FEDERAL RESERVE BANK OF DALLAS

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

DALLAS, TEXAS 75222

September 15, 1993

Notice 93-101

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

SUBJECT

Request for Public Comment on Proposed Amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks)

DETAILS

The Federal Reserve Board has requested public comment on proposed amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks). The proposed revisions would:

- Provide an exception to the aggregate insider lending limit for the purchase of certain consumer installment paper identical to the exception for such paper in the national bank lending limit (as authorized by the Housing and Community Development Act of 1992);

- Modify the definition of "extension of credit" (to implement amendments in the Federal Deposit Insurance Corporation Improvement Act) to:

  - clarify that an extension of credit is not attributed to an insider that receives a "tangible economic benefit" when the extension of credit is to a third party on arm's-length terms to finance the acquisition of property, goods, or services from the insider;

  - exclude the discount of obligations sold by an insider to the bank without recourse; and

  - increase from $5,000 to $15,000 the threshold for considering credit card plan debt to be an extension of credit.

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- Modify the recordkeeping requirements to allow banks greater latitude in devising procedures to ensure compliance with Regulation O;

- Adopt revisions to the limits on lending to executive officers to exempt home mortgage refinancing and certain collateralized loans; and

- Adopt other technical and housekeeping amendments.

The Board must receive comments by October 12, 1993. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0809.

ATTACHMENT

A copy of the Board's notice (Federal Reserve System Docket No. R-0809) is attached.

MORE INFORMATION

For more information, please contact Jane Anne Schmoker at (214) 922-5101. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Part 215

[Regulation O; Docket No. R-0809]

Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is proposing to amend its Regulation O, which governs extensions of credit to insiders of banks. The proposal narrows the definition of "extension of credit", adopts exceptions to the general restrictions on lending to insiders and special restrictions on lending to executive officers, and permits banks to follow alternative recordkeeping procedures. These amendments are intended to increase the ability of banks to make extensions of credit that pose minimal risk of loss, to remove other transactions from the regulation's coverage, and to eliminate recordkeeping requirements that impose a paperwork burden but do not significantly aid compliance with the regulation. These amendments are expected to increase the availability of credit, particularly in communities served by small banks, and to reduce the cost of compliance with the regulation. Other minor revisions to the regulation clarifying certain exemptions and conforming certain provisions to the enabling statutes are included as well. The Board is requesting public comment on each of these proposed revisions.

DATES: Comments should be submitted on or before October 12, 1993.

ADDRESSES: Comments, which should refer to Docket No. R-0809, may be mailed to the Board of Governors of the Federal Reserve System, 20th & C Street, NW., Washington, DC 20551, to the attention of Mr. William W. Wiles, Secretary. Comments addressed to the attention of Mr. Wiles may be delivered to the Board's mail room between 8:45 am and 5:15 pm, and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room B-1122 between 9:00 am and 5:00 pm weekdays, except as provided in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Gordon Miller, Attorney (202/452-2534), or Stephen Van Meter, Attorney (202/452-3554), Legal Division; or Stephen M. Lovette, Manager of Policy Implementation (202/452-3622), or William G. Spaniel, Supervisory Financial Analyst (202/452-3469), Division of Banking Supervision and Regulation; Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th & C Street, NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

I. Consumer Installment Paper

Section 22(h) of the Federal Reserve Act (Act) governs extensions of credit by a bank to its executive officers, directors, and principal shareholders (insiders), and to companies controlled by its insiders (related interests), individually and as a class. *See* 12 U.S.C. 375b(4) and (5). In order to permit appropriate revisions of these restrictions, the Housing and Community Development Act of 1992 (HCDA), Pub. L. 102-550 § 955, 106 Stat. 3672 (1992), authorized the Board to adopt exceptions to the definition of "extension of credit" in section 22(h) for transactions that pose minimal risk to the lending bank. Pursuant to such authority, the Board previously has adopted three exceptions to the definition for purposes of calculating the aggregate lending limit. *See* 58 **FR** 26507 (1993).

The proposed rule would adopt an additional exception to the aggregate lending limit for the discount of consumer installment paper from an insider with recourse, so long as the bank is relying primarily upon the creditworthiness of the maker of the paper and not on any endorsement or guarantee of the insider.[1]

The legislative history of HCDA states that the Board should make a "zero based review" of any exceptions it adopts. *See* 138 Cong. Rec. S17,914-15 (daily ed. October 8, 1992). The proposed exception is consistent with this directive. The Board believes that, where the bank is relying primarily upon the creditworthiness of the underlying maker, the accompanying extension of credit to an insider transferring the paper with recourse poses minimal risk of loss to the bank. In addition, like the previous three exceptions, the proposed exception is found in the National Bank Act, and is incorporated as an exception to the individual lending limit in Regulation O. *See* 12 U.S.C. 84(c)(8); 12 CFR 215.2(h) and 215.4(c).

Although extensions of credit made in conformity with the proposed exception would not count toward a bank's aggregate lending limit, such extensions of credit would continue to be extensions of credit under 12 CFR 215.3(a)(4) and would remain subject to the general requirements found at sections 215.4(a) and (b) of Regulation O, as a safeguard against abuse of this exception.

II. Definition of "Extension of Credit"

The Board is proposing three amendments to the definition of "extension of credit" in Regulation O concerning the "tangible economic benefit" rule, the discount by a bank of obligations sold by an insider without recourse, and the threshold for treating credit card debt as an extension of credit.

A. "Tangible Economic Benefit" Rule

Regulation O currently provides that an extension of credit is deemed to be made to an insider when the proceeds of the credit are used for the tangible

[1] Such transactions would continue to constitute extensions of credit subject to the aggregate lending limit if the maker of the consumer installment paper was an insider or a related interest of an insider.

economic benefit of, or are transferred to, the insider. 12 CFR 215.3(f). Following the enactment of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub.L. 102-242, section 306 (1991), which expanded the lending limit provision of section 22(h) to cover directors and their related interests, questions have been raised regarding the scope and proper application of the tangible economic benefit provision. If interpreted literally, the tangible economic benefit rule would apply whenever a bank extends credit to any person, including a member of the general public with no other relationship to the bank, and the proceeds of the extension of credit are transferred to or used for the benefit of an insider or an insider's related interest. For example, if a third party borrowed money from a bank in order to purchase a house owned by one of the bank's directors, the loan would be deemed an extension of credit to the director. Similarly, if a bank financed the purchase of consumer goods or services from a company controlled by one of its directors, the bank would be deemed under Regulation O to have extended credit to the director. The tangible economic benefit rule was not intended to reach arm's-length, bona fide transactions with the general public, and the proposed amendment would confirm that fact.

The tangible economic benefit rule is similar to a provision contained in section 23A of the Act, and was adopted at a time when the Board was required by section 22(h) to use the definition of "extension of credit" found in section 23A. *See* Pub. L. 95-630 § 104, 92 Stat. 3644 (1978). The definition of extension of credit in section 22(h), however, is no longer tied to section 23A, and the Board is authorized to adopt appropriate definitions of terms in the statute. *See* 12 U.S.C. 375b(9)(D) and 375b(10). The Board believes that the difficulties that have arisen with regard to the application of the tangible economic benefit rule can be remedied by providing explicitly that the rule does not apply to an arms-length[2] extension of credit by a bank to a third party where the proceeds of the credit are used to finance the bona fide acquisition of property, goods, or services from an insider or an insider's related interest.

Extensions of credit to an insider's nominee and transactions in which the proceeds of the credit are loaned to an insider would continue to be covered by the rule. The Board notes that other provisions in the definition of "extension of credit" would continue to reach transactions in which an insider actually becomes obligated 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." 12 CFR 215.3(a)(8).

B. Discounting Obligations Without Recourse

Currently, Regulation O includes within the definition of "extension of credit" any "discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, *whether with or without recourse*." 12 CFR 215.3(a)(5) (emphasis added). At the time this provision was adopted, the Board

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[2] In order to satisfy this requirement, the extension of credit to the general public must be on terms that would satisfy the standard set forth in § 215.4(a) of Regulation O if the extension of credit was being made directly to an insider or an insider's related interest.

was required by section 22(h) to include such items in the regulatory definition of extension of credit.[3] However, the current statutory definition does not require the inclusion of such items where the transaction is made without recourse to the transferor.[4] The proposed rule would delete this provision so as to exclude non-recourse transactions. Transactions entered into with recourse to the transferor would continue to be covered under other provisions of the definition. *See* 12 CFR 215.3(a)(4) and (8).

The Board believes that the proposed modification would be consistent with the purposes of Regulation O and the Act. Neither the statute nor the regulation is designed or intended to cover all transactions between a bank and its insiders, but only to cover transactions involving an extension of credit to the insider from the bank. Non-recourse transactions resemble a purchase of assets more than an extension of credit, and adoption of the proposed change would conform the treatment of these transactions with the treatment of other asset purchases between a bank and its insiders. Moreover, these non-recourse transactions do not constitute "extensions of credit" to the transferor under the National Bank Act as interpreted by the Office of the Comptroller of the Currency. *See* 12 U.S.C. 84(b)(1); 12 CFR 32.2(a). These transactions would continue to be governed by general standards of safety and soundness, prohibitions against fraud and abuse, and corporate fiduciary duties.[5]

C. Credit Card Plan Indebtedness

Regulation O currently exempts from the definition of "extension of credit" indebtedness of $5,000 or less arising through any general arrangement by which a bank: (1) Acquires charge or time credit accounts; or (2) Makes payments to or on behalf of participants in a bank credit card plan or other open-end credit plan.

To qualify for the exemption, the indebtedness must be on market terms and must not involve prior individual clearance or approval by the bank other than for the purpose of determining the borrower's eligibility and compliance with any applicable dollar limit under the arrangement.

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[3] The current definition of "extension of credit" in Regulation O was adopted in 1979, when the Board substantially amended the regulation in order to implement the Financial Institutions Regulatory Act of 1978 (FIRA), Pub. L. 95-630 § 104, 92 Stat. 3644 (1978). 44 FR 12963 (1979). FIRA added section 22(h) to the Act, which in turn incorporated the definition of "extension of credit" contained in section 23A. At that time, section 23A's definition included the above-referenced provision concerning the discount of paper acquired with or without recourse. *See* Pub. L. 89-485 § 12, 80 Stat. 241 (1966).

[4] The statutory cross-reference to section 23A was deleted from section 22(h) in 1982. *See* Pub. L. 97-230 § 410, 96 Stat. 1520 (1982). FDICIA added a new definition of "extension of credit" to section 22(h), which applies whenever a member bank makes or renews a loan, grants a line of credit, or enters into any similar transaction as a result of which a person becomes obligated to pay money or its equivalent to the bank. *See* 12 U.S.C. 375b(9)(D). This definition does not cover all transactions, such as the purchase of assets, covered by section 23A.

[5] In addition, sections 23A and 23B of the Act may be applicable to such transactions if the insider or the insider's related interest is an affiliate of the lending bank as defined in section 23A.

This credit card exemption, and the $5,000 limit, were enacted in 1979. Since 1979, inflation has reduced the purchasing power of this amount of credit, and credit card limits generally available to the public have increased. In 1979, a credit limit in excess of $5,000 would have been unusual. However, institutions now routinely extend credit to the holders of "premium" or "gold" cards in amounts considerably greater than $5,000. Accordingly, the Board is proposing to increase the limit from $5,000 to $15,000.[6] The requirements that the credit be granted on market terms and without prior individual approval (except to determine eligibility and compliance with the credit limit) would be retained, and would continue to protect against abuse.

III. Recordkeeping Procedures

Section 215.8 of Regulation O currently requires that each bank maintain records necessary for compliance with the insider lending restrictions of Regulation O. In particular, banks are required to maintain records identifying all insiders of the bank and its affiliates and all related interests of those insiders and records specifying the amount and terms of all credit extended to these persons. Section 215.8 further requires each bank to request its insiders to identify their related interests on an annual basis.

As bank holding companies have become increasingly large and diversified, and as commercial organizations have acquired credit card banks and limited purpose banks,[7] the recordkeeping burden imposed by Regulation O has become increasingly large and, in certain cases, unnecessary. The Board has received several requests for relief from the recordkeeping requirements and believes that the issues raised in those requests warrant regulatory treatment.

The proposed amendment to section 215.8 would retain the requirement that a bank maintain records necessary to ensure compliance with Regulation O, but would allow a bank to choose an appropriate method for doing so. The amendment would specify two methods for compliance that are presumptively sufficient, and would permit a bank to use any combination of those two methods or a method of its own that was appropriate given the particular circumstances of the bank.

The first method identified in the proposed regulation is the current system of maintaining a record of all insiders of the bank and its affiliates and all related interests of those insiders.[8] The list of insiders and related interests is then used by the bank to identify all existing or proposed extensions of credit covered by Regulation O, to monitor the amount thereof subject to the individual and aggregate lending limits, and to ensure that all appropriate approval procedures are followed.

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[6] The $5,000 limit would remain in effect for interest-bearing overdraft credit plans.

[7] *See* 12 U.S.C. 1841(c)(2).

[8] Under the proposal, the list could be updated through an annual request to insiders to identify related interests, as required by the current regulation, or through some other appropriate mechanism.

Under the second method identified in the proposed regulation, the bank could require each borrower to state, at the time an application is made for an extension of credit, whether the borrower is an insider or a related interest of an insider of the bank or one of its affiliates. Any affirmative responses would be used to maintain a list of insider credits and to monitor compliance with lending limits and approval procedures.

The proposed amendment would eliminate the requirement that each bank conduct an annual survey to identify its insiders' related interests. Banks that continue to use the first method for compliance would still need to conduct a survey or some other appropriate information-gathering procedure, in order to identify insiders and their related interests and to monitor changes in this group. Banks using the second method for compliance, however, might not need to make any effort to identify related interests that do not actually borrow from the bank.

By allowing a bank to choose a method for ensuring compliance that is adapted to the particular circumstances of the bank, the proposed amendment would allow banks to minimize unnecessary recordkeeping. In certain cases, a combination of methods might be considered to be appropriate. For example, a bank that actively made personal loans but made very few commercial loans might choose to continue surveying insiders about their personal borrowing but, instead of asking its insiders about their related interests, might choose to ask all commercial borrowers when a loan was applied for or renewed whether they were related interests of insiders. By identifying all extensions of credit to related interests through the lending process, the bank would make a survey of related interests unnecessary.[9]

In some cases, a bank may not need to maintain any records concerning related interests of insiders. For example, under the Competitive Equality Banking Act of 1987 (CEBA), an institution qualifies as a credit card bank only if it "does not engage in the business of making commercial loans." 12 U.S.C. 1841(c)(2)(F)(v). Because any extension of credit to a company or political or campaign committee would constitute a commercial loan, CEBA credit card banks are effectively prohibited from extending credit to related interests of insiders. Therefore, no purpose is served by the current rule requiring CEBA credit card banks to identify related interests of their insiders. Other financial institutions, including certain trust companies, thrifts, and other institutions that may refrain from making commercial loans, also may determine that maintaining records on related interests of insiders is unnecessary.

The suitability of any procedure for monitoring lending to insiders and their related interests must be determined, of course, on the basis of the effectiveness of the procedure in preventing violations of law and insider abuse. Any alternative recordkeeping procedure must sufficiently identify extensions of credit covered by Regulation O to ensure that proper monitoring of and compliance with insider lending restrictions is maintained.

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[9] Similarly, a bank that extends credit only in the United States might be able to devise an adequate recordkeeping system that does not track insiders of its overseas affiliates or the related interests of such insiders.

The Board seeks specific comment on whether any recordkeeping methods other than the two identified in the proposed regulation should be considered presumptively sufficient. The Board also seeks comment on whether the proposal on recordkeeping provides sufficient guidance to institutions and examiners regarding what constitutes adequate recordkeeping.

IV. Loans to Executive Officers

A. General Purpose Loans

Section 22(g) of the Act governs extensions of credit by a bank to its executive officers. Section 22(g) provides that a bank may make certain home mortgage loans and educational loans to its executive officers without any restriction as to amount. However, a bank may not make loans to its executive officers for other purposes in excess of an amount prescribed by the appropriate Federal banking agency. *See* 12 U.S.C. 375a(4). Pursuant to this authority, the Board has authorized a bank to extend credit to its executive officers for general purposes in an amount equal to the greater of $25,000 or 2.5 percent of the bank's capital and unimpaired surplus, but not to exceed $100,000. 12 CFR 215.5(c)(3). Currently, there is no exception to the Board's regulatory lending limit on loans for other purposes. This is in contrast to other provisions of Regulation O that contain exceptions to lending limits based on the manner in which the extension of credit is collateralized. *See* 12 CFR 215.4(c) and (d)(3).

The Board is proposing, under its authority to prescribe by regulation the amount of credit that may be extended by a bank to its executive officers for a purpose not otherwise specifically authorized, to exempt an extension of credit by a bank to its executive officer from the lending limit set forth in 12 CFR 215.5(c)(3) when the loan is fully secured by:

(a) Obligations of the United States or other obligations fully guaranteed as to principal and interest by the United States;

(b) Commitments or guarantees of a department or agency of the United States; or

(c) A segregated deposit account with the lending bank.

The Board previously has determined that extensions of credit collateralized in the manner described above pose minimal risk of loss to a bank. *See* 58 FR 26507 (1993). In view of this determination, the Board believes that it is consistent with safe and sound banking practices to increase the amount of credit that a bank may extend to its executive officers when the credit is secured as described above. In view of the fact that such loans would continue to be subject to the prohibition against preferential lending, the Board also believes that the proposed exception would not lend itself to evasions of the law or any other abuse.

B. Refinancing of Home Mortgage Loans

Section 22(g) of the Act provides that a bank may make a loan to its executive officer, without restriction as to amount, if the loan is secured by a first lien on a dwelling that is owned by the executive officer and used by the

executive officer as a residence after the loan is made. 12 U.S.C. 375a(2). Section 215.5(c)(2) of Regulation O implements this provision, and sets forth additional restrictions on such loans.

Questions have arisen as to whether the authority granted to a bank in Regulation O to finance the purchase, construction, maintenance, or improvement of a residence includes the authority to refinance an existing extension of credit that was made for such a purpose. The Board believes that such refinancings qualify as home mortgage loans not subject to the lending limit for other purpose loans to executive officers.

Under the proposal, the amount of a refinancing loan that may be included as a home mortgage loan, however, may not exceed the actual amount of the proceeds thereof that are used to repay the home mortgage loan that is refinanced or for the purposes enumerated in the regulation. Funds that are paid or made available to the executive officer in connection with a refinancing that may be used for unrestricted purposes would not be included within this category, and would be subject to the lending limit for general purpose loans.

C. Prior Approval of Home Mortgage Loans

Section 22(g) provides that the board of directors of a bank must specifically approve in advance a home mortgage loan to an executive officer. 12 U.S.C. 375a(2). Regulation O, however, does not set forth this requirement. The Board proposes to revise 12 CFR 215.5 to conform to the enabling statute.

V. Conforming Definition of "Bank"

Subpart B of Regulation O implements the reporting requirements of title VIII of FIRA, as amended by the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. 97-320 (1982) and FDICIA. 12 U.S.C. 1972(2)(G). Title VIII requires disclosure of:

(1) Lending by a bank to executive officers and principal shareholders of another bank when there is a correspondent account relationship between the banks; and

(2) The opening of a correspondent account relationship between banks when there is an extension of credit by one of the banks to an executive officer or principal shareholder of the other bank.

Subpart B of Regulation O requires an executive officer or principal shareholder of a bank to report to the bank each year if the person or any related interest of the person borrowed during the prior calendar year from a correspondent bank of the bank. 12 CFR 215.22.

As originally enacted, a correspondent bank was defined in title VIII of FIRA to include a bank as defined in the Bank Holding Company Act. Title VIII was subsequently amended to include in the definition a mutual savings bank, a savings bank, and a savings association as defined in section 3 of the Federal Deposit Insurance Act. 12 U.S.C. 1971 and 1972(H). The Board proposes to amend the definition of bank in subpart B of Regulation O to conform the rule to the statutory amendments.

VI. Request for Comments

The Board requests public comment on all of the proposals described above. The Board also asks that commenters identify additional amendments to Regulation O that they believe would reduce the burden imposed by Regulation O without adversely affecting the safety and soundness of affected institutions.

In connection with previous rulemaking by the Board to adopt exceptions to the definition of extension of credit for purposes of the aggregate lending limit, the Board received three comments specifically favoring the proposal to adopt an exception to the aggregate insider lending limit for the purchase of certain consumer installment paper, two comments specifically favoring the proposal to limit the application of the tangible economic benefit rule, two comments specifically favoring the proposal to remove from the definition of extension of credit the discount of obligations sold by an insider or a related interest of an insider without recourse, and three comments specifically favoring the adoption of exceptions to the limit on lending to executive officers. The Board also received six comments favoring the proposal to adopt the exception for certain consumer installment paper described above as part of a broader incorporation of exceptions to the definition of extension of credit contained in the National Bank Act. *See* 58 **FR** 26507 (1993). Those comments will be considered in connection with the current proposals.

VII. Initial Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires an agency to publish an initial regulatory flexibility analysis with any notice of proposed rulemaking. Two of the requirements of an initial regulatory flexibility analysis, a description of the reasons why the action by the agency is being considered, and a statement of the objectives of, and legal basis for, the proposed rule (5 U.S.C. 603(b)), are contained in the supplementary information above.

The Board's proposals impose little additional reporting or recordkeeping requirements, and there are no relevant federal rules that duplicate, overlap, or conflict with the proposed rule. The proposed exception to the aggregate insider lending limit, clarification of the tangible economic benefit rule, and exception to the definition of extension of credit would apply to all banks, regardless of size. These proposals should not have a negative economic impact on small institutions. Instead, they should reduce regulatory burden for banks, particularly in small communities and rural banking markets where local business people who originate consumer installment paper and other credit transactions with the general public are likely to serve as directors of a bank. In addition, the proposed exception to the aggregate lending limit should increase the ability of banks to make loans and other extensions of credit that pose little or no risk of loss, and to attract and retain outside directors. The proposed exception should also reduce the complications in maintaining dual systems for compliance with both the individual lending limit and the aggregate lending limit in Regulation O.

The proposed elimination of recordkeeping requirements for monitoring insider lending should also reduce the burden of maintaining records when those records are unnecessary or largely ineffective to ensure compliance with insider

lending limits and other requirements under Regulation O. It is anticipated that the alternative recordkeeping that banks may choose to implement would be adapted to the particular circumstances of the banks' lending practices, and therefore to be less burdensome to maintain. The amendment of the definition of bank in subpart B of Regulation O may require additional reporting by executive officers and principal shareholders of banks. These reports, however, are required by statute.

The proposed increase in the amount of pre-approved credit that may be extended under a credit card plan without constituting an extension of credit under Regulation O, and the proposed revisions to the restrictions on lending to executive officers, would apply to all banks, regardless of size. These proposals should not have a negative impact on small institutions. They should increase the ability of banks to make loans and other extensions of credit that pose little or no risk of loss, and to attract and retain executive officers. Conforming the requirements for home mortgage loans to executive officers to the enabling statute is required by such statute.

VIII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1980, 44 U.S.C. 3507, and 5 CFR 1320.130, the proposed amendments to Regulation O will be reviewed by the Board under authority delegated by the Office of Management and Budget after consideration of the comments received during the public comment period. The Board has preliminarily determined that the revisions do not significantly increase the burden of the reporting institutions. The proposed changes are expected to reduce regulatory burden for some banks, particularly small community and rural banks, but the estimated effect on aggregate burden calculations is not deemed to be significant.

List of Subjects in 12 CFR part 215

Credit, Federal Reserve System, Penalties, Reporting and recordkeeping requirements.

For the reasons set forth in the preamble, and pursuant to the Board's authority under section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) and section 955 of HCDA, the Board is proposing to amend 12 CFR Part 215, subpart A, as follows:

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

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

Authority: 12 U.S.C. 248(i), 375a(10), 375b(10), 1817(k)(3) and 1972(2)(F)(ix), Pub. L. 102-550, 106 Stat. 3895 (1992).

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

2. Section 215.3 is amended as follows:

a. By removing paragraph (a)(5) and redesignating paragraphs (a)(6) through (a)(8) as paragraphs (a)(5) through (a)(7);

b. By removing the word "or" at the end of paragraph (b)(4), amending paragraph (b)(5)(ii) introductory text by removing the phrase "interest-bearing overdraft credit plan of the type specified in section 215.4(e) of this part," removing the period at the end of paragraph (b)(5)(ii)(B) and adding in its place a semicolon followed by the word "or", and adding a new paragraph (b)(6), to read as follows; and

c. By revising paragraph (f), to read as follows:

§ 215.3 Extension of credit.

* * * * *

(b) * * *

(6) Indebtedness of $5,000 or less arising by reason of an interest-bearing overdraft credit plan of the type specified in § 215.4(e) of this part.

(f) (1) *In general.* An extension of credit is considered made to an insider to the extent that the proceeds of the extension of credit are used for the tangible economic benefit of, or are transferred to, the insider.

(2) *Exception.* An extension of credit is not considered made to an insider under paragraph (f)(1) when the credit is extended on terms that would satisfy the standard set forth in § 215.4(a) of this part for extensions of credit to insiders and the proceeds of the extension of credit are used in a bona fide transaction to acquire property, goods, or services from the insider.

3. Section 215.4 is amended by redesignating paragraph (d)(3)(iv) as paragraph (d)(3)(v), and adding a new paragraph (d)(3)(iv) to read as follows:

§ 215.4 General prohibitions.

* * * * *

(iv) Extensions of credit arising from the discount of negotiable or nonnegotiable installment consumer paper that is acquired from an insider and carries a full or partial recourse endorsement or guarantee by the insider, if—

(A) The bank's files or the knowledge of its officers of the financial condition of each maker of such consumer paper is reasonably adequate;

(B) An officer of the bank designated for that purpose by the board of directors of the bank certifies in writing that the bank is relying primarily upon the responsibility of each maker for payment of the obligation and not upon any endorsement or guarantee by the insider; and

(C) The maker of the instrument is not an insider.

4. Section 215.5 is amended by revising paragraph (c)(2), redesignating paragraph (c)(3) as paragraph (c)(4), adding a new paragraph (c)(3), and by revising paragraph (c)(4), to read as follows:

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

* * * * *

(c) * * *

(2) with the specific prior approval of the board of directors, in any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, provided—

(i) the extension of credit is secured by a first lien on the residence and the residence is owned (or expected to be owned after the extension of credit) by the executive officer, and

(ii) in the case of a refinancing, the amount thereof does not exceed the actual amount of the proceeds thereof used to repay the original extension of credit made under this paragraph (c)(2) or for any of the purposes enumerated in this paragraph (c)(2);

(3) in any amount, if the extension of credit is secured in a manner described in paragraphs (d)(3)(i) through (iii) of § 215.4 of this part; and

(4) for any other purpose not specified in paragraphs (c)(1) through (c)(3) of this section, if the aggregate amount of extensions of credit to that executive officer under this paragraph does not exceed at any one time the higher of 2.5 percent of the bank's unimpaired capital and unimpaired surplus or $25,000, but in no event more than $100,000.

5. Section 215.8 is revised to read as follows:

§ 215.8 Records of member banks.

(a) *In general.* Each member bank shall maintain records necessary for compliance with the requirements of this part.

(b) *Methods of recordkeeping.* Acceptable methods of complying with paragraph (a) are:

(1) Maintaining records that identify—

(i) Each executive officer, director, or principal shareholder of the member bank and each related interest of such person; and

(ii) Tthe amount and terms of each extension of credit by the member bank to such person and any related interests of that person; or

(2) As part of each extension of credit—

(i) Requiring that the borrower indicate whether the borrower is, or is a related interest of, an executive officer, director, or principal shareholder of the member bank; and

(ii) Maintaining records that identify the amount and terms of each extension of credit by the member bank to borrowers so identifying themselves; or

(3) Employing any other method that ensures compliance with the requirements of this part, given the particular circumstances of the member bank.

6. Section 215.21 is amended by replacing the word ''1841(c)'' in paragraph (a) with the words ''1971 and 1972''.

By order of the Board of Governors of the Federal Reserve System, September 3, 1993.
William W. Wiles,
Secretary of the Board.
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