FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8532
March 8, 1979]

LOANS BY BANKS TO INSIDERS

Comment Invited on Final Rules and Proposed Rules to Implement FIRA

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

The Board of Governors of the Federal Reserve System has (a) adopted a revison of its Regulation O, regarding loans to executive officers, directors, and principal shareholders of member banks, in order to implement section 104 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA), and (b) issued proposed rules, also regarding loans by member banks to insiders, to implement Titles VIII and IX of FIRA. The Board has invited comment on the revision of Regulation O and on the proposed changes. The following statements have been issued by the Board of Governors regarding these actions:

Revision of Regulation O

The Federal Reserve Board today [*March 6*] issued a final regulation implementing new section 22(h) of the Federal Reserve Act, a part of Title I of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA). The regulation applies to all member banks of the Federal Reserve System, including all national banks.

The Board said that because the final regulation differs in some important respects from the proposed regulation issued for public comment December 28, 1978, an additional 60-day comment period will be allowed.

Section 22(h) applies to loans by a member bank to the executive officers, directors and principal shareholders (1) of the member bank, (2) the member bank's parent bank holding company, and (3) any other subsidiaries of the parent bank holding company. A "principal shareholder" of the bank is defined as any individual or company that controls more than 10 per cent of any class of voting shares of the bank (18 per cent in certain circumstances). Section 22(h) also applies to related interests of bank officials. Related interests are companies controlled by, and political or campaign committees controlled by or benefiting, bank officials.

Section 22(h) establishes the following four requirements for loans by member banks to bank officials or their related interests:

1. An aggregate lending limit of 10 per cent of the bank's capital and surplus on loans (subject to certain exceptions) to any of its executive officers or principal shareholders and their related interests.

2. Prohibition of payment by the bank of an overdraft by an executive officer or director.

3. A requirement that every extension of credit by the bank to a bank official or to a related interest be made on substantially the same terms as those prevailing at the time for comparable transactions with other persons not associated with the bank, and not involve more than the normal risk of repayment or present other unfavorable features.

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4. A requirement that every extension of credit by the bank to a bank official or any related interest that would exceed $25,000 in the aggregate be approved in advance by a majority of the bank's entire board of directors, with the interested party abstaining.

The Board's proposed regulation to implement section 22(h) was issued on December 28, 1978, and the comment period expired on January 29, 1979. More than 200 comment letters were received.

Significant changes from the proposed regulation are:

(1) a rebuttable presumption of control is included in addition to a definition of control;

(2) a member bank's loans to its parent bank holding company or the non-bank subsidiaries of the holding company are excluded from the 10 per cent lending limit of section 22(h), since such loans are currently subject to a 20 per cent limit under section 23A of the Federal Reserve Act;

(3) the requirement for prior approval by the board of directors of lending to bank officials may be satisfied when the extension of credit is made under a line of credit previously approved by the board;

(4) capital and surplus of a member bank for purposes of determining lending limits is defined to include subordinated notes and debentures;

(5) inadvertent overdrafts of a nominal amount which are outstanding for a short period of time have been excluded from the overdraft prohibition;

(6) term loans (including residential mortgage loans) made prior to March 10, 1979, have been exempted from the deadlines for compliance with the lending limit and may be repaid in accordance with their original repayment schedules.

In any enforcement action under section 22(h) during the first 60 days of the statute's effectiveness, the agencies will consider the complexities of the statute and the brief period of time between publication of the regulation and March 10, 1979. The agencies have adopted this policy in recognition of the fact that some may inadvertently violate the regulation before they have developed procedures for compliance with the amended Regulation O.

The revision of Regulation O is effective March 10, 1979. However, comments thereon will be received through May 9, 1979, and may be sent to our Consumer Affairs and Bank Regulations Department. The text of the new regulation is enclosed for member banks; it will also be published in the *Federal Register*. Copies in pamphlet form will be sent to you when available.

Proposed changes

The Federal Reserve Board and the Federal Deposit Insurance Corporation today [*March 8*] published for comment proposed regulations to implement Titles VIII and IX of FIRA. The Federal Reserve Board's proposed regulation applies to all member banks, including national banks.

Title VIII prohibits banks that maintain correspondent account relationships from extending credit on preferential terms to each of their executive officers, directors and principal shareholders. The legislation also prohibits banks from opening a correspondent account relationship when one of the banks has outstanding a preferential extension of credit to an executive officer, director or principal shareholder of the other bank. The proposed regulation defines a correspondent account as an account that is maintanied by a bank with another bank for the deposit or placement of funds. Comment is specifically requested on this definition.

Title VIII establishes certain reporting and public disclosure procedures for insured banks and for their executive officers and principal stockholders of record, but not for directors.

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Each executive officer and principal stockholder of an insured bank would report annually to the bank's board of directors on the maximum amount of indebtedness of the officer or stockholder and each of his or her related interests to depository banks, the amount of such indebtedness outstanding on December 31, the range of interest rates on the loans and the terms and conditions. A depository bank is a bank that maintains a correspondent account for the insured bank.

Each insured bank would be required to forward an annual report to the appropriate Federal banking agency listing the name of each executive officer or principal stockholder who files a report of indebtedness and the aggregate amount of indebtedness of these persons and their related interests to the insured bank's depository banks.

In implementing Title IX, the proposed regulation would require each insured bank to file with the appropriate Federal banking agency an annual report listing the names of its executive officers and principal stockholders and the aggregate amount of indebtedness from the insured bank to these persons and their related interests.

Both of the reports filed with the bank agency would be made available to the public on request. As proposed, the first reports would cover the period from March 10, 1979, to December 31, 1980. However, comment is specifically requested on whether the reporting period for 1979 should start on July 1. As proposed, officers and stockholders would file reports with the boards of directors on January 10, 1980, and the insured banks would file their reports with the appropriate agency by January 31, 1980.

Comment on this proposal will be received through April 20, 1979, and may be sent to our Consumer Affairs and Bank Regulations Department. The full text of the proposal was not available at the time this circular was printed. It will be published in the *Federal Register* and copies will be mailed to member banks when available. Copies may also be obtained upon request directed to the aforementioned department.

PAUL A. VOLCKER,
President

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TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation O]

[Docket No. R-0194]

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

Rules to Implement New Law

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final regulation.

SUMMARY: The Board of Governors of the Federal Reserve System has amended its Regulation O (12 C.F.R. Part 215), formerly entitled "Loans to Executive Officers of Member Banks." Amended Regulation O implements new section 22(h) of the Federal Reserve Act, recently enacted by Congress as section 104 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 ("FIRA")(P.L. 95-630). The requirements of section 22(h) relate to loans by a member bank (1) to an executive officer, director or principal shareholder of the member bank or of any of its bank holding company affiliates or (2) to a company or political or campaign committee controlled by any of these persons.

The amendments to the regulation were adopted after review of the extensive public comment on the proposals. The amendments will become effective on March 10, 1979, to meet the effective date of section 22(h). However, the Board has invited additional public comment on the final rules for a further 60 day period. The Board will consider comments and adopt any appropriate amendments to the regulation as soon as practicable.

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DATES: The regulation is effective March 10, 1979. Comments must be received by May 9, 1979.

ADDRESS: Comments should be in writing and should refer to Docket No. R-0194. They should be sent to Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. The comments will be made available for inspection and copying as provided in the Board's Rules Regarding Availability of Information (12 C.F.R. Part 261).

FOR FURTHER INFORMATION CONTACT: James V. Mattingly or Michael E. Bleier, Senior Attorneys, Legal Division (202-452-3430 or 3721), or Mary Curtin, Senior Attorney, Division of Banking Supervision and Regulation (202-452-2620), Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: On December 28, 1978, the Board of Governors of the Federal Reserve System proposed amendments to its Regulation O to implement the requirements of new section 22(h) of the Federal Reserve Act (44 F.R. 893). Section 22(h) governs loans by a member bank to any of its executive officers, directors or principal shareholders and to their related interests. An executive officer, director or principal shareholder of the member bank is defined to include any person that has the same relationship with (1) a bank holding company of which the member bank is a subsidiary or (2) any other subsidiary of that bank holding company.[1/] A principal shareholder means an individual or company that controls more than 10 per cent[2/] of any class

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1/ In certain circumstances, as discussed below, executive officers of other subsidiaries of the member bank's parent bank holding company are not considered to be executive officers of the member bank.

2/ If the member bank is located in a city, town or village with a population of less than 30,000, this figure is 18 per cent for the purpose of the 10 per cent lending limit established by section 22(h). If such a member bank is a subsidiary of a bank holding company, a person will not be a principal shareholder of the bank holding company unless the person controls more than 18 per cent of any class of voting securities of the bank holding company.

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of voting shares of the bank or company. (Shares held by a member of an individual's immediate family are considered held by the individual in determining principal shareholder status). The limitations of section 22(h) (except for the overdraft prohibition) also apply to a related interest of any of these persons. A related interest is a company that is controlled by, or a political or campaign committee that is controlled by or that benefits, a person.

Section 22(h) has four limitations. The statute generally:

(1) establishes a lending limit of 10 per cent of a member bank's capital and surplus (subject to certain exceptions)[3/] for the aggregate amount of all loans by the bank to: (a) each of its executive officers and the officer's related interests, (b) each of its principal shareholders and the shareholder's related interests, or (c) the related interests of each of the bank's executive officers and principal shareholders;[4/]

(2) prohibits the payment by a member bank of an overdraft of an executive officer or director on an account at the bank;[5/]

3/ These exceptions are set forth in section 5200 of the Revised Statutes, 12 U.S.C. 84. The exceptions generally provide higher or no limits for certain types of secured obligations. For example, obligations fully secured by direct obligations of, or fully guaranteed as to principal and interest by, the United States are not subject to any limitation under section 5200 of the Revised Statutes. 12 C.F.R. 7.1580. A copy of that statute has been included as an appendix to the regulation. See also 12 C.F.R. 7, Subpart A, for a discussion of these exceptions.

4/ The 10 per cent lending limit does not apply to member bank loans to a director of (a) the member bank, (b) the member bank's parent bank holding company, or (c) any other subsidiary of the parent bank holding company, unless the director is also an executive officer or principal shareholder.

5/ The prohibition against payment by a member bank of an overdraft does not apply to an overdraft of a principal shareholder of (a) the member bank, (b) its parent bank holding company, or (c) any other subsidiary of the parent bank holding company, unless the principal shareholder is also an executive officer or director. The overdraft prohibition also does not apply to related interests.

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(3) requires that every extension of credit by a member bank to any of its executive officers, directors or principal shareholders or to any related interest of such a person (a) be made on substantially the same terms as those prevailing at the time for comparable transactions with other persons and (b) 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 any of its executive officers, directors or principal shareholders, or to any related interest of such a person, that would exceed $25,000, when all loans to the person and the person's related interests are aggregated, be approved in advance by a majority of the entire board of directors of the bank, with the interested party abstaining from voting.

The Board has received well over 200 written comments concerning the proposed regulation and has modified the regulation after considering the concerns expressed by the comments. The Board and the Comptroller of the Currency are aware of the complexities of the new statute and the brief period of time between publication of amended Regulation O and the effective date of the statute. The agencies will consider these factors in connection with any enforcement action for a violation occurring during the first 60 days that the regulation is in effect. The agencies have adopted this policy in recognition of the fact that some may inadvertently violate the regulation before they have developed procedures for compliance with it.

DISCUSSION OF ISSUES

1. Prior approval by the board of directors. Most of the comments received were directed to the statute's requirement that a majority of the entire board of directors of the member bank approve in advance loans by the member bank aggregating over $25,000 to any of its executive officers, directors or principal shareholders ("bank

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officials") or the related interests of these persons. The comments advised that the prior approval requirement was unnecessarily harsh and would tend to discourage qualified persons from serving as bank directors due to delays they could face in obtaining credit.

After considering these comments, the Board has amended the regulation to clarify that once a line of credit has been approved by a majority of the bank's entire board of directors, drawdowns on that line of credit do not require further approval by the board of directors if two conditions are met. The regulation requires (1) that the line of credit have been approved within 14 months of the date of the drawdown; and (2) that the terms of the drawdown comply with the statute's prohibition against preferential lending and not involve more than the normal risk of repayment or present other unfavorable features. This modification is consistent with both the letter and spirit of section 22(h).

2. Overdrafts. About 65 of the comments received by the Board suggested that provision be made in the regulation for inadvertent overdrafts. The regulation and the statute provide exceptions from the prohibition against payment of an overdraft when the overdraft is paid pursuant to: (1) a written, preauthorized interest-bearing loan plan that specifies a method of repayment, or (2) a written, preauthorized transfer of funds from another account of the account holder at the bank. In addition, the Board has modified the regulation to allow the payment of an inadvertent overdraft of a limited amount that will be promptly repaid. The regulation requires the member bank to charge the director or officer the same fee charged any other customer of the bank in similar circumstances. The Board intends that this provision

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be used solely in the unusual case of an inadvertent overdraft. This amendment is consistent with the Board's previous definition of extension of credit in Regulation O, with the statutory exception for interest-bearing overdraft plans, and with the purpose of section 22(h) to prevent self-dealing by bank officials.

3. Lending limit. A number of comments raised the question whether the 10 per cent lending limit of section 22(h) applies to a loan by a member bank to its parent bank holding company or a nonbank subsidiary of that holding company.[6/] Currently, loans by a member bank to its parent bank holding company and to all other subsidiaries of that holding company (including subsidiary banks) are subject, in the aggregate, to a lending limit of 20 per cent of the member bank's capital and surplus under section 23A of the Federal Reserve Act (12 U.S.C. 371c). Under section 23A, a member bank's parent bank holding company and any other subsidiary of that holding company would be considered an affiliate of the member bank.

To subject loans within a bank holding company system to the aggregate lending limit of section 22(h) would, in many situations, result in an amendment of the 20 per cent lending limit of section 23A. The Board finds no evidence of any Congressional intent to effect such an amendment or significant modification of section 23A. Indeed, a Congressional intent that the two statutes be interpreted consistently

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6/ Because insured banks are excluded from the definition of "company" in section 22(h), loans by a member bank to any of its insured bank affiliates are not subject to the restrictions of section 22(h) (including the 10 per cent lending limit).

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is evident from the requirement in section 22(h) that the term extension of credit shall have the same meaning as in section 23A. Accordingly, the regulation excludes from the lending limit of section 22(h) an extension of credit by a member bank to its parent bank holding company or to any other subsidiary of that bank holding company. The exclusion applies also to a foreign bank that controls a domestic bank and to the other subsidiaries of the foreign bank.

However, a member bank's loans to its parent bank holding company and to nonbank subsidiaries of that holding company remain subject to the prior approval and preferential lending restrictions of section 22(h). In addition, a member bank's loans to a principal shareholder or executive officer of the member bank's parent bank holding company or of any other subsidiary of that bank holding company and to all related interests of these persons are subject to the 10 per cent lending limit (and other applicable restrictions) of section 22(h).

The Board has also excluded from coverage as a member bank under section 22(h) a foreign bank that maintains a branch in the United States, whether or not the branch is insured. Under the International Banking Act of 1978 (P.L. 95-369), a foreign bank that has an insured branch is treated as a nonmember insured bank (12 U.S.C. 1813(h)). Without the exclusion, the foreign bank would be subject to the provisions of section 22(h), which are made applicable to nonmember insured banks as if they were member banks (12 U.S.C. 1828(j)(2)). This exclusion is consistent with the exemption from section 23A granted to such foreign banks under the International Banking Act (12 U.S.C. 1828(j)(1)) and with the requirement of that statute (12 U.S.C. 3105(d)) that the

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Board submit to the Congressional banking committees within two years a recommendation regarding limitations that should be placed on foreign banks regarding loans to their affiliates. It should be noted that the Board maintains residual supervisory authority over all U.S. operations of foreign banks.

4. Preferential Lending. Under the statute, a member bank's loans to bank officials and their related interests must be made on "substantially the same terms" as "comparable transactions with other persons." The proposed regulation issued for comment reflected the Board's view that "other persons" meant persons not associated with the bank. A number of the comments (mainly from State nonmember banks) inquired whether, under the proposed Regulation O issued for comment, executive officers may obtain preferential interest rates under bank employee benefit plans. The issue has arisen because State nonmember banks are not subject to the prohibition of section 22(g) of the Federal Reserve Act against lending by a member bank to its executive officers at preferential rates.7/

The Board has decided that the preferential lending rules should be uniform for all insured banks. Since the Board finds little basis to change its long-held view that preferential lending by a member bank to its executive officers is not permitted by section 22(g) or to conclude that new section 22(h) should be interpreted to allow preferential lending, the Board has rejected the requested change. The

7/ Under Regulation O, the Board has allowed executive officers of member banks to participate in bank credit card, check credit and similar open end credit plans as long as the terms of such indebtedness were not more favorable than those offered to the general public. The Board has also required other indebtedness of executive officers to a member bank to be on terms no more favorable than those available to persons not associated with the bank. See footnote 8, below.

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Board believes the Congress has indicated a desire to prohibit preferential lending by insured banks to their executive officers, directors, or principal shareholders. Indeed, in Title VIII of FIRA, Congress has prohibited such preferential lending by banks that maintain a correspondent account relationship to each other's executive officers, directors, or principal shareholders.

5. Executive officer. The Board has continued in Regulation O its previous definition of executive officer as one who participates or is authorized to participate (other than in the capacity of a director) in major policymaking functions of a bank or company. Under section 22(h), an "officer" of a bank holding company of which a member bank is a subsidiary and an "officer" of any other subsidiary of that holding company is deemed to be an "officer" of the member bank. While officers of a member bank's holding company affiliates are thus considered officers of the member bank for purposes of section 22(h), the statute's prohibitions run only to "executive officers".

Amended Regulation O makes it clear that the limitations of section 22(h) regarding member bank loans to its executive officers also apply to all executive officers of a bank holding company of which the member bank is a subsidiary. The regulation also includes, as executive officers of the member bank, all executive officers of all other subsidiaries of the member bank's parent bank holding company unless: (1) the executive officer 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 member bank and the

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other subsidiary, and (2) the executive officer does not actually participate in major policymaking functions of the member bank.

6. Definition of Subsidiary. A number of the comments have raised the question whether a subsidiary of a member bank would be considered to be an "other subsidiary" of the member bank's parent bank holding company. If so, member bank loans to its own subsidiaries would be subject to the lending restrictions of section 22(h). As noted in paragraph 3 above, the Board has excluded member bank loans to its bank holding company affiliates from the 10 per cent limitation of section 22(h).

Section 22(h) applies to loans by a member bank to its principal shareholders and to a company "controlled" by a principal shareholder. There does not appear to be any Congressional intent to cover credit transactions between a member bank and its own subsidiaries. In addition, the Board has long held that a credit transaction by a member bank with an operations subsidiary of the bank is not an extension of credit of the kind intended to be restricted by section 23A. (12 C.F.R. 250.240). The Board reasoned that the subsidiary is in effect part of its parent bank just as though it were a department of the bank. For these reasons and consistent with section 23A, the Board has revised Regulation O to clarify that member bank loans to its own subsidiaries are not subject to the limitations of section 22(h) (including the prior approval and preferential lending requirements) and that executive officers, directors and principal shareholders of such subsidiaries will not be deemed to have that same relationship with the parent member bank. To accomplish this, section 215.2(l) of the regulation specifies

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that the term "subsidiary" does not include a subsidiary of a member bank.

However, if an officer, director or principal shareholder of a subsidiary of a member bank participates, or has authority to participate, in major policymaking functions of the member bank, that individual is considered to be an executive officer of the member bank under the definition of executive officer in amended Regulation O, whether or not the person holds any official position with the member bank. Such a person and all his related interests would then be subject to all the restrictions of section 22(h). The Board's rules concerning member bank lending with respect to its own subsidiaries have been adopted on the basis of the Board's experience in the supervision of such relationships and in the light of the purposes of the Act.

7. Control of a bank or company. A number of comments questioned whether an individual would, by reason of a position as an executive officer or director of a bank or company, be considered to control the bank or company or to exercise a controlling influence over its management or policies. The Board has amended the regulation to clarify that an individual will not be presumed to control a company or a bank solely because of the individual's position as a director or executive officer of the company or bank. The regulation also establishes rebuttable presumptions of control in the following two situations:

1. where an executive officer or director controls more than 10 per cent of the shares of the bank or company; or

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2. where any person owns more than 10 per cent of the shares of a bank or company and no other person owns or controls a greater percentage of the institution's shares.

Provision has been made in the regulation for a person to rebut these presumptions.

8. Immediate family. Under the regulation, shares owned or controlled by a member of an individual's immediate family are considered to be owned or controlled by the individual for the purpose of determining whether the individual is a principal shareholder. The Board has limited the definition of immediate family to an individual's spouse, minor children, and the individual's children (including adults) living in the same household.

9. Time to bring outstanding loans into compliance with the lending limit. The proposed regulation issued for comment provided two different schedules for bringing loans outstanding on the effective date of section 22(h) (March 10, 1979) into compliance with the 10 per cent lending limit. The Board proposed one schedule for loans made before November 10, 1978 (the date section 22(h) was enacted), and another schedule for loans made between November 10, 1978, and March 10, 1979.

Many of the comments stated that these periods were too short (especially in the case of State banks not before subject to the general 10 per cent limit of section 5200 of the Revised Statutes) and that the effect of the compliance deadlines would be particularly harsh in the case of term loans, such as residential mortgage loans, that are payable on a fixed schedule.

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The Board has revised the proposed regulation to allow term loans with fixed maturities (including residential mortgage loans) that were made before March 10, 1979, to be repaid in accordance with their existing payment schedules. Other loans (typically demand loans) are required to be reduced in amount to comply with the lending limit by March 10, 1980 (with two one-year extensions available for good cause).

The Board has also revised the proposed regulation to eliminate the separate compliance schedule for loans made between the enactment date and effective date of section 22(h)--that is, between November 10, 1978, and March 10, 1979. Loans made during this interim period (except for term loans with fixed maturities) must now be brought into compliance within the same time period as loans made before November 10, 1978, that is, by March 10, 1980. The Board expects that no extensions of time beyond March 10, 1980, to bring these loans into compliance will be granted.

The appropriate Federal banking agency will examine term loans made during this interim period closely, particularly those made between February 28, 1979 (the date of the Board meeting at which amended Regulation O was adopted), and March 10, 1979, to determine if they were made to avoid the lending limit or preferential lending restrictions of the statute. If so, these loans may be subject to supervisory action by the appropriate banking agency or to further regulatory action.

The prohibitions of section 22(h) against preferential lending are prospective. Preferential loans that are outstanding on March 10, 1979, are not specifically addressed in the statute or Regulation O. However, member banks should eliminate the preferential terms on such

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loans as soon as practicable. If such terms are not eliminated, they may be subject to criticism. This policy applies particularly to demand loans that are within the power of the bank to call and renegotiate at any time.

Finally, consideration is being given to requiring that an extension of credit by a member bank to a person that subsequently becomes a bank official or to a related interest of such a person be brought into compliance with the lending limit and preferential lending restrictions of sections 215.4(a) and 215.4(c) within 2 years of the date the person becomes covered by the regulation. This 2 year time period would be subject to extension by the appropriate Federal banking agency for good cause. Such a requirement may be necessary to prevent evasions of section 22(h). Public comment is requested specifically on this possible amendment.

10. Capital and Surplus. As indicated, the lending limit of section 22(h) is based on the member bank's capital stock and unimpaired surplus. In its original notice, the Board requested comment on whether subordinated notes and debentures should be included as capital and surplus for the purposes of this lending limit.

The comments were virtually unanimous in urging the agencies to adopt a common definition of capital to avoid any inequality that might result between national and State banks. The comments were also virtually unanimous in urging that subordinated notes and debentures be included as capital. The regulation now defines a member bank's capital stock and surplus to be an amount equal to the sum of (1) the "total equity capital" of the member bank as reported in its most recent

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consolidated report of condition, (2) subordinated notes and debentures that have been approved as an addition to the bank's capital structure by the appropriate Federal banking agency, and (3) valuation reserves created by charges to the member bank's income.

The Board's inclusion of subordinated notes and debentures in the definition of capital and surplus is solely for the purposes of the lending limit established by section 22(h) and should not be construed as reflecting any position of the Board on whether subordinated notes and debentures should be considered part of a member bank's capital or surplus for other purposes.

11. Section 22(g) of the Federal Reserve Act. Under the Board's proposed regulation, the lending limit of section 22(h) would not have applied to prevent an extension of credit authorized under section 22(g) of the Federal Reserve Act (which governs member bank loans to its executive officers).[8/] The Board received little favorable comment on the proposal. The proposed provision would not have been available to national banks, because they are in any event subject to a 10 per cent limit under section 5200 of the Revised Statutes.

The Board proposed the rule as a means to lessen the impact of section 22(h) and the proposed compliance deadlines with respect to home mortgage loans made before March 10, 1979, by State banks to their executive officers. As originally proposed, such loans would

8/ Section 22(g) of the Federal Reserve Act limits member bank loans to each of its executive officers to $30,000 for home mortgage credit, $10,000 to educate the executive officer's children, and $5,000 for other purposes. Effective March 10, 1979, section 110 of Title I of FIRA doubles these amounts.

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have been required to be reduced by March 10, 1980, to comply with the 10 per cent lending limit. Since the regulation now exempts home mortgage loans made before March 10, 1979, from the compliance deadline of March 10, 1980, and such mortgage loans may be reduced in accordance with their original repayment schedules, the proposed exclusion is no longer necessary. Therefore, a loan by a member bank to any of its executive officers must comply with the requirements of both sections 22(g) and 22(h).

The Board has also decided to retain in amended Regulation O a recitation of the lending limitations and reporting requirements of former Regulation O, which implemented section 22(g). However, the regulation shortens and simplifies the language of former Regulation O with respect to these provisions.

Unlike the requirements of section 22(h), which are applicable to member bank loans to executive officers of the member bank as well as to executive officers of the member bank's parent bank holding company and other subsidiaries of that bank holding company, section 22(g) is applicable only to member bank loans to its <u>own</u> executive officers. A great many State nonmember insured banks questioned whether FIRA had caused section 22(g) to apply to nonmember insured banks. The answer is that section 22(g) is not applicable, and has not been made applicable by FIRA, to nonmember insured banks. Section 22(g) is applicable only to member banks and their loans to their <u>own</u> executive officers. The lending restrictions and reporting requirements of section 22(g) are now contained in sections 215.5, 215.8, and 215.9 of amended Regulation O.

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12. Extension of Credit. The regulation defines an extension of credit as a making or renewal of any loan, the granting of a line of credit, or an extending of credit in any manner whatsoever. The regulation specifically includes a purchase of securities under repurchase agreement, the issuance of a standby letter of credit, and an endorsement or guarantee.[9/] The regulation excludes certain indebtedness necessary to protect the bank against loss and bank credit card plans and other types of open end credit in an amount not to exceed $5,000 if the credit is on terms not more favorable than those offered to the general public. It should be noted that the provisions of section 22(h) do not apply to credit transactions between insured bank affiliates since an insured bank is excluded from the definition of company in section 22(h) (see footnote 6, above).

As indicated above, the term extension of credit in section 22(h) has the same meaning as in section 23A. The Board intends to interpret the term extension of credit for the purposes section 22(h) consistently with its interpretations of section 23A.

The Board has also modified the definition of extension of credit to clarify that when a bank official or a related interest receives the proceeds or tangible economic benefit of an extension of credit, the extension of credit will be considered made to that person for purposes of section 22(h). This provision is consistent with a similar provision in section 23A and is designed to prevent evasion of the statute through the use of nominee borrowers. When a lending bank does not know, and has no reason to know, that the proceeds of

9/ To avoid double counting of extensions of credit to a bank official and the related interests of the bank official, an endorsement or guarantee by a bank official of an extension of credit to a related interest of the bank official (or vice-versa) will be considered a single extension of credit in the amount of the direct obligation of the related interest for the purposes of the 10 per cent lending limit of section 22(h).

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the extension of credit are used for the benefit of, or transferred to, a bank official or a related interest of that person, the lending bank is not in violation of the provisions of Regulation O. The persons involved in the nominee scheme may, of course, be in violation of the regulation. The regulation also makes clear that a participation without recourse is considered to be an extension of credit by the participating bank, but not by the originating bank.

13. Advisory Director. The Board has excluded advisory directors from coverage under the statute if they provide solely general policy advice to the board of directors and do not vote.

14. Miscellaneous. The Board has drafted these rules to effect the purposes of section 22(h) in the area of loans by a member bank to bank officials and their related interests. The Board will review the regulation periodically and adopt any modifications to the regulation that are shown by experience to be necessary or appropriate to carry out the intent of the Congress in this area or to prevent evasions of the statute.

The expanded procedures set forth in the Board's policy statement of January 15, 1979 (44 F.R. 3957), were not strictly followed in developing this regulation, since it was proposed for comment before the policy statement was adopted. In addition, a delay in promulgating the regulation is inappropriate in light of the necessity to meet the statute's effective date of March 10, 1979, and the necessity for providing immediate guidance to persons affected by section 22(h). In the development of this final regulation, the Board has, however, complied with the spirit and intent of its policy statement by making every effort to reduce unnecessary regulatory burdens with due regard for the purposes of the statute.

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The modifications to the regulation were made after full consideration of the extensive public comments submitted to the Board. In furtherance of the Board's policy to encourage full public participation in its rulemaking proceedings and in response to specific requests and comments, the Board invites further public comment on the rules for a further 60 days. The Board will consider comments and adopt any further amendments to the regulation that the Board finds are necessary or appropriate. The Board will make any changes as soon as practicable after the comment period.

The Board finds that publication of the amended Regulation O for the full 30 day period specified in 5 U.S.C. 553(d) would not be in the public interest because the statute takes effect on March 10, 1979.

Accordingly, the Board of Governors of the Federal Reserve System amends its Regulation O (12 C.F.R. Part 215) to read as set forth below:

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

CONTENTS

SECTION 215.1 — AUTHORITY, PURPOSE, AND SCOPE

(a) Authority. This Part 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(7)).

(b) Purpose and Scope. This Part governs any extension of credit by a member bank to an executive officer, director, or principal shareholder of (1) the member bank, (2) a bank holding company of which the member bank is a subsidiary, and (3) any other subsidiary of that bank holding company. It also applies to any extension of credit by a member bank to (1) a company controlled by such a person and (2) a political or campaign committee that benefits or is controlled by such a person.

SECTION 215.2 — DEFINITIONS

For the purposes of this Part, the following definitions apply:

(a) "Company" means any corporation, partnership, trust (business or otherwise), association, joint venture, pool syndicate, sole proprietorship,

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unincorporated organization, or any other form of business entity not specifically listed herein. However, the term does not include (1) an insured bank (as defined in 12 U.S.C. 1813(h)) or (2) a corporation the majority of the shares of which are owned by the United States or by any State.

(b)(1) "Control of a company or bank" means that a person directly or indirectly, or acting through or in concert with one or more persons:

(i) owns, controls, or has the power to vote 25 per cent or more of any class of voting securities of the company or bank;

(ii) controls in any manner the election of a majority of the directors of the company or bank; or

(iii) has the power to exercise a controlling influence over the management or policies of the company or bank.

(2) A person is presumed to have control, including the power to exercise a controlling influence over the management or policies, of a company or bank if:

(i) the person is (A) an executive officer or director of the company or bank and (B) directly or indirectly owns, controls, or has the power to vote more than 10 per cent of any class of voting securities of the company or bank; or

(ii) (A) the person directly or indirectly owns, controls, or has the power to vote more than 10 per cent of any class of voting securities of the company or bank, and (B) no other person owns, controls, or has the power to vote a greater percentage of that class of voting securities.

(3) An individual is not considered to have control, including the power to exercise a controlling influence over the management or policies, of a company or bank solely by virtue of the individual's position as an officer or director of the company or bank.

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(4) A person may rebut a presumption established by paragraph (b)(2) of this section by submitting to the appropriate Federal banking agency (as defined in 12 U.S.C. 1813 (q)) written materials that, in the agency's judgment, demonstrate an absence of control.

(c) "Director of a member bank" includes (1) any director of a member bank, whether or not receiving compensation, (2) any director of a bank holding company (as defined in 12 U.S.C. 1841(a)) of which the member bank is a subsidiary, and (3) any director of any other subsidiary of that bank holding company. An advisory director is not considered a director if the advisory director (1) is not elected by the shareholders of the company or bank, (2) is not authorized to vote on matters before the board of directors, and (3) 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 (1) the officer is excluded, by resolution of the board of directors

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.

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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 (2) the officer does not actually participate therein. For the purpose of sections 215.4 and 215.7 below, an executive officer of a member bank includes an executive officer of (1) a bank holding company (as defined in 12 U.S.C. 1841(a)) of which the member bank is a subsidiary and (2) any other subsidiary of that bank holding company, unless the executive officer of the subsidiary (i) 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 (ii) does not actually participate in such major policymaking functions.

(e) "Immediate family" means the spouse of an individual, the individual's minor children, and any of the individual's children (including adults) residing in the individual's home.

(f) The "lending limit" for a member bank is an amount equal to the limit on loans to a single borrower established by section 5200 of the Revised Statutes, 12 U.S.C. 84. This amount is 10 per cent of the bank's capital stock and unimpaired surplus or any higher amount permitted by section 5200 of the Revised Statutes for the types of obligations listed therein as exceptions to the 10 per cent limit. A member bank's capital stock 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.

(g) "Member bank" means any banking institution that is a member of the Federal Reserve System. The term does not include any foreign bank (as

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defined in 12 U.S.C. 3101(b)(7)) 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).

(h) "Pay an overdraft on an account" means to pay an amount upon the order of an account holder in excess of funds on deposit in the account.

(i) "Person" means an individual or a company.

(j) "Principal shareholder" means an individual or a company (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 per cent of any class of voting securities of a member bank or company. However, for the purposes of section 215.4(c) below, this percentage shall be "more than 18 per cent" if the member bank is located in a city, town, or village with a population of less than 30,000. 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 bank holding company (as defined in 12 U.S.C. 1841(a)) of which the member bank is a subsidiary and (2) a principal shareholder of any other subsidiary of that bank holding company.

(k) "Related interest" means (1) a company that is controlled by a person or (2) a political or campaign committee that is controlled by a person or the funds or services of which will benefit a person.

(l) "Subsidiary" has the meaning given in 12 U.S.C. 1841(d), but does not include a subsidiary of a member bank.

SECTION 215.3 -- EXTENSION OF CREDIT

(a) An extension of credit is a making or renewal of any loan, a granting of a line of credit, or an extending of credit in any manner whatsoever, and includes:

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(1) a purchase under repurchase agreement of securities, other assets, or obligations;

(2) an advance by means of an overdraft, cash item, or otherwise;

(3) issuance of a standby letter of credit (or other similar arrangement regardless of name or description) or an ineligible acceptance, as those terms are defined in section 208.8(d) of this Chapter;

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

(5) a discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse; but the acquisition of such paper by a member bank from another bank, without recourse, shall not be considered a discount by the member bank for the other bank;

(6) an increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for (i) accrued interest or (ii) taxes, insurance, or other expenses incidental to the existing indebtedness;

(7) an advance of unearned salary or other unearned compensation for a period in excess of 30 days; and

(8) any other 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,

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or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

(b) An extension of credit does not include:

(1) an advance against accrued salary or other accrued compensation, or an advance for the payment of authorized travel or other expenses incurred or to be incurred on behalf of the bank;

(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 section 215.4(d) below);

(3) an acquisition of a note, draft, bill of exchange, or other evidence of indebtedness through (i) a merger or consolidation of banks or a similar transaction by which a bank acquires assets and assumes liabilities of another bank or similar organization or (ii) foreclosure on collateral or similar proceeding for the protection of the bank, provided that such indebtedness is not held for a period of more than three years from the date of the acquisition, subject to extension by the appropriate Federal banking agency for good cause;

(4) (i) an endorsement or guarantee for the protection of a bank of any loan or other asset previously acquired by the bank in good faith or (ii) any indebtedness to a bank for the purpose of protecting the bank against loss or of giving financial assistance to it; or

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(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 section 215.4(d) below, or similar open-end credit plan, provided: (A) the indebtedness does not involve prior individual clearance or approval by the bank other than for the purposes of determining authority to participate in the arrangement and compliance with any dollar limit under the arrangement, and (B) the indebtedness is incurred under terms that are not more favorable than those offered to the general public.

(c) Non-interest-bearing deposits to the credit of a bank are not considered loans, advances, or extensions of credit to the bank of deposit; nor is the giving of immediate credit to a bank upon uncollected items received in the ordinary course of business considered to be a loan, advance, or extension of credit to the depositing bank.

(d) For purposes of sections 215.4(b) and (c) below, an extension of credit by a member bank is considered to have been made at the time the bank enters into a binding commitment to make the extension of credit.

(e) A participation without recourse is considered to be an extension of credit by the participating bank, not by the originating bank.

(f) An extension of credit is considered made to a person covered by this Part to the extent that the proceeds of the extension of credit are used for the tangible economic benefit of, or are transferred to, such a person.

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SECTION 215.4 — GENERAL PROHIBITIONS

(a) Terms and Creditworthiness. No member bank may extend credit to any of its executive officers, directors, or principal shareholders or to any related interest of that person unless the extension of credit: (1) is made on substantially the same terms, including interest rates and collateral, as 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) does not involve more than the normal risk of repayment or present other unfavorable features.

(b) Prior Approval. (1) No member bank may extend credit or grant 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 and lines of credit by the member bank to that person and to all related interests of that person, exceeds $25,000, unless (i) the extension of credit or line 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) Approval by the board of directors under paragraph (b)(1) of this section is not required for an extension of credit that is made pursuant to a line of credit that was approved under paragraph (b)(1) of this section within 14 months of the date of the extension of credit. The extension of credit must also be in compliance with the requirements of section 215.4(a) above.

(3) Participation in the discussion, or any attempt to influence the voting, by the board of directors regarding an extension of credit constitutes indirect participation in the voting by the board of directors on an extension of credit.

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(c) Aggregate Lending Limit. No member bank may extend credit to any of its executive officers or principal shareholders or to any related interest of that person[2/] 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 section 215.2(f) above. This prohibition does not apply to an extension of credit by a member bank to a bank holding company (as defined in 12 U.S.C. 1841(a)) of which the member bank is a subsidiary or to any other subsidiary of that bank holding company.

(d) Overdrafts. No member bank may pay an overdraft of an executive officer or director of the bank[3/] on an account at the bank, unless the payment of funds is made in accordance with (1) a written, preauthorized, interest-bearing extension of credit plan that specifies a method of repayment or (2) a written, preauthorized transfer of funds from another account of the account holder at the bank. This prohibition does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of $1,000 or less, provided (1) the account is not overdrawn for more than 5 business days, and (2) the member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances.

2/ This prohibition does not apply to member bank loans to a director of the member bank or to a related interest of the director, unless the director is also an executive officer or principal shareholder. See also the definition of principal shareholder in section 215.2(j) above, in the case of a member bank located in a city, town or village with a population of less than 30,000.

3/ This prohibition does not apply to the payment by a member bank of an overdraft of a principal shareholder of the member bank, unless the principal shareholder is also an executive officer or director. This prohibition also does not apply to the payment by a member bank of an overdraft of a related interest of an executive officer, director, or principal shareholder of the member bank.

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SECTION 215.5 -- ADDITIONAL RESTRICTIONS ON LOANS TO EXECUTIVE OFFICERS OF MEMBER BANKS

(a) No member bank may extend credit to any of its executive officers,[4/] and no executive officer of a member bank shall borrow from or otherwise become indebted to the bank, except in the amounts, for the purposes, and upon the conditions specified in paragraphs (c) and (d) of this section.

(b) No member bank may extend credit in an aggregate amount greater than $10,000 outstanding at any one time to a partnership in which one or more of the executive officers of the member bank are partners and, either individually or together, hold a majority interest. For the purposes of paragraph (c)(3) below, the total amount of credit extended by a member bank to such partnership is considered to be extended to each executive officer of the member bank who is a member of the partnership.

(c) A member bank is authorized to extend credit to an executive officer of the bank in an aggregate amount not to exceed:

(1) $20,000 outstanding at any one time to finance the education of the executive officer's children;

(2) $60,000 outstanding at any one time to finance the purchase, construction, maintenance, or improvement of a residence of the executive officer, if 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

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4/ Sections 215.5, 215.8 and 215.9 of Regulation O implement section 22(g) of the Federal Reserve Act and do not apply to nonmember banks. For the purposes of these 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.

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(3) $10,000 outstanding at any one time for a purpose not otherwise specifically authorized under this paragraph.

(d) Any extension of credit by a member bank to any of its executive officers shall be: (1) promptly reported to the member bank's board of directors; (2) in compliance with the requirements of section 215.4(a) above; (3) preceded by the submission of a detailed current financial statement of the executive officer; and (4) made subject to the condition 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.

SECTION 215.6 — EXTENSIONS OF CREDIT OUTSTANDING ON MARCH 10, 1979

(a) Any extension of credit that was outstanding on March 10, 1979, and that would, if made on or after March 10, 1979, violate section 215.4(c) above, shall be reduced in amount by March 10, 1980, to be in compliance with the lending limit in section 215.4(c). Any renewal or extension of such an extension of credit on or after March 10, 1979, shall be made only on terms that will bring the extension of credit into compliance with the lending limit of section 215.4(c) by March 10, 1980. However, any extension of credit made before March 10, 1979, that bears a specific maturity date of March 10, 1980, or later, shall be repaid in accordance with its repayment schedule in existence on or before March 10, 1979.

(b) If a member bank is unable to bring all extensions of credit outstanding on March 10, 1979, into compliance as required by paragraph (a) of this section, the member bank shall promptly report that fact to the Comptroller of the Currency, in the case of a national bank, or to the appropriate Federal

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Reserve Bank, in the case of a State member bank, and explain the reasons why all the extensions of credit cannot be brought into compliance. The Comptroller or the Reserve Bank, as the case may be, is authorized, on the basis of good cause shown, to extend the March 10, 1980, date for compliance for any extension of credit for not more than two additional one-year periods.

SECTION 215.7 — RECORDS OF MEMBER BANKS

Each member bank shall maintain records necessary for compliance with the requirements of this Part. These records shall (a) identify all executive officers, directors, and principal shareholders of the member bank and the related interests of these persons and (b) specify the amount and terms of each extension of credit by the member bank to these persons and to their related interests. Each member bank shall request at least annually that each executive officer, director, or principal shareholder of the member bank identify the related interests of that person.

SECTION 215.8 — REPORTS BY EXECUTIVE OFFICERS

Each executive officer[5/] of a member bank who becomes indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in section 215.5(c) above, shall, within 10 days of the date the indebtedness reaches such a level, make a written report to the board of directors of the officer's bank. The report shall state the lender's name, the date and amount of each extension of credit, any security for it, and the purposes for which the proceeds have been or are to be used.

5/ See note 4 above.

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SECTION 215.9 -- REPORTS BY MEMBER BANKS

Each member bank shall include with (but not as part of) each report of condition (and copy thereof) filed pursuant to 12 U.S.C. 1817(a)(3) a report of all extensions of credit made by the member bank to its executive officers[6/] since the date of the bank's previous report of condition.

SECTION 215.10 -- CIVIL PENALTIES

As specified in section 29 of the Federal Reserve Act (12 U.S.C. 504), 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 Part is subject to a civil penalty of not more than $1,000 per day for each day during which the violation continues.

Effective date: March 10, 1979.

Board of Governors of the Federal Reserve System, March 5, 1979.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

(SEAL)

6/ See note 4 above.

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APPENDIX

SECTION 5200 OF THE REVISED STATUTES

The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. The term "obligations" shall mean the direct liability of the maker or acceptor of paper discounting with or sold to such association and the liability of the indorser, drawer, or guarantor who obtains a loan from or discounts paper with or sells paper under his guaranty to such association and shall include in the case of obligations of a copartnership or association the obligations of the several members thereof and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest. Such limitation of 10 per centum shall be subject to the following exceptions:

(1) Obligations in the form of drafts or bills of exchange drawn in good faith against actually existing values shall not be subject under this section to any limitation based upon such capital and surplus.

(2) Obligations arising out of the discount of commercial or business paper actually owned by the person, copartnership, association, or corporation negotiating the same shall not be subject under this section to any limitation based upon such capital and surplus.

(3) Obligations drawn in good faith against actually existing values and secured by goods or commodities in process of shipment shall not be subject under this section to any limitation based upon such capital and surplus.

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(4) Obligations as indorser or guarantor of notes, other than commercial or business paper excepted under (2) hereof, having a maturity of not more than six months, and owned by the person, corporation, association, or copartnership indorsing and negotiating the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(5) Obligations in the form of banker's acceptances of other banks of the kind described in sections 372 and 373 of this title shall not be subject under this section to any limitation based upon such capital and surplus.

(6) Obligations of any person, copartnership, association or corporation, in the form of notes or drafts secured by shipping documents, warehouse receipts, or other such documents transferring or securing title covering readily marketable nonperishable staples when such property is fully covered by insurance, if it is customary to insure such staples shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such obligation, and to an additional increase of limitation of 5 per centum of such capital and surplus in addition to such 25 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 120 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such

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30 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 125 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 130 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 40 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 135 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 45 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 140 per centum of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, copartnership, association, or corporation arising from the same transactions and/or secured by the identical staples for more than ten months. Obligations of any person, copartnership, association, or corporation in the form of notes or drafts secured by shipping documents, warehouse receipts, or other such documents transferring or securing title covering refrigerated or frozen readily marketable staples when such property is fully covered by insurance, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per

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centum of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such additional obligation but this exception shall not apply to obligations of any one person, copartnership, association, or corporation arising from the same transactions and/or secured by the identical staples for more than six months.

(7) Obligations of any person, copartnership, association, or corporation in the form of notes or drafts secured by shipping documents or instruments transferring or securing title covering livestock or giving a lien on livestock when the market value of the livestock securing the obligation is not at any time less than 115 per centum of the face amount of the notes covered by such documents shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus. Obligations arising out of the discount by dealers in dairy cattle of paper given in payment for dairy cattle, which bear a full recourse endorsement or unconditional guarantee of the seller and are secured by the cattle being sold, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(8) Obligations of any person, copartnership, association, or corporation secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, treasury bills of the United States or obligations fully guaranteed both as to principal and interest by the

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United States, shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(9) Obligations representing loans to any national banking association or to any banking institution organized under the laws of any State, or to any receiver, conservator, or superintendent of banks, or to any other agent, in charge of the business and property of any such association or banking institution, when such loans are approved by the Comptroller of the Currency, shall not be subject under this section to any limitation based upon such capital and surplus.

(10) Obligations shall not be subject under this section to any limitation based upon such capital and surplus to the extent that such obligations are secured or covered by guaranties, or by commitments or agreements to take over or to purchase, made by any Federal Reserve bank or by the United States or any department, bureau, board, commission, or establishment of the United States, including any corporation wholly owned directly or indirectly by the United States: Provided, That such guaranties, agreements, or commitments are unconditional and must be performed by payment of cash or its equivalent within sixty days after demand. The Comptroller of the Currency is hereby authorized to define the terms herein used if and when he may deem it necessary.

(11) Obligations of a local public agency (as defined in section 1460(h) of Title 42) or of a public housing agency (as defined

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in the United States Housing Act of 1937, as amended; which have a maturity of not more than eighteen months shall not be subject under this section to any limitation, if such obligations are secured by an agreement between the obligor agency and the Secretary of Housing and Urban Development in which the agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the agency, prior to the maturity of such obligations, monies in an amount which (together with any other monies irrevocably committed to the payment of interest on such obligations) will suffice to pay the principal of such obligations with interest to maturity, which monies under the terms of said agreement are required to be used for that purpose.

(12) Obligations insured by the Secretary of Agriculture pursuant to the Bankhead-Jones Farm Tenant Act, as amended, or the Act of August 28, 1937, as amended (relating to the conservation of water resources), or sections 1471-1485 of Title 42, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(13) Obligations as endorser or guarantor of negotiable or non-negotiable installment consumer paper which carriers a full recourse endorsement or unconditional guarantee by the person, copartnership, association, or corporation transferring the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus: Provided, however, That if the bank's files or the knowledge of its officers of the

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financial condition of each maker of such obligations is reasonably adequate, and upon certification by an officer of the bank designated for that purpose by the board of directors of the bank, that the responsibility of each maker of such obligations has been evaluated and the bank is relying primarily upon each such maker for the payment of such obligations, the limitations of this section as to the obligations of each such maker shall be the sole applicable loan limitation: Provided further, That such certification shall be in writing and shall be retained as part of the records of such bank.

(14) Obligations of the Student Loan Marketing Association shall not be subject to any limitation based upon such capital and surplus.

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