



**FEDERAL RESERVE BANK
OF DALLAS**

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

DALLAS, TEXAS
75265-5906

May 16, 1996

Notice 96-47

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**

DETAILS

The Board of Governors of the Federal Reserve System has requested comment on proposed amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks).

The proposed amendments would implement authority granted the Board by the Riegle Community Development and Regulatory Improvement Act of 1994. Under the proposed rule, the aggregate and individual lending limits, overdraft restriction, and prior approval requirements of Regulation O would not apply to extensions of credit by a bank to executive officers and directors of the bank's affiliates, provided that those executive officers and directors were not engaged in major policymaking functions of the lending bank. Of the restrictions in Regulation O, only the prohibition on preferential lending would apply to extensions of credit to such persons.

The Board must receive comments by June 17, 1996. Please address comments 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-0924.

ATTACHMENT

A copy of the Board's notice as it appears on pages 19863-65, Vol. 61, No. 87, of the *Federal Register* dated May 3, 1996, 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-0924]

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:** Proposed rule.

SUMMARY: The proposed rule would amend the Board's Regulation O, which limits how much and on what terms a bank may lend to its own insiders and insiders of its affiliates. Under the proposed rule, four of the five restrictions of Regulation O would not apply to extensions of credit by a bank to executive officers and directors of the bank's affiliates, provided that those executive officers and directors were not engaged in major policymaking functions of the lending bank. Of the restrictions in Regulation O, only the prohibition on preferential lending would apply to extensions of credit to such persons.

The Board was granted authority to create such an exception for directors of affiliates for the first time by the Riegle Community Development and Regulatory Improvement Act of 1994; Regulation O already contains a blanket regulatory exception for executive officers of affiliates not involved in policymaking at the lending bank, which as a result of the statute must be scaled back to no longer include the prohibition on preferential lending.

DATES: Comments must be received on or before June 17, 1996.

ADDRESSES: Comments should refer to Docket No. R-0924 and be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551. They may also be delivered to the guard station in the Eccles Building Courtyard on 20th Street, NW., (between Constitution Avenue and C Street) between 8:45 a.m. and 5:15 p.m. weekdays. Except as provided in the Board's rules regarding the availability of information (12 CFR 261.8), comments will be available for inspection and copying by members of the public in the Freedom of Information Office, Room MP-500 of the Martin Building, between 9:00 a.m. and 5:00 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT:

Gregory Baer, Managing Senior Counsel (202/452-3236), or Gordon Miller, Attorney (202/452-2534), Legal

Division, Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:**Background**

Section 22(h) of the Federal Reserve Act, 12 U.S.C. 375b, restricts insider lending by banks, and Regulation O implements section 22(h). Regulation O limits total loans to any one insider and aggregate loans to all insiders to a percentage of the bank's capital and requires that such loans be on non-preferential terms—that is, on the same terms a person not affiliated with the bank would receive.¹ 12 CFR 215.4 (a), (c) and (d). For this purpose, an "insider" means an executive officer, director, or principal shareholder, and loans to an insider include loans to any "related interest" of the insider, including any company controlled by the insider. 12 CFR 215.2(h). Regulation O requires that banks maintain records to document compliance with all these restrictions. 12 CFR 215.8.

Section 22(h) restricts lending not only to insiders of the bank making the loan but also to insiders of the bank's parent bank holding company and any other subsidiary of that bank holding company. As amended by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA),² section 22(h)(8) provides that "any executive officer, director, or principal shareholder (as the case may be) of any company of which the member bank is a subsidiary, or of any other subsidiary of that company, shall be deemed to be an executive officer, director, or principal shareholder (as the case may be) of the member bank." 12 U.S.C. 375b(8)(A).

At the time that the FDICIA amendment became effective, the Board's rules did not place any restrictions on loans to an executive officer of a bank's affiliates (other than the parent bank holding company) unless the executive officer was involved in major policymaking functions at the bank.³ 12 CFR 215.2(d)

¹ Regulation O also requires prior approval of the bank's board of directors for certain loans to insiders and prohibits overdrafts by executive officers and directors.

² Pub. L. 102-242, section 306 (1991).

³ Subsection (h) of section 22 was added in 1978. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. 95-630, section 104. However, the statute was ambiguous about whether an executive officer of a bank's affiliate was required to be treated like an executive officer of the bank itself. (The statute imposed restrictions on lending by banks to "executive officers" of the bank. The statute provided that an "officer" of a

(1992). The Board considered this treatment appropriate for two reasons. First, such persons generally were not considered to be in a position to exert sufficient leverage on the bank to obtain a loan on anything but arm's lengths terms, in contrast to executive officers of the bank or its parent. Thus, in terms of protecting the safety and soundness of banks, the Board considered the benefits of restricting loans to these affiliate insiders to be small. Second, applying these restrictions to affiliate insiders would have required each bank to maintain an updated list of all its affiliates' executive officers and all related interests of those executive officers, and to check all loans against this list. Particularly for a bank in a large bank holding company structure, this effort would have constituted a significant burden—and one not outweighed by any substantial benefit.

However, after the FDICIA amendment to section 22(h)(8), the language of the statute no longer appeared to allow such an exception for executive officers of affiliates, who are explicitly treated like executive officers of the bank itself. Still, nothing in the legislative history of FDICIA indicated that Congress intended to invalidate the Board's regulatory exception and extend coverage to all executive officers of affiliates.

In the Riegle Community Development and Regulatory Improvement Act of 1994, Congress addressed this issue by amending section 22(h)(8) yet again. Congress allowed the Board to make exceptions to the statutory restrictions on lending to affiliate insiders embodied in paragraph (8). The extension of the statute to affiliate insiders was moved to a new paragraph (8)(A), and authority for the Board to make exceptions was placed in a new paragraph (8)(B), which reads as follows:

The Board may, by regulation, make exceptions to subparagraph (A), except as that subparagraph makes applicable paragraph (2), for an executive officer or director of a subsidiary of a company that controls the member bank, if that executive officer or director does not have authority to participate, and does not participate, in major policymaking functions of the member bank.

Section 22(h)(2)—the "paragraph (2)" to which the Board may not make

bank included officers of affiliates—but did not so provide with respect to "executive officers.") No such ambiguity arose with respect to directors and principal shareholders of affiliates, who were explicitly treated like their banking counterparts. In 1980, the Board amended Regulation O to cover insiders of affiliates, but included a regulatory exception for executive officers of affiliates not involved in major policymaking functions at the bank.

exceptions—is the prohibition against lending on preferential terms.

The 1994 amendment to section 22(h) allows the Board to exempt executive officers and directors of affiliates (other than the bank holding company) from insider lending restrictions, provided they are not involved in major policymaking functions at the lending bank. The legislative history of the provision indicates that it was intended to allow the Board to extend its existing exception for executive officers to directors as well.⁴ However, the 1994 amendment clearly does not allow the Board to exempt either executive officers or directors from the restriction on preferential lending in section 22(h)(2).

Thus, the apparent effect of the 1994 amendments regulation is (1) to reaffirm the Board's regulation insofar as it exempts executive officers of affiliates who are not involved in policymaking functions at the bank from the aggregate and individual lending limits, overdraft restriction, and prior approval requirements of Regulation O; (2) to invalidate the Board's regulation insofar as it exempts such executive officers from the prohibition on preferential lending; and (3) to grant the Board authority to extend the remaining parts of its executive officer exemption to directors as well.

Exception for Certain Executive Officers and Directors of Affiliates

Accordingly, the Board is proposing amendments to Regulation O that would eliminate its restrictions—other than the restriction on preferential lending—on a bank's lending to executive officers and directors of affiliates who are not involved in major policymaking functions of the lending bank. The Board believes that extending the exemption to directors would relieve regulatory burden on bank holding companies without increasing the risk of insider lending or resultant safety and soundness problems. Reimposing the preferential lending restriction on executive officers (and maintaining the restriction on directors) might negate some of this relief; although banks would no longer be required to document that loans to executive officers and directors of affiliates fall within the lending limits of Regulation O, they might be required to maintain similar documentation to demonstrate that the loans were not on preferential terms. However, the Board believes that the plain language of the statute requires coverage of preferential lending.

There is some reason to believe that this effect on the Board's regulation was unintended, and that Congress intended for the Board's across-the-board exemption for executive officers of affiliates to continue. The Riegle-Neal conference report stated, "It is not the intent of the Conferees to affect the exemptions that the Federal Reserve Board has already extended to executive officers, but rather to allow the Board the authority to provide appropriate treatment for directors." House Report 103-652 at 180 (1994). However, where, as here, the provisions of a statute are unambiguous, legislative history may not be used to alter that plain meaning. The Board has, however, suggested and supported an amendment to section 22(h) to make its language consistent with its apparent intent.

Elimination of Unnecessary Board of Directors Approval

In order to qualify for the regulatory exception for executive officers of affiliates, an executive officer currently must be excluded from major policymaking functions of the lending bank by resolutions of the board of directors of both the lending bank and the affiliate for which the executive officer works. Because a bank has full control over who participates in its policymaking, the Board believes that requiring a board resolution of the affiliate in addition to the resolution of the bank is superfluous and unduly burdensome. Accordingly, the Board is proposing to delete this requirement from the existing exception for executive officers and not to include it in the new exception for directors.

Regulatory Flexibility Act

The Board has concluded after reviewing the proposed regulation that, if adopted, it would not impose a significant economic hardship on small institutions. The proposal does not necessitate the development of sophisticated recordkeeping or reporting systems by small institutions; nor will small institutions need to seek out the expertise of specialized accountants, lawyers, or managers in order to comply with the regulation. The proposal is designed to reduce the burden of Regulation O consistent with the requirements of the underlying statute. The Board therefore certifies pursuant to section 605b of the Regulatory Flexibility Act (5 U.S.C. 605b) that the proposal, if adopted, will not have a significantly adverse economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*).

Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR part 1320, Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. Comments on the collections of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0036), Washington, DC 20503, with copies of such comments to be sent to Mary M. McLaughlin, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

The collection of information requirements in this proposed regulation are found in 12 CFR part 215. This information is required to evidence compliance with the requirements of Section 22(h) of the Federal Reserve Act. The respondents and recordkeepers are for-profit financial institutions, including small businesses. Records must be retained for two years.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The OMB control number is 7100-0036.

The proposed amendments are expected to provide for some reduction in the recordkeeping and disclosure practices of state member banks, and would not affect the banks' reporting requirements to the Federal Reserve. The recordkeeping and disclosure requirements on extensions of credit by the reporting bank to insiders of the bank and its affiliates are contained in the information collection for the Consolidated Reports of Condition and Income (FFIEC 031-034; OMB No. 7100-0036).

Because the records would be maintained at state member banks and the notices are not provided to the Federal Reserve, no issue of confidentiality under the Freedom of Information Act arises.

Comments are invited on: (a) whether the proposed revision to the collection of information is necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) ways to enhance the quality, utility, and clarity of the information to be collected; and (c) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

⁴ House Report 103-652, 103d Cong., 2d Sess. 180 (1994).

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), 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 (REGULATION O)

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

Authority: 12 U.S.C. 248(i), 375a(10), 375b (9) and (10), 1817(k)(3) and 1972(2)(C)(ii); Pub. L. 102-242, 105 Stat. 2236.

2. Section 215.2 is amended as follows:

a. Paragraph (d) introductory text and paragraphs (d)(1) through (d)(3) are redesignated as paragraph (d)(1) introductory text and paragraphs (d)(1)(i) through (d)(1)(iii), respectively;

b. A new paragraph (d)(2) is added; and

c. Paragraph (e)(2) is revised.

The addition and revision read as follows:

§ 215.2.2 Definitions.

* * * * *

(d)(1) *Director of a company or bank*

* * *

* * * * *

(2) *Exception.* Extensions of credit to a director of an affiliate of a member bank (other than a company that controls the bank) shall not be subject to §§ 215.4 (b) through (d) and 215.6, provided that—

(i) The director of the affiliate is excluded (by name or by title) from participation in major policymaking functions of the member bank by resolution of the bank's boards of directors, and does not actually participate in such major policymaking functions; and

(ii) The director is not otherwise subject to §§ 215.4 (b) through (d) and 215.6.

(e) * * *

(2) Extensions of credit to an executive officer of an affiliate of a member bank (other than a company that controls the bank) shall not be subject to §§ 215.4 (b) through (d) and 215.6, provided that—

(i) The executive officer of the affiliate is excluded (by name or by title) from participation in major policymaking functions of the member bank by resolution of the bank's boards of

directors, and does not actually participate in such major policymaking functions; and

(ii) The executive officer is not otherwise subject to §§ 215.4 (b) through (d) and 215.6.

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By order of the Board of Governors of the Federal Reserve System, April 25, 1996.

Jennifer J. Johnson,

Deputy Secretary of the Board.

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