

Af circ no. 8537
March 14, 1979

To All Member Banks in the
Second Federal Reserve District:

As indicated in this Bank's Circular No. 8532, dated March 8, 1979, the Board of Governors of the Federal Reserve System has invited comment on proposed rules, regarding loans by members banks to insiders, to implement Titles VIII and IX of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

Enclosed is a copy of the text of the proposal. Comments will be received through April 20, 1979, and may be sent to this Bank's Consumer Affairs and Bank Regulations Department.

Circulars Division
FEDERAL RESERVE BANK OF NEW YORK

FEDERAL RESERVE SYSTEM

[12 CFR Part 215]

Loans to Executive Officers, Directors, and
Principal Shareholders

FEDERAL DEPOSIT INSURANCE CORPORATION

[12 CFR Parts 304, 349]

Forms, Instructions, and Reports

Loans by Correspondent Banks

(Docket No. R-0210)

AGENCIES: Board of Governors of the Federal Reserve System,
Comptroller of the Currency, and Federal Deposit Insurance
Corporation.

ACTION: Proposed regulations.

SUMMARY: The agencies listed above are considering methods
and procedures to implement Title VIII (Correspondent Accounts)
and Title IX (Disclosure of Material Facts) of the Financial
Institutions Regulatory and Interest Rate Control Act of 1978,
P.L. 95-630 ("FIRA"). Titles VIII and IX of FIRA take effect
on March 10, 1979.

Title VIII prohibits banks that maintain a correspon-
dent account relationship with each other from extending credit
on preferential terms to each other's executive officers,
directors or principal shareholders. It also prohibits the
opening of a correspondent account relationship between banks
where there is a preferential extension of credit from one
bank to an executive officer, director or principal shareholder
of the other bank. In addition, Titles VIII and IX require
insured banks and the executive officers and principal stock-

holders of record of insured banks to file certain reports.

DATE: Comments must be received by April 20, 1979.

ADDRESS: Interested persons are invited to submit comments regarding the proposed regulations. National banks should address their comments to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, with a copy to John E. Shockey, Chief Counsel, Office of the Comptroller of the Currency, 490 L'Enfant Plaza East, S.W., Washington, D.C. 20219. State banks that are members of the Federal Reserve System should send their comments to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. Insured banks that are not members of the Federal Reserve System should address their comments to the Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. All other interested persons should address their comments to the Board of Governors of the Federal Reserve System, with a copy to any other appropriate agency. All material submitted should refer to F.R.B. Docket No. R-0210. All comments received will be made available for public inspection.

FOR FURTHER INFORMATION CONTACT: Board of Governors of the Federal Reserve System: Bronwen Mason, Senior Attorney, Legal Division (202/452-3564), or Michael Bleier, Senior Attorney, Legal Division (202/452-3721); Federal Deposit Insurance Corporation: Alan J. Kap Senior Attorney, Legal Division (202/389-4433); Comptroller of the Currency: William H. Rivoir, Attorney, Enforcement and Compliance Division (202/447-1989).

SUPPLEMENTARY INFORMATION: a. Title VIII -- Effective March 10, 1979, Title VIII of FIRA, which amends section 106 of the Bank Holding Company Act Amendments of 1970, prohibits banks that maintain a correspondent account relationship with each other from extending credit to each other's executive officers, directors or principal shareholders unless the extension of credit is (1) made on substantially the same terms as those prevailing at the time for comparable transactions with other persons and (2) does not involve more than the normal risk of repayment or present other unfavorable features. The agencies propose to interpret the term "other persons" to mean other persons not associated with, or employed by, the bank.

Title VIII also prohibits the opening of a correspondent account relationship between banks where there is a preferential extension of credit from one of the banks to an executive officer, director, or principal shareholder of the other bank.

Persons covered by these prohibitions include any individual or company that directly or indirectly owns or controls more than ten per cent of any class of voting shares of a bank. In the proposed rule, a principal shareholder includes a person who controls a principal shareholder, such as a person that controls a bank holding company. In addition, shares owned by an individual's immediate family, as defined in the Federal Reserve Board's Regulation O, are deemed to be owned by the individual.

The proposed rule defines a correspondent account as an account that is maintained by a bank with another bank for

the deposit or placement of funds. The agencies are considering exclusions from the definition of correspondent account such as time deposit accounts at prevailing interest rates and accounts maintained solely for the purpose of effecting federal funds transactions or loan participations. The agencies request comment on this definition as well as suggestions for other possible inclusions or exclusions. Such suggestions should be justified in light of the purposes of the Act.

In addition to its prohibitions, Title VIII imposes reporting requirements upon executive officers and principal stockholders of record. The proposed regulations define principal stockholder of record as a person that, directly or indirectly owns, controls, or has the power to vote more than ten percent of any class of voting securities of an insured bank.

For the purposes of these requirements, the term insured bank includes a branch of a foreign bank, the deposits of which are insured by the FDIC. If a foreign bank maintains a non-insured branch or an agency or a commercial lending company in the United States, the branch, agency or company would qualify as a bank for purposes of the prohibitions of Title VIII, but would not be subject to Title VIII's reporting requirements.

Executive officers and principal stockholders of record of insured banks are required to provide the board of directors of their bank with a report regarding any extension of credit to them and to each of their related interests by each of their bank's depository banks during a calendar year. A depository

bank is defined as a bank that maintains a correspondent account for another bank. A related interest is a company controlled by, or a political or campaign committee that benefits or is controlled by, an executive officer or principal stockholder of record. These reporting requirements do not apply to directors, unless they are executive officers or principal stockholders of record. For the purposes of the reporting requirements, a depository bank does not include a bank that maintains a correspondent account(s) that does not exceed \$100,000 in the aggregate at any time during the reporting year. The agencies are considering a lower triggering amount for smaller banks. In particular, the agencies are considering a cut-off based upon a percentage of the depositing bank's total deposits.

Executive officers and principal stockholders must include in the report filed with the bank's board of directors (1) the "maximum amount of indebtedness" of the executive officer or principal stockholder and of each of that person's related interests to each depository bank; (2) the amount of indebtedness outstanding ten days before the report is filed of the executive officer or principal stockholder and of each of that person's related interests to each depository bank; (3) the range of interest rates on the indebtedness; and (4) the terms and conditions of the indebtedness. Separate amounts are to be reported for the executive officer or principal stockholder and for each of that person's related interests.

The agencies propose to define the term "maximum amount of indebtedness" as the highest amount that was owed during the

year. As an alternative, the agencies are considering defining "maximum amount of indebtedness" as the sum of all extensions of credit. While the alternative method of calculation appears less burdensome, it yields a higher figure that may not accurately reflect the extent of correspondent borrowing by a bank's executive officers and principal stockholders. Comment is specifically requested on the cost and burden to insured banks that would be imposed by adopting either alternative. Comment is also requested on whether the "highest amount" should mean (1) the highest average daily, weekly, or monthly balance during the calendar year, (2) the highest end-of-the-month balance during the calendar year, or (3) the highest amount calculated on some other basis.

Title VIII requires each insured bank to compile the reports submitted to it by its executive officers and principal stockholders of record and to furnish such compilation annually to the appropriate bank supervisory agency. The format for the compilation will be published at a later date. The reports submitted by such persons to the board of directors of the insured bank must be maintained at the bank for five years and should not be forwarded to the appropriate Federal banking agency unless requested. The appropriate agency may require the reports to be retained by the bank for an additional period of time.

Finally, Title VIII requires each insured bank to file an annual report with the appropriate Federal banking agency. In the report, the bank must list by name each executive officer and principal stockholder of record

that files a report with the bank's board of directors concerning indebtedness from depository banks. The insured bank also reports the "aggregate amount of all extensions of credit" made to such persons by depository banks. This single figure is calculated by totaling the "maximum amounts of indebtedness" reported by the executive officers and principal stockholders of record. This report will be part of the report filed by the insured bank under Title IX and will be made available to the public upon request.

b. Title IX -- Title IX, which amends section 7 of the Federal Deposit Insurance Act, requires each insured bank to file a report annually with its appropriate Federal banking agency. In that report, the insured bank lists each of its executive officers and principal stockholders of record and the aggregate amount of extensions of credit by the bank to such persons and their related interests. The agencies propose to define "aggregate amount" as the total of the highest amounts of indebtedness owed to the insured bank by each of the bank's executive officers and principal stockholders of record and each of that person's related interests. As an alternative, the agencies are considering defining "aggregate amount" as the sum of all extensions of credit made during the reporting year. These reports will be made available to the public at the bank and at the appropriate Federal banking agency upon request.

The proposed regulations incorporate the definitions in the Federal Reserve Board's Regulation O for the terms "executive officer," "extension of credit," "immediate family,"

and "control of a bank or company." It should be noted that under Regulation O, a person is not considered to control a company or a bank solely because of that person's position as a director or executive officer of the bank or company.

The prohibitions against preferential lending in Title VIII are prospective only. Preferential loans that are outstanding as of March 10, 1979, are not specifically addressed in the statute or the proposed regulations. However, banks should eliminate the preferential terms on such loans as soon as practicable. If such preferential terms are not eliminated, they may be subject to criticism by the agencies. This policy applies particularly to demand loans that are within the power of the bank to call and renegotiate at any time.

It is emphasized that, although these are proposals and not final regulations, the actual statute takes effect on March 10, 1979, and all banks are expected to comply with the law beginning on that date. Until final action is taken on the proposals, however, banks should refer to the definitions of terms contained in the proposed regulations (in particular, the definition of "correspondent account") for guidance in complying with the prohibitions of Title VIII.

The agencies are considering whether it is necessary to provide forms on which the statements and reports required under Titles VIII and IX must be filed. Any such forms, and accompanying instructions, would be published at a later date. The first reports under Titles VIII and IX are due to

be filed by executive officers and principal stockholders of record of insured banks by January 10, 1980, and by insured banks by January 31, 1980. The period covered by such reports will be from March 10, 1979 (the effective date of FIRA) through December 31, 1979. However, the agencies may consider limiting the first reporting period to July 1, 1979 to December 31, 1979, in order to provide for the orderly implementation of the Act's reporting requirements. Also, comment is requested on whether the January 31 filing date for insured banks should be extended to a later date.

Accordingly, the Board of Governors of the Federal Reserve System hereby proposes to amend the title to the Board's Regulation O (12 CFR Part 215) to read "Part 215 - Loans to Executive Officers, Directors, and Principal Shareholders," to add a new paragraph (b) to section 215.9 of Regulation O, to include sections 215.1 through 215.10 of Regulation O in Subpart A titled "Loans by Member Banks," and to add a new Subpart B to Regulation O, to read as set forth below, and the Board of Directors of the Federal Deposit Insurance Corporation hereby proposes to amend 12 CFR by adding thereto a new Part 349 and a new section 304.4 to read as set forth below.

FEDERAL RESERVE SYSTEM

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

SUBPART A--LOANS BY MEMBER BANKS

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SECTION 215.9--REPORTS BY MEMBER BANKS

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(b) On or before January 31 of each year, each member bank shall file with the appropriate Federal Reserve Bank or the Comptroller of the Currency, as the case may be, a report that shall include the following information with respect to the preceding calendar year:

- (1) a list by name of each executive officer of the member bank and a list by name of each principal stockholder of record of the member bank; and
- (2) the aggregate amount of all extensions of credit made by the member bank to its executive officers and principal stockholders of record and their related interests. For the purposes of this paragraph, "aggregate amount of all extensions of credit" means the sum of the highest amounts of indebtedness owed to the member bank during the year by each executive officer or principal stockholder of record and each of the reporting person's related interests. Principal stockholder of record has the meaning given in section 215.21(h) of Subpart B below.

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SUBPART B--LOANS BY CORRESPONDENT BANKS

CONTENTS

Sec.

215.20	Authority, Purpose, and Scope
215.21	Definitions
215.22	Prohibited Transactions
215.23	Reports By Executive Officers and Principal Stockholders of Record
215.24	Reports by Member Banks
215.25	Civil Penalties

SECTION 215.20--AUTHORITY, PURPOSE, AND SCOPE

(a) Authority. This Subpart is issued pursuant to Title VIII of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 ("FIRA") (P.L. 95-630), and under authority of sections 11(i) and 22(h) (7) of the Federal Reserve Act (12 U.S.C. 248(i) and 375b(7)) and 12 U.S.C. 1817(k) (1). Title VIII amends section 106(b) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972).

(b) Purpose and Scope. The purpose of this Subpart is to implement the provisions of Title VIII of FIRA. It prohibits (1) preferential lending by a bank to executive officers, directors and principal shareholders of another bank when there is a correspondent account relationship between the banks, and (2) the opening of a correspondent account relationship between banks when there is a preferential extension of credit by one of the banks to an executive officer, director or principal shareholder of the other bank. This Subpart also establishes procedures to implement the reporting and public disclosure requirements

of Title VIII of FIRA with respect to member banks and executive officers and principal stockholders of record of member banks.

SECTION 215.21--DEFINITIONS

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

- (a) "Bank" has the meaning given in 12 U.S.C. 1841(c).
The term includes a branch of a foreign bank, or a commercial lending company that is controlled by a foreign bank, or by a company that controls a foreign bank, where the branch or agency is maintained in a State of the United States or in the District of Columbia or the commercial lending company is organized under State law.^{1/}
(12 U.S.C. 3106(d)).
- (b) "Company" means any person, estate, trust, partnership, corporation, association, or similar organization. The term does not include any corporation the majority of the shares of which are owned by the United States or by any State.^{2/}
- (c) "Control of a company or bank," "executive officer," "extension of credit," and "immediate family" shall have the meanings provided in Subpart A.

^{1/} Under this definition, a foreign bank's branch in a State would be a bank but, unless the branch's deposits were insured by the FDIC, the branch would not be an "insured bank" and would not, therefore, be subject to the reporting requirements of sections 215.23 and 215.24, below.

^{2/} The definition of a company in this Subpart differs from that contained in Subpart A. The definition in Subpart A excludes insured banks and includes sole proprietorships.

- (d) "Correspondent account" is an account that is maintained by a bank with another bank for the deposit or placement of funds.
- (e) "Depository bank" means a bank that maintains a correspondent account(s) for a member bank in an amount aggregating more than \$100,000 at any time during the reporting year.
- (f) "Person" means an individual or a company.
- (g) "Principal shareholder" means any person 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 bank or company. The term includes a person that controls a principal shareholder (e.g., a person that controls a bank holding company). Shares owned or controlled by a member of an individual's immediate family are considered to be owned or controlled by the individual.
- (h) "Principal stockholder of record" means a person who directly or indirectly owns, controls, or has the power to vote more than 10 per cent of any class of voting securities of an insured bank. The term includes a person that controls a principal stockholder of record.

- (i) "Related interest" means any company controlled by a person and any political or campaign committee, the funds or services of which will benefit a person or that is controlled by a person.^{3/}

SECTION 215.22--PROHIBITED TRANSACTIONS

- (a) (1) No bank that maintains a correspondent account for another bank shall make an extension of credit to an executive officer, director, or principal shareholder of such other bank unless the extension of credit is not preferential.
- (2) No bank shall open a correspondent account at another bank that has outstanding an extension of credit to an executive officer, director, or principal shareholder of the bank desiring to open the account unless the extension of credit is not preferential.
- (3) No bank that maintains a correspondent account at another bank shall make an extension of credit to an executive officer, director or principal shareholder of such other bank unless the extension of credit is not preferential.
- (4) No bank that has outstanding an extension of credit to an executive officer, director, or principal shareholder of another bank shall open a correspondent account at the other bank unless the extension of credit is not preferential.

^{3/} The definition of related interest in this Subpart differs from that in Subpart A. The definition in Subpart A excludes insured banks.

- (b) For the purposes of this section, an extension of credit is not preferential if (1) it is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons that are not covered by this Subpart and who are not employed by the bank, and (2) it does not involve more than the normal risk of repayment or present other unfavorable features.

SECTION 215.23--REPORTS BY EXECUTIVE OFFICERS AND
PRINCIPAL STOCKHOLDERS OF RECORD

- (a) If during any calendar year an executive officer or principal stockholder of record of a member bank had outstanding an extension of credit from a depository bank(s) of the member bank, the executive officer or stockholder shall, on or before January 10 of the following year, make a written report to the board of directors of the member bank.^{4/}
- (b) The report required by this section shall include the following information:
- (1) the "maximum amount of indebtedness" of the executive officer or principal stockholder of record and of each of that person's related interests to each depository bank;

^{4/} Persons reporting under this section are not required to include information on extensions of credit that are fully described in a report by a person they control or a person that controls them, provided they identify their relationships with such other person.

- (2) the amount of indebtedness of the executive officer or principal stockholder of record and of each of that person's related interests outstanding as of December 31 of the calendar year for which the report is made to each depository bank;
 - (3) the range of interest rates charged on the indebtedness reported in paragraphs (b) (1) and (b) (2) of this section; and
 - (4) a general description of the terms and conditions of the indebtedness reported in paragraphs (b) (1) and (b) (2) of this section.
- (c) For the purposes of this Subpart, "maximum amount of indebtedness" shall mean the highest amount owed during the calendar year for which the report is made.
- (d) The report required by this section must be filed by a person who was an executive officer or a principal stockholder of record of a member bank at any time during the reporting year and who received an extension of credit during that year from a depository bank of the member bank.

SECTION 215.24--REPORTS BY MEMBER BANKS

- (a) On or before January 31 of each year, each member bank shall compile the reports filed under section 215.23(a) above, and shall forward a compilation of such reports to the Comptroller of the Currency, in the case of a national bank, or the appropriate Federal Reserve Bank, in the case of a State member

bank. The reports required by section 215.23(a) above, shall be retained at the member bank for a period of five years. The appropriate Federal banking agency may require these reports to be retained by the bank for an additional period of time.

(b) Each member bank shall include in the report required under section 215.9(b) of Subpart A the following information:

- (1) a list by name of each person who files a report under section 215.23(a) above; and
- (2) the aggregate amount, or sum, of all the maximum amounts of indebtedness reported under section 215.23(b) (1) above.

SECTION 215.25--CIVIL PENALTIES

As specified in subsection 106(b) (2) (F) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(b) (2) (F)), any 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 Subpart shall forfeit and pay a civil penalty of not more than \$1,000 per day for each day during which the violation continues.

By Order of the Board of Governors of the Federal Reserve System, March 6, 1979.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]