FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 9556
September 26, 1983

INTERLOCKING BANK RELATIONSHIPS

LOANS TO INSIDERS

Amendments to Regulations L and O

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

Amendments to Regulation L

The Board of Governors of the Federal Reserve System has announced the adoption of amendments to its Regulation L, "Management Official Interlocks," which implements the Depository Institution Management Interlocks Act. The following is quoted from the text of the statement issued by the Board of Governors:

> The Board acted after consideration of comment on proposals published late in 1982. The other Federal financial institutions regulators are preparing similar changes in their regulations.
>
> The Interlocks Act prohibits certain interlocking relationships among officials of financial institutions, including depository holding companies and their affiliates.
>
> The amendments adopted by the Board, substantially as proposed for comment, revise Regulation L to:
>
> (1) Simplify procedures for obtaining exceptions to the Act and extensions of time to permit compliance with the Act, by requiring only one agency's approval;
>
> (2) Ease the burden of compliance by redefining terms to avoid covering holding companies located in the same geographic area when neither company has an affiliated depository institution in the area;
>
> (3) Broaden the exclusion from the prohibitions of the Act for management officials whose functions relate exclusively to retail merchandising and manufacturing;
>
> (4) Broaden the circumstances under which the exception to the prohibitions of the Act is available on grounds of disruptive management loss;
>
> (5) Clarify the circumstances that require termination -- due to changes in circumstances -- of non-grandfathered management official interlocks, and provide that the 15-month grace period for compliance following such changes applies whether the change in circumstances is voluntary or involuntary.
>
> The five Federal financial institutions regulators (Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, Federal Reserve Board and the National Credit Union Administration) are preparing a joint Federal Register notice of revisions in their regulations implementing the Depository Institutions Interlock Act, to be published shortly.

The text of the amendments to Regulation L will be sent to you as soon as they are available. Questions thereon may be directed to our Regulations Division (Tel. No. 212-791-5914).

(Over)

Amendments to Regulation O

The Board of Governors of the Federal Reserve System has also announced the adoption of final amendments, effective October 20, 1983, to its Regulation O, "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks," in order to implement recent legislative changes affecting Section 22 of the Federal Reserve Act. The following is quoted from the text of the Board's announcement:

> The Board acted after consideration of comment received on proposals published in May. The other Federal bank regulatory agencies are considering similar revisions of their rules.
>
> The Garn-St Germain Depository Institutions Act of 1982 amended Section 22 of the Federal Reserve Act, dealing with member bank credit to bank insiders, including executive officers, directors, principal shareholders and their related interests.
>
> Previously, the Federal Reserve Act and the Board's Regulation O limited loans by a state member bank to executive officers to specific dollar amounts for a home mortgage, education of an executive officer's children and for all other purposes. The new legislation -- which was supported by the Federal Reserve -- eliminated these specific dollar limitations, and the Board in October 1982 conformed Regulation O to the new legislation with respect to home mortgage and education loans.
>
> To further implement the provisions of the new legislation, the Board amended Regulation O as follows:
>
> --With respect to loans for purposes other than home mortgages or education a member bank may lend to an executive officer up to $25,000 or 2.5 percent of its capital and unimpaired surplus, whichever is greater, with an overall limit of $100,000.
>
> --Prior approval is required of a state member bank's board of directors for a loan to an insider (including related interests of the insider) that, taken together with other such loans, exceeds the higher of $25,000 or 5 percent of the bank's capital and surplus.
>
> --Lending to an insider may not exceed, in the aggregate, the limit of credit that may be extended to any one borrower (15 percent of the bank's capital and surplus for loans not fully collateralized and an additional 10 percent of the bank's capital and surplus for loans that are fully collateralized).
>
> --Prior approval of the bank's directors is required for all loans exceeding $500,000 in the aggregate.

Enclosed -- for member banks and others who maintain sets of the Board's regulations -- is the text of the amendments to Regulation O, which has been reprinted from the *Federal Register* of September 20, 1983. Questions regarding that regulation may be directed to our Regulations Division (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,
President.

Board of Governors of the Federal Reserve System

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

AMENDMENTS TO REGULATION O

(effective October 20, 1983)

FEDERAL RESERVE SYSTEM

12 CFR Part 215

[Docket No. R-0469]

Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Lending Limits

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board of Governors of the Federal Reserve System is amending Regulation O (12 CFR Part 215), which governs loans by a member bank to insiders, to implement amendments to 12 U.S.C. 84, and sections 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. 375a and 375b) that were included in Title IV of the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97–320, 96 Stat. 1469). The amendments relate to the limitations on loans by a member bank to its executive officers, the aggregate dollar limitation on loans by a member bank to its insiders, and the dollar amount above which loans by a member bank to its insiders must be approved in advance by the board of directors of the member bank.

EFFECTIVE DATE: October 20, 1983

FOR FURTHER INFORMATION CONTACT: Jennifer Johnson, Senior Counsel (202/452–3584), or Stephen Lovette, Supervisory Financial Analyst (202/452–3622), Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: Prior to the enactment of the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97–320, 96 Stat. 1469) ("Garn Act"), section 22(g) of the Federal Reserve Act prescribed the following limitations on loans by a member bank to its executive officers: $60,000 for a home mortgage; $20,000 to finance the education of the officer's children; and $10,000 for all other purposes. Section 421(a) of the Garn Act eliminated the specific dollar limitation on home mortgage and educational loans and on November 1, 1982, the Board amended Regulation O to provide that a member bank may extend credit to its executive officers in any amount for home mortgage or educational purposes (47 FR 49347 (1982)).

Section 421(b) of the Garn Act eliminated the dollar limitation for "other" loans and now provides that the member bank's appropriate federal regulatory agency shall prescribe a limit for such loans. The rule adopted by the Board to implement this statutory change provides that, for other than home mortgage or educational purposes (for which there are no dollar limitations), a state member bank may lend to any of its executive officers up to $25,000 or 2.5 percent of its capital and unimpaired surplus, whichever amount is higher.[1] However, at no time may the bank's outstanding loans to any executive officer for other than home mortgage or educational purposes exceed $100,000.

In response to comments received and in order that the rules proposed by all of the federal regulatory agencies will be uniform, the term "capital and unimpaired surplus" has been substituted for the term "capital," wherever it appeared in the proposal. In response to other comments received regarding the new limitations on "other" loans, the rule clarifies that the new limitations on such loans apply also to loans to partnerships in which one or more executive officers of the member bank is a partner holding a majority interest. In other words, a member bank may lend an amount equal to 2.5 percent of its capital and unimpaired surplus or $100,000, whichever is lower, to a partnership in which one or more of its executive officers has a majority interest.

Also prior to the enactment of the Garn Act, section 22(h)(2) of the Federal Reserve Act provided that no member bank should lend to any executive officer, director or principal shareholder, or to any related interest of such person, if the amount of the loan, when aggregated with all other loans to such executive officer, director or principal shareholder, or to any related interest of such person, exceeded $25,000, unless the loan was approved in advance by a majority of the bank's entire board of directors, with the interested party abstaining from the vote. Section 422 of the Garn Act eliminated the specific

[1]The appropriate limits for national banking associations, which are identical to the limits adopted herein, are contained in regulations of the Comptroller of the Currency.

For this Regulation to be complete, retain:

1) Regulation O pamphlet, amended effective December 31, 1979.
2) Amendments effective November 1, 1982.
3) This slip sheet.

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dollar amount in section 22(h)(2) and now provides that the member bank's appropriate federal regulatory agency shall prescribe the amount above which the prior approval of the bank's board of directors is required.

The rule adopted by the Board provides that a state member bank must obtain the prior approval of its board of directors for a loan to an executive officer, director or principal shareholder, or to any related interest of that person, if the amount of such loan, when aggregated with all other loans to that person or to any related interest of that person, exceeds $25,000 or 5 percent of the member bank's capital and unimpaired surplus, whichever is higher.[2] In addition, regardless of the size of the bank, all loans to insiders that exceed $500,000 in the aggregate require the prior approval of the bank's board of directors.

Section 22 h(1) of the Federal Reserve Act provides that no member bank shall make any loan to any of its executive officers, principal shareholders or to any related interest of such persons in an amount that, when aggregated with all other loans made to such person or to any related interest of such person, exceeds the limit in section 5200 of the Revised Statutes (12 U.S.C. 84) on loans to a single borrower by national banks. Section 401 of the Garn Act increased the limit in section 5200 of the Revised Statutes, effective April 15, 1983, and the rule amends the definition of "lending limit" in Regulation O accordingly. In states where applicable laws have established lending limits that are lower than the limits in section 5200 of the Revised Statutes, state member banks are required to comply with the lower state lending limits.

The Board received 35 comments on the proposed amendments, only two of which opposed the proposal. One unfavorable commenter indicated that it would favor the proposal if the term "capital and unimpaired surplus" was substituted for the term "capital" in the amendment. Numerous other commenters made this suggestion, stating that the suggested term is the term used in the section of Regulation O that defines the lending limit for member banks. The final rule includes this suggestion and the term "capital and unimpaired surplus" has been substituted for the term "capital" in the final rule.

The other unfavorable comment indicated the commenter's belief that increasing the limit on loans to executive officers to a maximum of $100,000 would permit executive officers to enter business transactions that would be detrimental to their banks. This commenter did not offer any reason in support of the belief that the loans would be detrimental to banks.

The Board does not believe that increasing the lending limit as proposed is likely to cause harm to member banks. In the first place, the rule provides that the lending limit is 2.5 percent of the capital and unimpaired surplus of the member bank rather than a flat $100,000. Only banks with approximate total assets of $55,000,000 or more would be permitted to lend $100,000 to their executive officers. In addition, loans to executive officers must be on the same terms as loans to other customers and cannot involve more than the normal risk of repayment or present other unfavorable features. Finally, loans to executive officers are reviewed by the appropriate regulatory agency during the on site examinations of member banks. Thus, the Board believes the rule would not endanger the safety and soundness of member banks but would merely place insiders on the same footing as other borrowers from the bank.

Several of the commenters, while agreeing with the Board's plan to increase the limits applicable to loans to insiders, suggested that other methods be used to establish the limits. These suggestions have been considered, and the Board has concluded that the most convenient and appropriate method for determining the lending limit and prior approval amount with respect to loans to insiders is a percentage of the bank's capital and unimpaired surplus.

Other commenters agreed with the percentage of capital approach but suggested that the $100,000 maximum for loans to executive officers be increased to as much as $500,000 and the $500,000 amount above which prior approval is required be increased to as much as $5 million. The Board has evaluated these suggestions and determined that the amounts it proposed previously will reduce the burden imposed on the banking industry by the statutory requirements and permit continuing review of loans to insiders that could affect the safety and soundness of member banks.

Finally, some commenters offered technical amendments and nonsubstantive wording changes that have been included in the final rule.

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96–354; 5 U.S.C. 601 *et seq.*), the Board of Governors of the Federal Reserve System certifies that the amendments will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation. The amendments will liberalize existing regulations and will not have any particular effect on small entities that would be subject thereto.

List of Subjects in 12 CFR Part 215

Banks—Banking, Credit, Reporting and recordkeeping requirements.

Accordingly, pursuant to its authority under sections 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. 375a and 375b), the Board of Governors is amending 12 CFR Part 215 (Regulation O) as follows:

1. Paragraph (f) of § 215.2 is amended by revising the first two sentences and adding a third sentence. As amended, paragraph (f) reads as follows:

§ 215.2 Definitions.

* * * * *

(f) The "lending limit" for a member bank is an amount equal to the limit of loans to a single borrower established by section 5200 of the Revised Statutes.[2] 12 U.S.C. 84. This amount is 15 per cent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured, and and additional 10 per cent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the loan. The lending limit also includes any higher amounts that are permitted by section 5200 of the Revised Statutes for the types of obligations listed therein as exceptions to the 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.

[2] Where state law establishes a lending limit for a state member bank that is lower than the amount permitted in section 5200 of the Revised Statutes, the lending limit established by applicable state laws shall be the lending limit for the state member bank.

[3] Id.

2. Paragraph (b)(1) of § 215.4 is revised to read as follows:

§ 215.4 General prohibitions.

* * * * *

(b) *Prior Approval.* (1) No member bank may extend credit (which term includes granting 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 to that person and to all related interests of that person, exceeds the higher of $25,000 or 5 per cent of the member bank's capital and unimpaired surplus, unless: (i) The extension 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. In no event may a member bank extend credit to any one of its executive officers, directors, or principal shareholders, or to any related interest of that person, in an amount that, when aggregated with all other extensions of credit to that person, and all related interests of that person, exceeds $500,000, except by complying with the requirements of this paragraph.

* * * * *

3. The first sentence of paragraph (b) of § 215.5 is revised to read as follows:

§ 215.5 Additional restrictions on loans to executives officers of member banks.

* * * * *

(b) No member bank may extend credit in an aggregate amount greater than the amount permitted in paragraph (c)(3) of this section to a partnership in which one or more of the bank's executive officers are partners and, either individually or together, hold a majority interest. * * *

* * * * *

4. The first sentence of paragraph (c)(3) of § 215.5 is revised to read as follows:

* * * * *

(c) * * *

(3) for any other purpose not specified in § 215.5(c)(1) and (2), if the aggregate amount of loans to that officer under this paragraph does not exceed at any one time the higher of 2.5 per cent of the bank's capital and unimpaired surplus or $25,000, but in no event more than $100,000.

* * * * *

5. Footnotes 2 to 11 are renumbered footnotes 3 to 12.

* * * * *

6. The Appendix is revised to read as follows:

Appendix—Section 5200 of the Revised Statutes Total Loans and Extensions of Credit

(a)(1) The total loans and extensions of credit by a national banking association to a person outstanding at one time and not fully secured, as determined in a manner consistent with paragraph (2) of this subsection, by collateral having a market value at least equal to the amount of the loan or extension of credit shall not exceed 15 per centum of the unimpaired capital and unimpaired surplus of the association.

(2) The total loans and extensions of credit by a national banking association to a person outstanding at one time and fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the funds outstanding shall not exceed 10 per centum of the unimpaired capital and unimpaired surplus of the association. This limitation shall be separate from and in addition to the limitations contained in paragraph (1) of this subsection.

Definitions

(b) For the purposes of this section—

(1) the term "loans and extensions of credit" shall include all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds or repayable from specific property pledged by or on behalf of the person, and to the extent specified by the Comptroller of the Currency, such term shall also include any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment; and

(2) the term "person" shall include an individual, sole proprietorship, partnership, joint venture, association, trust, estate, business trust, corporation, sovereign government, or agency, instrumentality, or political subdivision thereof, or any similar entity or organization.

Exceptions

(c) The limitations contained in subsection (a) of this section shall be subject to the following exceptions:

(1) Loans or extensions of credit arising from the discount of commercial or business paper evidencing an obligation to the person negotiating it with recourse shall not be subject to any limitation based on capital and surplus.

(2) The purchase of bankers' acceptances of the kind described in section 372 of this title and issued by other banks shall not be subject to any limitation based on capital and surplus.

(3) Loans and extensions of credit secured by bills of lading, warehouse receipts, or similar documents transferring or securing title to readily marketable staples shall be subject to a limitation of 35 per centum of capital and surplus in addition to the general limitations if the market value of the staples securing each additional loan or extension of credit at all times equals or exceeds 115 per centum of the outstanding amount of such loan or extension of credit. The staples shall be fully covered by insurance whenever it is customary to insure such staples.

(4) Loans or extensions of credit secured by bonds, notes, certificates of indebtedness, or Treasury bills of the United States or by other such obligations fully guaranteed as to principal and interest by the United States shall not be subject to any limitation based on capital and surplus.

(5) Loans or extensions of credit to or secured by unconditional takeout commitments or guarantees of any department, agency, bureau, board, commission, or establishment of the United States or any corporation wholly owned directly or indirectly by the United States shall not be subject to any limitation based on capital and surplus.

(6) Loans or extensions of credit secured by a segregated deposit account in the lending bank shall not be subject to any limitation based on capital and surplus.

(7) Loans or extensions of credit to any financial institution or to any receiver, conservator, superintendent of banks, or other agent in charge of the business and property of such financial institution, when such loans or extensions of credit are approved by the Comptroller of the Currency, shall not be subject to any limitation based on capital and surplus.

(8)(A) Loans and extensions of credit arising from the discount of negotiable or nonnegotiable installment consumer paper which carries a full recourse endorsement or unconditional guarantee by the person transferring the paper shall be subject under this section to a maximum limitation equal to 25 per centum of such capital and surplus, notwithstanding the collateral requirements set forth in subsection (a)(2) of this section.

(B) If the bank's files or the knowledge of its officers of the financial condition of each maker of such consumer paper is reasonably adequate, and an officer of the bank designated for that purpose by the board of directors of the bank certifies in writing that the bank is relying primarily upon the responsibility of each maker for payment of such loans or extensions of credit and not upon any full or partial recourse endorsement or guarantee by the transferor, the limitations of this section as to the loans or extensions of credit of each such maker shall be the sole applicable loan limitations.

(9)(A) Loans and extensions of credit 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 note covered, shall be subject under this section notwithstanding the collateral requirements set forth in subsection (a)(2) of this section, to a maximum limitation equal to 25 per centum of such capital and surplus.

(B) Loans and extensions of credit which arise from the discount by dealers in dairy cattle of paper given in payment for dairy cattle, which paper carries a full recourse endorsement or unconditional guarantee of the seller, and which are secured by the cattle being sold, shall be subject under this section, notwithstanding the collateral requirements set forth in subsection (a)(2) of this section, to a limitation of 25 per centum of such capital and surplus.

(10) Loans or extensions of credit to the Student Loan Marketing Association shall not be subject to any limitation based on capital and surplus.

Authority of Comptroller of the Currency

(d)(1) The Comptroller of the Currency may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to define or further define terms used in this section and to establish limits or requirements other than those specified in this section for particular classes or categories of loans or extensions of credit.

(2) The Comptroller of the Currency also shall have authority to determine when a loan putatively made to a person shall for purposes of this section be attributed to another person.

Board of Governors of the Federal Reserve System, September 1, 1983.

William W. Wiles,

Secretary of the Board.

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