FEDERAL RESERVE BANK
OF NEW YORK

December 6, 1965

Interpretations of Regulation F

To State Member Banks in the Second Federal Reserve District:

Printed below are copies of two interpretations, issued by the Board of Governors of the Federal Reserve System, under Regulation F (Securities of Member State Banks), relating to—

(1) Financial statements to be included in annual reports to security holders pursuant to the provisions of section 206.5(c) of the regulation, and

(2) Disclosure of loans to insiders in management proxy statements furnished in accordance with the requirements of section 206.5(a) of the regulation.

The interpretations will be published shortly in the *Federal Register* and *Federal Reserve Bulletin*, but they are being sent to you now so that you may have prompt notice of their contents.

ALFRED HAYES,
President.

Regulation F: Financial Statements to be Included in Annual Reports to Security Holders

Since 1966 will generally be the first time that banks subject to the public disclosure requirements of the Securities Exchange Act of 1934 will be soliciting proxies in accordance with such requirements, the Board of Governors directs the attention of registrant banks to section 206.5(c) of Federal Reserve Regulation F, "Securities of Member State Banks". It is provided therein that a bank's proxy statement (or the statement that must be distributed where management does not solicit proxies) which relates to an annual meeting of security holders at which directors are to be elected, shall be accompanied or preceded by an annual report to such security holders "containing such financial statements for the last fiscal year as will, in the opinion of the management, adequately reflect the financial position and operations of the bank."

Adherence to the following reporting standards, prescribed in Regulation F, is considered necessary to reflect adequately the financial position and results of operations of registrant banks in such annual reports to security holders:

1. Financial statements should be prepared on a consolidated basis to the extent required by Regulation F.

2. A statement of income should be furnished in a form providing for the determination of the "amount transferred to undivided profits" as a result of all activity related to the preceding year.

3. A statement of changes in capital accounts, including capital reserves, should be included.

4. Valuation reserves should be reported as reductions of related asset values.

5. A reconciliation of valuation reserves should be presented, showing material charges and credits.

Section 206.5(c) further provides that—

"The financial statements included in the annual report may omit details or summarize information if such statements, considered as a whole in the light of other information contained in the report and in the light of the financial statements of the bank filed or to be filed with the Board, will not by such procedure omit any material information necessary to a fair presentation or to make the financial statements not misleading under the circumstances. Subject to the foregoing requirements with respect to financial statements, the annual report to security holders may be in any form deemed suitable by the management."

Pursuant to these provisions, the financial statements included in annual reports to security holders should not be inconsistent with the financial reporting prescribed by Regulation F and they should conform in all material respects to the accounting principles stated therein. However, annual reports to security holders need not include the detailed information required in annual reports filed with the Federal Reserve Board on Federal Reserve Form F–2.

(OVER)

Regulation F: Proxy Solicitation by Bank Management—Disclosure of Loans to "Insiders"

The Board of Governors has recently been asked to clarify its position with respect to disclosure of loans to "insiders"—that is, officers, directors, and persons holding more than 10 per cent of the bank's stock—in management proxy statements furnished in accordance with the requirements of section 206.5 of Federal Reserve Regulation F ("Securities of Member State Banks") and Federal Reserve Form F–5. This interpretation is also applicable to disclosure of such transactions under comparable provisions relating to registration of bank securities (Federal Reserve Form F–1) under section 12 of the Securities Exchange Act of 1934.

Item 7(f) of Form F–5 and Item 12 of Form F–1 in effect require a description of any material[1] interest of any insider or any of his "associates"[2] in any material transaction to which the bank was, or is to be, a party. These Items contain a number of specific exemptive instructions—for example, no disclosure is required where the only interlock is that a director of a bank is a director and/or officer of another corporation that is a party to the transaction. Generally, these Items require disclosure of loans to a corporate borrower only where insiders, individually or with members of their immediate families,[3] own at least 10 per cent of the borrower's outstanding stock.

The Board does not regard loans and other extensions of credit by a registrant bank in the ordinary course of its business as "material" for the purposes of Regulation F (and therefore required to be disclosed unless otherwise specifically exempted by the instructions in these Items) if such loans (a) are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other than insiders, (b) at no time aggregate more than 10 per cent of the equity capital accounts of the bank or $10 million, whichever is less, and (c) do not involve more than the normal risk of collectibility or present other unfavorable features.

Item 7(e) of Form F–5 requires disclosure of indebtedness to the bank of each director or officer of the bank and each nominee for election as a director. An instruction to this Item specifically excludes indebtedness resulting from transactions in the ordinary course of the bank's business. The effect of this instruction is to exempt the bank from reporting *under Item 7(e)* normal extensions of credit to such persons, of types and amounts customarily made by the bank in the usual course of its operations. However, even if disclosure of indebtedness is not required by Item 7(e), consideration must be given to whether it must be reported in the light of the provisions of Item 7(f), referred to above.

It should also be noted that Item 7(e) requires disclosure of any liability to the bank that appears to have arisen under section 16 of the Securities Exchange Act of 1934 as a result of "insider" transactions in the bank's stock (or other equity security).

---

[1] "The term 'material', when used to qualify a requirement for furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered." Regulation F, section 206.2(n).

[2] "The term 'associate', when used to indicate a relationship with any person, means (1) any corporation or organization (other than the bank or a majority-owned subsidiary of the bank) of which such person is an officer or partner or is, directly or indirectly, either alone or together with one or more members of his immediate family, the beneficial owner of 10 per cent or more of any class of equity securities, (2) any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as a trustee or in a similar fiduciary capacity, and (3) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of the bank or any of its parents or subsidiaries." Regulation F, section 206.2(d).

[3] "The term 'immediate family' includes a person's (1) spouse; (2) son, daughter, and descendant of either; (3) father, mother, and ancestor of either; (4) stepson and stepdaughter; and (5) stepfather and stepmother. For the purpose of determining whether any of the foregoing relationships exist, a legally adopted child shall be considered a child by blood." Regulation F, section 206.2(k).