FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10518**
March 3, 1992]

PROPOSED AMENDMENTS TO REGULATIONS O AND Y

Comments Invited by March 23

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

The following statement has been issued by the Board of Governors of the Federal Reserve System:

> The Federal Reserve Board has issued for public comment a proposal to revise the Board's Regulations O and Y to conform the regulations to the amendments of section 22(h) of the Federal Reserve Act (12 U.S.C. §375b) made by section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991.
>
> Comment is requested by March 23, 1992.

Printed on the following pages is the text of the proposal, which has been reprinted from the *Federal Register.* Comments thereon should be submitted by March 23, and may be sent to the Board of Governors, as specified in the Board's notice, or to our Domestic Banking Department.

E. GERALD CORRIGAN,
President.

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FEDERAL RESERVE SYSTEM

12 CFR Parts 215 and 225

[Docket No. R-0747]

Regulation O—Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Regulation Y—Bank Holding Companies and Change in Bank Control

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing to revise Regulations O and Y to conform the regulations to the amendments of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) made by section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). Section 22(h) restricts the amount and terms of extensions of credit from a bank to its executive officers, directors, and principal shareholders and to any company or political campaign controlled by a bank's executive officers, directors, or principal shareholders. The Board promulgated Regulation O to implement this statute.

The proposal would revise Regulation O to implement the amendments of section 22(h) made by the FDICIA and to make certain technical corrections. The proposal also would revise Regulation Y to implement a loan reporting requirement created by the FDICIA that applies to executive officers and directors of certain bank holding companies.

DATES: Comments must be received by March 23, 1992.

ADDRESSES: Comments, which should refer to Docket No. R-0747, may be mailed to the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551, to the attention of Mr. William W. Wiles, Secretary; or delivered to the Board's Mail Room between 8:45 a.m. and 5:15 p.m., or to the Board's Security Control Room outside of those hours. Both the Mail Room and the Security Control Room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in room B-1122 between 9 a.m. and 5 p.m. weekdays, except as provided in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Andrew Karp, Attorney (202/452-3554), Legal Division; Stephen M. Lovette, Manager (202/452-3622), or William G. Spaniel (202/452-3469), Senior Financial Analyst, Division of Banking Supervision and Regulation. For the hearing impaired only, Telecommunications Device for the Deaf ("TDD"), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: On December 19, 1991, the President signed into law the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").[1] Section 306 of the FDICIA amends section 22(h) of the Federal Reserve Act (12 U.S.C. 375b).[2] Section 22(h) restricts the amount and terms of extensions of credit from a bank to its executive officers, directors, and principal shareholders (collectively, "insiders") and to any company or political campaign controlled by an insider ("related interests"). The Board promulgated Regulation O to implement this statute. In general, section 22(h):

1. Requires a bank's board of directors to approve any extension of credit to an insider or a related interest in excess of a threshold amount (generally the higher of $25,000 or five percent of the bank's capital and unimpaired surplus, up to $500,000);

2. Prohibits any extension of credit to an insider or a related interest on preferential terms;

3. Limits the amount a bank may lend to each of its executive officers and principal shareholders and their related interests; and

4. Prohibits overdrafts to executive officers and directors (but not to principal shareholders).

Section 306 of the FDICIA replaces the language of section 22(h) with the provisions of the Board's Regulation O without making substantial changes. Specifically, section 306 makes the following substantive modifications of and additions to section 22(h):

1. Requires that, when lending to an insider, a bank follow credit underwriting procedures that are "not less stringent than those applicable to comparable transactions by the bank with (persons outside the bank)."

2. Subjects directors (and their related interests) to the same aggregate lending limit currently applicable to executive officers and principal shareholders (and of their related interests) under section 22(h).[3]

Previously, section 22(h) did not limit the amount directors and their related interests could borrow from their banks.

3. Creates a new limitation on the total amount a bank may lend in the aggregate to its insiders and their related interests as a class. In general, this limit is equal to the bank's unimpaired capital and surplus.

4. Defines the term "member bank" to include any subsidiary of the member bank, clarifying that an extension of credit from a subsidiary of a member bank is subject to the same insider restrictions as an extension credit from the member bank itself.

5. Tightens the definition of principal shareholder for banks located in small communities. Currently, a principal shareholder is a person who owns or controls more than 10 percent of a class of the voting shares of a bank, except for banks located in communities with populations of less than 30,000, in which case the amount is 18 percent. The 10 percent definition now applies to all banks, regardless of the size of the community where the bank is located.

6. Covers all companies that owns banks, regardless of whether the company is technically a bank holding company.

7. Prohibits insiders from knowingly receiving (or knowingly permitting their related interests to receive) any extension of credit not authorized by section 22(h).

8. Defines the terms "company," "control," "executive officer," "extension of credit," "related interest," and "subsidiary." Each definition is consistent with the corresponding definitions in current Regulation O.

9. Requires executive officers and directors of member banks and bank holding companies without publicly traded stock to report to their institutions annually the outstanding amount of any loan that is secured by shares of the insider's institution.

The proposal would revise Regulation O to implement the amendments of section 22(h) made by the FDICIA and to make certain technical corrections. The proposal does not modify the present regulation where the statutory amendments track the present

[1] Pub. L. No. 102-242, 105 Stat. 2236 (1991).

[2] The FDICIA requires the Board to promulgate regulations that implement the FDICIA amendments by April 17, 1992.

[3] This amount is 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured. In calculating this limit, all of the bank's loans to the insider and the insider's related interests are aggregated.

PRINTED IN NEW YORK, FROM *FEDERAL REGISTER*, VOL. 57, NO. 34, pp. 6077-81

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regulatory language.[4] The proposal also would revise Regulation Y to implement a loan reporting requirement created by the FDICIA that applies to executive officers and directors of certain bank holding companies.

The FDICIA provides that amendments made by the FDICIA do not affect the validity of any extension of credit or other transaction lawfully entered into on or before the effective date of the FDICIA amendments. The effective date of the amendments relating to Regulation O is the earlier of (i) the date on which the required revisions to Regulation O become effective or (ii) 150 days after the date of enactment of the FDICIA.

As noted above, the FDICIA amendments establish a new limit on the total amount a member bank may lend to its insiders as a class. The statute generally restricts that amount to an amount no greater than the bank's unimpaired capital and surplus, but authorizes the Board to (i) set a more stringent general limit and (ii) make an exception to the limit for banks with deposits of less than $100 million if the Board determines that the exception would be "important to avoid constricting the availability of credit in small communities or to attract directors to such banks." The statute provides that a limit implemented under the small bank exception may not exceed 200 percent of the bank's unimpaired capital and surplus.

The proposed total limit—100 percent of a bank's unimpaired capital and unimpaired surplus—is the same as provided in the statute. The Board requests comment regarding whether to provide an exception to the general limit for banks with deposits of less than $100 million. In particular, the Board requests comment on whether a 100 percent limit would inhibit unduly lending by small banks or limit the availability of directors for such banks, especially with respect to banks that may rely on certain exceptions to the National Bank Act's loans to one borrower rules (such as the exceptions for loans secured by bills of lading, warehouse receipts or similar documents covering marketable staples, or loans secured by livestock, or dairy cattle). In connection with these requests, the Board requests that commenters submit specific data as to the effect of the new aggregate limit.

The proposal also contains several technical revisions to conform Regulation O with section 306 and to correct existing ambiguities. In this respect, the proposal would, for example:

1. Clarify that, where Regulation O provides more liberal limits on member bank extensions of credit to their executive officers to finance a residence, the residence must be the executive officer's primary residence.

2. Modify the requirement that member bank loans to executive officers be "made subject to the condition that the extension of credit will, at the option of the member bank, become due and payable" to clarify that the condition must be in writing.

3. Replace the term "bank" with the term "insured depository institution" where appropriate to reflect statutory usage.

4. Provide a dedicated definition of foreign bank that is the same as the existing definition that is provided in the definition of member bank.

5. Replace the term "capital stock" with "unimpaired capital" where appropriate to reflect statutory usage.

6. Add a date specification to the calculation of valuation reserves for purposes of determining a bank's unimpaired capital and unimpaired surplus under Regulation O.

7. Clarify the definition of extension of credit on which a party may be liable.

Section-by-Section Analysis

The following describes the proposed revisions to Regulation O.

Sections 215.2(a), 215.9: The proposed revision replaces the term "bank" with the term "depository institution" to reflect statutory usage.

Sections 215.2 (c), (d), and (k), 215.4(c): The proposed revision replaces the term "bank holding company" with the term "company" and removes the reference to the statutory definition of bank holding company.

Section 215.2(e): The proposed revision creates a new paragraph (e) that relocates the existing Regulation O definition of the term "foreign bank." The definition, which remains unchanged, was previously part of the Regulation O definition of "member bank."

Section 215.2(e) through (l): The proposed revision redesignates these paragraphs as § 215.2 (f) through (m) to accommodate new § 215.2(e).

Section 215.2(g): The proposed revision replaces the regulatory term "capital stock" with the statutory term "unimpaired capital" and adds a date specification to the definition of valuation reserves for purposes of calculating a bank's capital.

Section 215.2(h): The proposed revision clarifies that the term "member bank" includes any subsidiary of the member bank.

Section 215.2(k): The proposed revision replaces the phrase "an individual or company" with the term "person" to reflect statutory usage. The proposed revision also strikes the sentence that implemented the control standard for determining "principal shareholder" of banks located in communities with populations of less than 30,000 persons.

Section 215.2(l): The proposed revision adds the phrase "of a person" to the definition of "related interest" to reflect statutory usage.

Section 215.3(a)(4): The proposed revision replaces the term "person" with the phrase "an executive officer, director, or principal shareholder of the acquiring member bank" to clarify that the definition applies when the party liable is a bank insider.

Section 215.4(a)(1): The proposed revision adds to the existing qualitative requirements the new requirement that, in extending credit to an insider, a member bank follow credit underwriting procedures no less stringent than those prevailing for comparable transactions with non-insiders. The proposed revision also replaces the term "repayment" with the term "default" to characterize more accurately the risk described.

Section 215.4(b)(2): The proposed revision reorganizes section 215.4(b) by creating a new subparagraph (2) to contain the existing $500,000 limitation. The limitation provision is not modified substantively.

Section 215.4(b) (2) and (3): The proposed revision redesignates existing § 215.4(b) (2) and (3) as 215.4(b) (3) and (4) to accommodate new § 215.4(b)(2).

Section 215.4(c): The proposed revision adds the term "directors" to the list of persons subject to the aggregate lending limit. This reflects the FDICIA revision to section 22(h) that subjects directors to the section 22(h) aggregate lending limit.

Section 215.4(e): The proposed revision creates a new paragraph (e). This paragraph implements the new aggregate limit on extensions of credit to all insiders as a class mandated by the FDICIA.

Section 215.5(a), footnote 4: The proposed revision strikes the first sentence to reflect the FDICIA revisions that revise section 22(g) of the Federal Reserve Act to cover non-member insured banks.

Section 215.5(c)(3): The proposed revision adds the term "the primary" to

[4] Thus, for example, the existing regulatory definitions of "control," "executive officer," "extension of credit," "overdraft," "related interest," and "subsidiary" remain unchanged, as the new statutory definitions are fully consistent with the present regulatory definitions.

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clarify that the amount limit under this subparagraph applies to an executive officer's primary residence.

Section 215.5(d): The proposed revision adds the phase "in writing" after the term "condition" to clarify that the condition required by this subparagraph must be in writing. The proposed revision also adds the term "corresponding" before the phase "category of credit."

Section 215.6: The proposed revision creates a new § 215.6 that implements FDICIA revisions to section 22(h) that prohibit an insider from knowingly receiving (or knowingly permitting the insider's related interest from receiving) an extension of credit that is not authorized under Regulation O.

Section 215.5 through 215.9: The proposed revision redesignates these sections as §§ 215.7 through 215.10 to accommodate new § 215.6.

Section 215.9: The proposed revision adds the term "corresponding" before the phrase "category of credit."

Section 215.11: The proposed revision redesignates § 215.11 as § 215.12 and adds a new § 215.11 to implement the FDICIA requirement that executive officers and directors of certain member banks report certain credits to the board of directors of the executive officer's or director's member bank.

The following describes the proposed revision to Regulation Y.

Section 225.4(f): The proposed amendment adds a new paragraph (f) to implement the FDICIA requirement that executive officers and directors of certain bank holding companies report certain credits to the board of directors of the executive officer's or director's bank holding company.

Regulatory Flexibility Act Analysis

The Federal Reserve Board does not believe that adoption of the proposed amendments would have a significant economic impact on a substantial number of small business entities (in this case, small banking organizations).

List of Subjects

12 CFR Part 215

Credit, Federal Reserve System, Reporting and recordkeeping requirements, Security measures.

12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this proposed rule, and pursuant to the Board's authority under sections 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. 375a and 375b), section 5(b) of the Bank Holding Company Act (12 U.S.C. 1844(b)), and section 306 of the Federal Deposit Insurance Corporation Improvement Act (Pub. L. No. 102–242, 105 Stat. 2236 (1991), the Board is proposing to amend 12 CFR part 215 subpart A and 12 CFR part 225 subpart A to read as follows:

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

Subpart A—Loans by Member Banks to Their Executive Offices, Directors, and Principal Shareholders

1. The authority citation for part 215 continues to read as follows:

Authority: Sections 11(i), 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. 248(i), 375a, and 375(b)) and 12 U.S.C. 1817(k)(3).

2. In part 215, the footnotes are redesignated as shown below:

Section and paragraph	Current No.	New No.
§§ 215.4(c)	3	[1].
215.4(d)	4	3
215.5(a)	5	4
215.8	6	5
215.9	7	6
215.10	8	7

[1] Removed.

3. 12 CFR 215.2 is amended by revising paragraph (a), redesignating paragraphs (e) through (l) as paragraphs (f) through (m), adding a new paragraph (e), and revising redesignated paragraphs (g), (h), (k), and (l) to read as follows:

§ 215.2 Definitions.

* * * * *

(a) "*Company*" means any corporation, partnership, trust (business or otherwise), association, joint venture, pool syndicate, sole proprietorship, unincorporated organization, or any other form of business entity not specifically listed herein. However the term does not include (1) an insured depository institution (as defined in 12 U.S.C. 1813) or (2) a corporation the majority of the shares of which are owned by the United States or by any State.

* * * * *

(e) "Foreign bank" has the meaning given in 12 U.S.C. 3101(7).

* * * * *

(g) 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 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured, and additional 10 percent 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 amount that are permitted by section 5200 of the Revised Statues for the types of obligations listed therein as exceptions to the limit. A member bank's unimpaired capital 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 as reported on its most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3).

(h) "Member bank" means any banking institution that is a member of the Federal Reserve System, including any subsidiary of a member bank. The term does not include any foreign bank 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. 1838(j)(2).

* * * * *

(k) "Principal shareholder" means a person (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 percent of any class of voting securities of a member bank or company. 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 company of which the member bank is a subsidiary and (2) a principal shareholder of any other subsidiary of that company.

(l) "Related interest" of a person means (1) a company that is controlled

[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 Statues, the lending limit established by applicable state laws shall be the lending limit for the state member bank.

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by that person or (2) a political or campaign committee that is controlled by that person or the funds or services of which will benefit that person.

* * * * *

4. 12 CFR 215.3 is amended by revising paragraph (a)(4) to read as follows:

§ 215.3 Extension of credit.

(a) * * *

(4) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which an executive officer, director or principal shareholder of the acquiring member bank may be liable as maker, drawer, endorser, guarantor, or surety;

* * * * *

5. 12 CFR 215.4 is amended by revising paragraphs (a)(1) and (c), and adding paragraph (e) to read as follows:

§ 215.4 General prohibitions.

(a)* * *

(1) is made on substantially the same terms, (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, 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 default or present other unfavorable features.

* * * * *

(c) *Aggregate lending limit.* No member bank may extend 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 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 § 215.2(g) of this part. This prohibition does not apply to an extension of credit by a member bank to a company of which the member bank is a subsidiary or to any other subsidiary of that company.

* * * * *

(e) *Aggregate limit on extensions of credit to all executive officers, directors, and principal shareholders.* A member bank may extend credit to any executive officer, director or principal shareholder, or to any related interest of such a person, if the extension of credit is in an amount that, when aggregated with the amount of all outstanding extensions of credit by that bank to its executive officers, directors or principal shareholders and the related interests of those persons would not exceed the bank's unimpaired capital and unimpaired surplus (as defined at § 215.2(g)).

6. 12 CFR 215.5 is amended by revising redesignated footnote 4 in paragraph (a), and paragraph (c)(2) and (d) to read as follows:

215.5 Additional restrictions on loans to executive officers of member banks.

(a) * * * [4]

* * * * *

(c) * * *

(2) in any amount of finance the purchase, construction, maintenance, or improvement of the primary 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

* * * * *

(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 § 215.4(a) of this part; (3) preceded by the submission of a detailed current financial statement of the executive officer; and (4) made subject to the condition in writing that the extension of credit will, at the option of the member bank, become due an payable at any time that the officer is indebted to any bank or banks in an aggregate amount greater than the amount specified for a corresponding category of credit in paragraph (c) of this section.

7. 12 CFR 215.11 is redesignated as § 215.13, §§ 215.6 through 215.10 are redesignated as §§ 215.7 through 215.11, respectively, and a new § 215.6 is added to read as follows:

§ 215.6 Prohibition of knowingly receiving unauthorized extension of credit.

No executive officer, director, or principal shareholder of a member bank shall knowingly receive (or knowingly permit any of that person's related interests to receive) from a member bank, directly or indirectly, any extension of credit not authorized under this section.

8. Redesignated 12 CFR 215.9 is revised to read as follows:

§ 215.9 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 corresponding category of credit in § 215.5(c) of this part, 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.

§ 215.11 [Added]

9. A new 12 CFR 215.11 is added to read as follows:

Each executive officer or director of a member bank the shares of which are not publicly traded shall report annually to the board of directors of the member bank the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the member bank.

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

Subpart A—General Provisions

1. The authority for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818i, 1831(i), 1843(c)(8), 1844(b) 3106, 3108, 3907, 3909, 3310, and 3331–3351.

2. 12 CFR 225.4 is amended by adding paragraph (f) to read as follows:

§ 225.4 Corporate practices.

* * * * *

(f) *Loan reporting requirements.* Each executive officer or director of a bank holding company the shares of which are not publicly traded shall report annually to the board of directors of the bank holding company the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the bank holding company. For purposes of this paragraph, the terms "executive officer" and "director" shall have the meaning given in § 215.2 of Regulation O, 12 CFR 215.2

Board of Governors of the Federal Reserve System, February 13, 1992.

Jennifer J. Johnson,

Associate Secretary of the Board.

[FR Doc. 92–3879, Filed 2–19–92; 8:45 am]

BILLING CODE 6210–01–M

[4] For the purposes §§ 215.5, 215.9 and 215.10 of this part, 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.

[5] See footnote 4 to § 215.5(a).