

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 8489
January 5, 1979

PROPOSED REVISION OF REGULATION O
Requirements Relating to Loans by Member Banks to Insiders

*To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:*

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board today [December 28, 1978] proposed regulatory rules to implement new legislation tightening restraints on lending by member banks to insiders. At the same time, the Board proposed simplification of Regulation O, which would be amended by the proposals.

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

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

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

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

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

The lending limit to insiders (other than directors) and their related interests would be 10 per cent of the bank's capital and surplus as defined by the bank's supervisor. The Comptroller of the Currency (supervisor of national banks) includes subordinated capital notes in capital and surplus, while the Board (supervisor of State chartered member banks) does not. The Board specifically requested comment on these definitions, which are under review by the agencies.

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

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

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

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

Printed below is the text of an explanatory notice by the Board of Governors regarding the proposal. Also, we are enclosing, for member banks and other institutions that may be affected by the revised Regulation O, a copy of the complete text of the proposed revision. Copies may also be obtained upon request directed to the Circulars Division of this Bank.

Comments on the proposal should be submitted by January 29, 1979, and may be sent to our Regulations Division.

PAUL A. VOLCKER,
President.

REGULATION O
[Docket No. R-0194]

Part 215 — LOANS TO INSIDERS OF MEMBER BANKS

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board of Governors of the Federal Reserve System proposes to amend Regulation O (12 CFR Part 215), which governs loans by a member bank to its executive officers, to implement certain additional requirements imposed by section 22(h) of the Federal Reserve Act on loans by member banks to certain persons associated with the bank. Section 22(h) was recently enacted by Congress as section 104 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (92 Stat. 3641). The additional requirements relate to loans by a member bank to executive officers, directors and principal shareholders of the member bank and of its holding company affiliates. The requirements are also applicable to companies and political or campaign committees controlled by such insiders.

DATE: Comments must be received by January 29, 1979.

FOR FURTHER INFORMATION CONTACT:
Michael E. Bleier, Senior Attorney, Legal Division (202-452-3721), or Mary Curtin, Senior Attorney, Divi-

sion of Banking Supervision and Regulation (202-452-2620), Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: Section 22(h) of the Federal Reserve Act imposes four requirements on loans by member banks to insiders and their related interests. Insiders include the executive officers and directors of a bank and its principal shareholders, *i.e.* any individual or company that controls more than ten per cent of any class of voting shares of the bank. Persons that have the same relationship with the member bank's parent bank holding company and other subsidiaries of the parent bank holding company are also considered insiders. The proposed regulation would include shares held by an individual's immediate family in determining principal shareholder status. Related interests include companies controlled by insiders and political or campaign committees that are controlled by or benefit insiders.

The statute:

(1) establishes an aggregate lending limit of 10 per cent of a member bank's capital and surplus for loans by the bank to an insider (other than a director) and all related interests of such an insider;

(2) prohibits the payment by a member bank of an overdraft on an account of an insider (other than a principal shareholder) at the bank;

(3) requires that every extension of credit by a member bank to an insider or to an insider's related interests be made on substantially the same terms as those prevailing at the time for comparable transactions with other persons and not involve more than the normal risk of repayment or present other unfavorable features; and

(4) requires that every extension of credit by a member bank to an insider or to any related interest of the insider that would exceed, when aggregated, \$25,000, be approved in advance by a majority of the bank's board of directors, with the interested party abstaining.

The proposed regulation defines the terms "executive officer," "extension of credit," and "lending limit" used in section 22(h). The current definitions of "executive officer" and "extension of credit" in Regulation O have been incorporated into the proposed rule. The definition of extension of credit excludes (1) certain indebtedness necessary to protect the bank against loss and (2) credit card and similar indebtedness in an amount not to exceed \$5,000.

The proposed rule defines a bank's lending limit to insiders and their related interests to be an amount equal to 10 per cent of the bank's capital stock and unimpaired surplus as those terms are defined by its appropriate Federal banking agency. In the case of a national bank, capital stock and surplus are defined in 12CFR 7.1100. In the case of a State-chartered member bank, those terms are defined in 12 CFR 250.162. These definitions are currently under review by the agencies. Comment is specifically requested on these definitions in the context of the lending limit established by section 22(h) (1) of the Federal Reserve Act.

As proposed, the regulation would exempt an extension of credit by a member bank to any of its executive

officers from the 10 per cent lending limit where the extension would be authorized under section 22(g) of the Federal Reserve Act, which permits loans to executive officers for housing or educational purposes.

The proposed rule further requires that any extension(s) of credit made by a member bank that was outstanding on November 10, 1978, and that would, if made after March 10, 1979, exceed the statutory 10 per cent lending limit be brought into compliance with the lending limit by March 10, 1980. Such extension(s) of credit may only be renewed after March 10, 1979, on terms that will bring them into compliance with the lending limit by March 10, 1980. If such extension(s) of credit cannot be brought into timely compliance, an explanation shall be promptly furnished to the bank's appropriate Federal banking agency. Two additional one-year extensions may be granted by the appropriate agency for good cause shown.

In the case of extensions of credit made between November 10, 1978, and March 10, 1979, that would, if made after March 10, 1979, exceed the statutory lending limit, compliance with the lending limit is required by June 10, 1979. The Comptroller or the appropriate Reserve Bank may extend this period, for good cause, until March 10, 1980.

Finally, to ensure compliance with section 22(h) of the Federal Reserve Act, member banks will be required to maintain appropriate records.

To aid in consideration of this matter by the Board, interested persons are invited to submit relevant data, views, or comments. Any such materials should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received by January 29, 1979. All material submitted should include the Docket Number R-0194. Such material will be made available for inspection and copying upon request, except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).