105 Stat. 2236 (1991)).

2. 12 CFR 225.4 is amended by adding paragraph (f) to read as follows:

(f) *Reporting requirement for credit secured by certain bank holding company stock.* Each executive officer or director of a bank holding company the shares of which are not publicly traded shall report annually to the board of directors of the bank holding company the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the bank holding company. For purposes of this paragraph, the terms ''executive officer'' and ''director'' shall have the meaning given in § 215.2 of Regulation O, 12 CFR 215.2.

Board of Governors of the Federal Reserve System, May 7, 1992.

(signed) Jennifer J. Johnson

**Jennifer J. Johnson,**
*Associate Secretary of the Board*
[FR Doc. 92-00000 Filed 00-00-92; 8:45 am]
**BILLING CODE 6210-01-F**