FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10543**
June 9, 1992]

REGULATIONS O AND Y AMENDMENTS

— Lending Limits and Reporting Requirements on Loans to Insiders

— Expansion of Permissible Leasing Activities of Bank Holding Companies

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

The Board of Governors of the Federal Reserve System has adopted amendments to its Regulations O and Y to implement the requirements of the Federal Deposit Insurance Corporation Improvement Act of 1991 with regard to loans to bank and bank holding company insiders. Note, as explained below, that the effective date of these amendments, as published in the *Federal Register* of May 19, was incorrect; the effective date for those amendments is *May 18, 1992*. In addition the Board has amended Regulation Y, effective May 14, 1992, to expand the leasing activities permissible to bank holding companies to include non-full-payout leasing.

The following statements were issued by the Board in announcing the amendments and the *Federal Register* correction:

Loans to Insiders

The Federal Reserve Board has announced approval of amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks) to implement the requirements of section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

The most significant changes are:

- a new aggregate lending limit applicable to all of a bank's insiders; and
- the extension of an existing Regulation O lending limit on loans to directors and their related interests.

In connection with the implementation of the general aggregate insider lending limit, the Board has determined to exercise its discretion under FDICIA to permit banks with deposits of less than $100 million to establish a higher limit up to a maximum of two times the bank's unimpaired capital and unimpaired surplus.

The higher aggregate limit will be effective for a one-year period during which the Board, in consultation with the other Federal banking agencies, will collect specific data on bank lending to insiders, including directors, in order to analyze the effect of a limitation on the ability of banks to attract directors and to serve the credit needs of local communities.

The Board also announced approval of an amendment to Regulation Y (Bank Holding Companies and Change in Bank Control) to implement a credit reporting requirement created by FDICIA that applies to executive officers and directors of certain bank holding companies.

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Correction of Effective Date

The amendments to Regulation O and Y that the Board adopted to implement the requirements of section 306 of the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") are effective as of May 18, 1992.

The Board took this action in light of the fact that the requirements of section 306 of the FDICIA became effective on that date. The Board has issued a notice to correct the effective date of the final rule published in the Tuesday, May 19, 1992, issue of the *Federal Register.*

The original *Federal Register* notice contained an effective date of June 18, 1992, which was in error.

Leasing Activities

The Federal Reserve Board has announced approval of amendments to Regulation Y (Bank Holding Companies and Change in Bank Control) to expand the leasing activities that are generally permissible for bank holding companies to include non-full-payout leasing.

The amendments raise the maximum estimated residual value of leased personal property on which bank holding companies may rely for their compensation in leasing transactions to up to 100 percent of the acquisition cost of the leased property, subject to certain conditions, including volume limitations.

These transactions remain subject to the prudential limitations previously set forth in Regulation Y.

Enclosed is a copy of the text of (1) the corrected amendments to Regulations O and Y, effective May 18, 1992, revising the lending limits on insider loans, and (2) the amendments to Regulation Y, effective May 14, 1992, expanding leasing activities generally permissible to bank holding companies.

Questions regarding the insider lending amendments may be directed to our Domestic Banking Department (Tel. No. 212-720-6611); questions regarding the leasing activity amendments may be directed to our Domestic Banking Applications Division (Tel. No. 212-720-5861).

E. Gerald Corrigan,
President.

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Board of Governors of the Federal Reserve System

AMENDMENTS TO REGULATION Y

Leasing Activities Permissible to Bank Holding Companies

Effective May 14, 1992

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R-0694]

RIN 7100-AB12

Bank Holding Companies and Change in Bank Control Leasing Personal Property

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending Regulation Y to expand the leasing activities that are generally permissible for bank holding companies. The rule allows bank holding companies to enter into leasing transactions in which the companies may rely for compensation of their full leasing costs, at the inception of the initial lease, on estimated residual values for the leased property of up to 100 percent of the acquisition cost of the property, subject to certain conditions (so-called "higher residual value leasing"). The Board has by order previously permitted bank holding companies to engage in higher residual value leasing. The final rule requires that higher residual value leasing transactions conform to the current leasing provision in Regulation Y except with respect to the residual value reliance limitation. The final rule contains additional requirements applicable only to the expanded leasing activity. These requirements include a limit on the volume of such leasing transactions similar to the limitation placed on the leasing activities of national banks under section 108 of the Competitive Equality Banking Act (CEBA), amending the National Bank Act.

The final rule also alters the existing authority for a bank holding company to engage in full-payout leasing transactions by permitting bank holding companies to engage in these transactions and rely for compensation of their full leasing costs, at the inception of the initial lease, on estimated residual values for the leased property of up to 25 percent of the acquisition cost of the property.

EFFECTIVE DATE: May 14, 1992.

FOR FURTHER INFORMATION CONTACT: Scott G. Alvarez, Associate General Counsel (202/452–3583), Thomas M. Corsi, Senior Attorney (202/452–3275) Donna R. Nordenberg, Attorney (202/452–3281), Legal Division; Molly S. Wassom, Manager, Applications Issues (202/452–2305), or Theresa A. Claffey, Supervisory Financial Analyst (202/452–2964), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION:

Background

Since 1971, bank holding companies have been permitted to engage in leasing personal or real property where the lease is the functional equivalent of an extension of credit (so-called "full-payout leasing"). Under Regulation Y, full-payout leases must be on a nonoperating basis and only upon the order of customers.[1] In addition, at the inception of the initial lease, the effect of the transaction must yield a return that will compensate the bank holding company for its full leasing costs (including the total cost of financing the property) through rentals, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial term of the lease. In calculating this yield, the existing regulation limits reliance on estimated residual values to a maximum of 20 percent of the acquisition cost of the property. In the case of a personal property lease of no more than seven years in duration, bank holding companies may rely on an additional amount, up to 60 percent of the property's acquisition cost, if the residual value is guaranteed by the lessee or a third party.

In 1987, section 108 of CEBA amended the National Bank Act to authorize national banks specifically to lease tangible personal property so long as the leases are on a "net lease basis" and represent, in the aggregate, no more than 10 percent of the bank's assets.[2] The legislative history indicates that this amendment was intended to permit the Office of the Comptroller of the Currency (OCC) to relax or eliminate, in a manner consistent with sound banking practices, the residual value limitation in the OCC's existing regulations authorizing personal property leasing activities by national banks.[3] The legislative history of section 108 also indicates that the section is not intended to allow national banks to engage in the

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[1] 12 CFR 225.25(b)(5). The nonoperating condition places the responsibilities for the leased property's care and maintenance upon the customer. In such lease arrangements, the lessor may not provide or pay for operational services such as repair and insurance.

[2] See 12 U.S.C. 24 (Tenth). The OCC has interpreted the term "net lease basis" to mean that the lease must be on a nonoperating basis.

[3] S. Rep. No. 19, 100th Cong., 1st Sess. 43 (1987).

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daily or short-term equipment or automobile rental business.[4]

Based on this statutory authorization, a number of national banks currently engage in leasing personal property with reliance on residual values as high as 100 percent of the cost of the leased property.[5] A number of states also have permitted state-chartered banks to conduct leasing activities without limit on the amount of residual value that may be relied on by the lessor bank.[6]

The Board previously has determined by order that the activity of higher residual value leasing of tangible personal property is closely related to banking and a proper incident to banking for purposes of section 4(c)(8) of the Bank Holding Company Act.[7] In that case, Security Pacific committed that it would limit the volume of its higher residual value leasing transactions, and that the higher residual value leases would have a minimum term of one year.[8] Security Pacific also committed to conform its higher residual value leasing activities to the existing restrictions imposed by the Board on full-payout leasing. Since the Security Pacific decision, several other bank holding companies have received approval from the Board to engage in the same leasing activity subject to identical conditions.[9]

Rule Adopted by the Board

The Board has sought public comment on a proposal to add higher residual value leasing activities to its regulatory list of activities permissible for bank holding companies. 55 FR 22348, June 1, 1990; 55 FR 23446, June 8, 1990. This amendment would permit bank holding companies seeking to conduct this activity to take advantage of the streamlined procedures contained in Regulation Y for obtaining review of these proposals. Following review of the comments received, the Board has determined to adopt its amendment substantially as proposed.

Several modifications, discussed below, have been made to the proposal to address matters raised by the comments. The final rule adopted by the Board adds the activity of conducting higher residual value leasing of tangible personal property to the regulatory list of permissible nonbanking activities for bank holding companies. This activity will be permitted within certain prudential limitations. In particular, the rule provides that higher residual value lease transactions will remain subject to the current provisions of Regulation Y applicable to full-payout leasing activities (other than the residual value limitations applicable to full-payout leasing), including that: (1) Bank holding companies may acquire property to be leased only in connection with a specific leasing transaction under consideration, (2) bank holding companies must either sell or release the leased property within two years of the expiration of the initial lease, and (3) the leases must be on a non-operating basis.

The Board also has determined to adopt certain restrictions that would apply only to the expanded leasing activities. First, the higher residual value leases arranged by bank holding companies must have a minimum lease term of at least 90 days. Second, consistent with the limit imposed by CEBA on national banks, the total volume of bank holding company investments in higher residual value leases must be limited to no more than 10 percent of the bank holding company's total consolidated assets. Third, bank holding companies must capitalize their leasing subsidiaries commensurate with industry standards and to an extent necessary to support fully the expanded leasing activity. Fourth, bank holding companies must maintain records regarding their higher residual value leasing activities that are separate from their records for full-payout leasing transactions. These limitations are consistent with the limitations adopted by the OCC for higher residual value leasing activities of national banks.

Public Comments

The Board received 22 public comments regarding this proposal. All except one of the commenters supported the Board's proposal allowing bank holding companies to engage in higher residual value leasing of tangible personal property. Several commenters recommended certain modifications to the restrictions proposed by the Board.

Authority for Activity

Commenters in favor of the proposal supported the Board's determination in Security Pacific that the activity of higher residual value leasing is closely related to banking for purposes of section 4(c)(8) of the Bank Holding Company Act. Commenters stated that the activity is permissible for national banks under the National Bank Act and is permissible for state banks under various state laws. Commenters also argued that higher residual value leasing activities are functionally similar to other leasing activities conducted by banking organizations.[10]

Most of the commenters also argued that these activities are a proper incident to banking for purposes of section 4(c)(8) of the Bank Holding Company Act. In particular, commenters maintained that the expanded leasing authority is necessary in order for bank holding companies to compete effectively with other lessors and to better serve the needs of their customers.

Risk of Activity

The commenter opposing the proposal contended that financial institutions have shown a willingness to rely on unrealistic and excessive residual value forecasts and that it would be prudent to retain existing limitations on residual value reliance. This commenter argued that a relaxation of residual value limitations will increase the riskiness of financial institutions' leasing activities.

This comment suggested that leasing activities that rely on limited residual values are less risky than leasing activities with a greater reliance on residual values because of uncertainties in predicting residual values. A study by Board staff, however, suggests that limitations on the ability of bank holding companies to rely on residual value may not reduce the riskiness of the leasing activities of bank holding companies.[11] The leasing activities of bank holding company leasing subsidiaries appear to be less profitable and have higher charge-off and past due rates than leases made by companies and banks that have greater flexibility to rely on residual values. This might result from the fact that, while bank holding

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[4] H.R. Conf. Rep. No. 261, 100th Cong., 1st Sess. 143 (1987).

[5] Prompted by the expanded authority of section 108, the OCC recently amended its regulation on lease financing transactions of national banks. 56 FR 28314, June 20, 1991 (to be codified at 12 CFR part 23).

[6] These states include California, Florida, Maryland, Michigan, Illinois, and Indiana.

[7] Security Pacific Corporation. 76 Federal Reserve Bulletin 462 (1990) ("Security Pacific").

[8] Security Pacific committed to limit the total amount of its investment in leases with estimated residual values in excess of 25 percent of the acquisition cost of the leased property to no more than 10 percent of the holding company's total consolidated assets. In addition, Security Pacific committed to limit the total amount of its investment in leases with estimated residual values in excess of 70 percent of the acquisition cost of the leased property to the lesser of: 0.5 percent of the holding company's total consolidated assets or 10 percent of the holding company's total consolidated shareholders' equity.

[9] The Fuji Bank, Limited, 77 Federal Reserve Bulletin 490 (1991); The Sanwa Bank, Limited, 77 Federal Reserve Bulletin 187 (1991), Dai-Ichi Kangyo Bank, Limited, 76 Federal Reserve Bulletin 960 (1990).

[10] See *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975).

[11] See Residual Value Regulation and the Performance of Bank Holding Company Leasing Subsidiaries, Jim Burke and Nellie Liang.

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company leases currently are not subject to significant risk from miscalculation of residual values, leases by bank holding companies are subject to a greater degree of credit risk.

Permitting greater reliance on residual values increases the possibility that bank holding companies may miscalculate residual values. However, companies not associated with bank holding companies appear to be able to estimate residual values reasonably successfully and there is no indication that bank holding companies do not have, or could not develop, the same expertise. In addition, generally accepted accounting principles require that assumed residual values be reviewed and adjusted annually. These values and compliance with GAAP would be subject to annual review by the external auditors for the holding company, and in bank holding company examinations. A lease could be subject to criticism or classification to the extent that the holding company relies on over-estimated residual values to achieve full compensation for the costs of the lease. Finally, the Board's proposal includes an aggregate limit on the amount of higher residual value leasing transactions that a bank holding company may conduct.

Minimum Lease Term Requirement

Five public commenters argued that the Board should not impose a requirement that the initial lease term be for a minimum of 90 days. The Board's current rule for full-payout leasing transactions does not contain a minimum duration requirement. However, the combination of the existing limitations on residual value and the requirement that the bank holding company project full compensation for the transaction based on the initial lease effectively eliminate the possibility of very short-term leases. Short-term and daily leases became a possibility once the limitation on residual value is relaxed.

The legislative history of CEBA indicates that Congress intended not to permit national banks to engage in short-term leasing transactions. For that reason, the OCC has restricted national banks from engaging in higher residual value leasing transactions with a duration of less than 90 days. Commenters have not suggested an alternative method for implementing a duration requirement other than to leave a determination regarding duration to the discretion of each bank holding company. Accordingly, in this final rule the Board is adopting a minimum lease term requirement similar to that adopted by the OCC. In response to several comments, the Board has also amended its final rule to permit bank holding companies to hold originally conforming leases acquired from other lessors where the term remaining on the lease is less than 90 days.[12]

Volume Limitation

The Board's original proposal limited the aggregate volume of a bank holding company's higher residual value leasing activity to a maximum of 10 percent of the bank holding company's consolidated assets. This limitation is analogous to the 10 percent of assets limitation contained in CEBA and adopted by the OCC for national banks. Several commenters suggested that the Board not impose any limit on the level of this activity. Other commenters, however, suggested that, in light of the risks associated with this activity, the Board consider imposing a lower aggregate limit based on the capital level of the bank holding company.

The Board believes that adopting an asset-based limit analogous to the statutory limit in CEBA and the limit adopted by the OCC is an appropriate way to limit the potential risks associated with higher residual value leasing until such time as holding companies and the Board have gained additional experience with the activity. On the other hand, the Board has determined not to adopt a lower limit at this time because establishing a lower limit for bank holding companies, either in relation to assets or capital, could encourage banks to conduct this activity directly in order to avoid a lower limit on the holding company's activity.[13]

Three commenters requested that the Board clarify the proposed volume limitation for higher residual value leases as it applies to domestic banks with foreign assets and to foreign banks. In particular, these commenters requested clarification that the volume limitation is tied to a banking organization's total worldwide assets. The final rule clarifies that the aggregate limit is based on total domestic and foreign assets of the organization. This clarification is consistent with the Board's orders approving higher residual value leasing activities for foreign banking organizations, and with the instructions on the periodic Reports of Condition.

In calculating whether an organization has reached its aggregate limit, the proposal also clarifies that all higher residual value leasing transactions conducted within domestic bank subsidiaries of the bank holding company as well as within certain nonbank subsidiaries must be included within the aggregate amount of higher residual value leasing activities conducted by the bank holding company. This method of calculation takes into account the possibility that banks owned by a holding company may engage in higher residual value leasing transactions up to a percentage of the bank's assets, and avoids the possibility of double counting the bank's assets in the holding company limit without taking account of its leasing transactions. This method of calculation does not impose any limit on the amount of higher residual value leasing conducted directly by banks owned by a bank holding company. It does, however, have the effect of limiting the amount of higher residual value leasing transactions that a bank holding company or its nonbank subsidiary may conduct if these activities are simultaneously conducted within a bank affiliate. The final rule also clarifies that traditional full-payout leasing transactions, and leasing transactions conducted by domestic and foreign bank holding companies under other leasing authority, including leasing activities outside the United States, are not subject to the aggregate limit.[14]

[12] Several commenters requested that the Board not apply the 90-day minimum lease term requirement to leases that are entered into at the conclusion of the initial lease term and prior to the disposition of the leased property by the bank holding company or to leases that have been terminated prior to maturity by the lessee. The Board's current rules regarding leasing transactions require that a bank holding company either dispose of leased property or re-lease the property in an authorized leasing transaction within two years of the termination of the initial lease (subject to possible extensions of this time by the Board). 12 CFR 225.25(b)(5) n.6. It has been the Board's policy to permit bank holding companies to maximize the value of this off-lease property during this divestiture period, including by permitting short-term leases of the property, provided that the bank holding company conforms with the requirement that the property either be liquidated or re-leased in a conforming lease within the two-year period. The Board's final rule has been amended to state this policy expressly.

[13] The OCC applies the lending limits applicable to national bank lending to leases arranged by national banks because these leases are viewed as the functional equivalent of an extension of credit. Bank holding companies are not subject to similar limits on their lending activities and the Board has not imposed a similar limit on the full-payout leasing activities of bank holding companies. Accordingly, this proposal does not establish such limits on individual leases made by bank holding companies.

[14] The volume limitation would not apply to companies advised by leasing subsidiaries of bank holding companies, nor would it apply to lease brokerage transactions entered into by these leasing subsidiaries.

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Capital Level of Leasing Affiliate

Two commenters objected to the proposed requirement that a company that conducts higher residual value leasing activities be capitalized in accordance with industry levels. These commenters maintained that the only relevant capital requirements in connection with this activity should be the capital standards for the subsidiary banks or the bank holding company on a consolidated basis.

The Board's capital adequacy guidelines provide that all nonbanking subsidiaries of a bank holding company "should maintain levels of capital consistent with levels that have been established by industry norms or standards" unless the Board establishes a different standard.[15] The industry norms for equipment leasing appear to be generally higher than the capital levels for bank holding companies.[16] The Board believes that it is appropriate to expect holding company affiliates engaged in higher residual value leasing to maintain capital levels that reflect the higher risk of this activity as reflected in the market.

Finally, two commenters contended that the Board should not require bank holding companies that already have authority to engage in full-payout leasing to seek additional Board approval to engage in higher residual value leasing. On the other hand, one commenter suggested that the Board should require formal and separate applications to conduct this activity because of the added risk of this activity.

Because higher residual value leasing transactions involve more risk than other leasing transactions, the Board believes it is appropriate to require bank holding companies to seek approval to engage in these transactions in order to assess properly each company's ability to assume this additional risk. Because this activity is being added to the Board's regulatory list of permissible activities, bank holding companies seeking to conduct this activity would be able to take advantage of the streamlined notice procedures in the regulation.

Comments Regarding Board's Current Full-Payout Leasing Provisions

Five commenters recommended that the Board conform its provisions governing more traditional full-payout leasing activities to the OCC's residual value limitation for full-payout leases. The OCC permits reliance on up to 25 percent of the property's acquisition cost for traditional leasing transactions rather than the 20 percent residual value limit established under the Board's current provision.[17] The commenters argued that modifying this provision to match the OCC's rules will increase the competitiveness of bank holding company lessors and will avoid the burden that results from imposing different requirements on national banks and their nonbank affiliates.

In light of the benefits of reduced burden, the increased competitiveness from adopting a uniform rule for leasing transactions, and the fact that the OCC has not identified any significant increased risk from permitting reliance on this somewhat higher level of residual values, the Board has adopted this suggestion. This amendment applies to full-payout leasing activities involving personal property as well as full-payout leasing of real estate, as otherwise permitted under the Board's Regulation Y. Bank holding companies that are currently authorized to conduct full-payout leasing activities pursuant to section 4(c)(8) of the Bank Holding Company Act are not required to seek additional Board approval to conduct full-payout leasing transactions that rely on residual values up to 25 percent of the acquisition cost of the property, provided that these activities are conducted within the other limitations in the Board's Regulation Y and any other conditions imposed on the individual bank holding company by order.

Final Regulatory Flexibility Act Analysis

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 amendment will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation.

This amendment will add to the list of permissible bank holding company activities in the Board's Regulation Y, an activity that has been previously approved for bank holding companies by Board order. This addition will have the effect of reducing the burden on bank holding companies, including small bank holding companies, that wish to conduct these activities by simplifying and streamlining the regulatory review process. The amendment does not impose more burdensome requirements on bank holding companies than are currently applicable.

Effective Date

The provisions of 5 U.S.C. 553(d) generally prescribing 30 days' prior notice of the effective date of a rule have not been followed in connection with the adoption of this amendment because adoption of the rule reduces a regulatory burden. Section 553(d) grants a specific exemption from its deferred effective date requirements in these instances.

List of Subjects in 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 the preamble, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)), the Board amends 12 CFR part 225 as follows:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

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

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1843(c)(8), 1844(b), 1972(l), 3106, 3108, 3907, 3909, 3310, and 3331–3351.

2. In § 225.25, footnotes 7 through 14 are redesignated as 8 through 15, respectively. Paragraphs (b)(5) heading and introductory text, (b)(5)(i) through (iii), (b)(5)(iv) introductory text, (b)(5)(iv)(A) through (D), and (b)(5)(v) and (vi) are redesignated as (b)(5)(i) heading and introductory text, (b)(5)(i)(A) through (C), (b)(5)(i)(D), (b)(5)(i)(D)(*1*) through (*4*), and (b)(5) (E) and (F), respectively. The heading for paragraph (b)(5) is added. Newly designated paragraphs (b)(5)(i) introductory text, (b)(5)(i)(D) introductory text, (b)(5)(i)(D)(*3*), and (b)(5)(i)(F) are revised, and paragraph (b)(5)(ii) is added to read as follows:

§ 225.25 List of permissible nonbanking activities.

* * * * *

(b) * * *

(5) *Leasing*—(i) *Leasing personal or real property.* Leasing personal or real property or acting as agent, broker, or adviser in leasing such property if—

(A) * * *

(B) * * *

(C) * * *

(D) At the inception of the initial lease the effect of the transaction (and, with

[15] 12 CFR part 225 appendix B (1991).

[16] See American Association of Equipment Lessors, The Annual Survey of Industry Activity 1991).

[17] Compare 12 CFR 225.25(b)(5) with 12 CFR part 23 (1991).

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respect to governmental entities only, reasonably anticipated future transactions[4]) will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease,[5] from —

* * * * *

(3) the estimated residual value of the property at the expiration of the initial term of the lease, which in no case shall exceed 25 percent of the acquisition cost of the property to the lessor; and

* * * * *

(F) At the expiration of the lease (including any renewals or extensions with the same lessee), all interest in the property shall be either liquidated or released on a nonoperating basis as soon as practicable but in no event later than two years from the expiration of the lease;[6] however, in no case shall the lessor retain any interest in the property beyond 50 years after its acquisition of the property.

(ii) *Certain Higher Residual Value Leasing.* Leasing tangible personal property or acting as agent, broker, or adviser in leasing such property, in which the lessor relies on an estimated residual value of the property in excess of the 25 percent limitation described in paragraph (b) (5) (i) (D) (3) of this section, if —

(A) The activity otherwise meets the requirements of paragraph (b) (5) (i); of this section;

(B) The lessor in no case relies on an estimated residual value of the property in excess of 100 percent of the acquisition cost of the property to the lessor;

(C) (1) The aggregate book value of all personal property described in paragraph (b) (5) (ii) (C) (2) of this section does not exceed 10 percent of the bank holding company's consolidated domestic and foreign assets;

(2) For purposes of calculating the limit provided in paragraph (b) (ii) (C) subclause (1) of this section, the bank holding company shall include all tangible personal property held for lease in transactions in which the bank holding company or any of its nonbank subsidiaries acting under authority of this paragraph, or any domestic subsidiary bank of such holding company, relies on an estimated residual value in excess of 25 percent of the acquisition cost of the property;

(D) The initial term of the lease is at least 90 days[7];

(E) Each company that conducts leasing transactions under paragraph (b) (5) (ii) of this section maintains capitalization fully adequate to meet its obligations and support its activities, and commensurate with industry standards for companies engaged in comparable leasing activities; and

(F) The bank holding company maintains separately identifiable records of the leasing activities conducted under paragraphs (b) (5) (i) and (ii) of this section, where it conducts leasing activities under the authority of both paragraphs (b) (5) (i) and (ii) of this section.

Board of Governors of the Federal Reserve System, May 8, 1992.

Jennifer J. Johnson
Associate Secretary of the Board

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[4] The Board understands that some federal, state, and local governmental entities may not enter into a lease for a period in excess of one year. Such an impediment does not prohibit a company authorized to conduct leasing activities under this paragraph from entering into a lease with such governmental entities if the company reasonably anticipates that the governmental entities will renew the lease annually until such time as the company is fully compensated for its investment in the leased property plus its costs of financing the property. Further, a company authorized to conduct personal property leasing activities under this paragraph may also engage in so-called "bridge" lease financing of personal property, but not real property, if the lease is short-term pending completion of long-term financing, by the same or another lender.

[5] The estimate by the lessor of the total cost of financing the property over the term of the lease should reflect, among other factors, the term of the lease, the modes of financing available to the lessor, the credit rating of the lessor and/or the lessee, if a factor in the financing, and prevailing rates in the money and capital markets.

[6] In the event of a default on, or early termination of, a lease agreement prior to the expiration of the lease term, the lessor shall either re-lease the property, subject to all the conditions of this paragraph, or liquidate the property as soon as practicable but in no event later than two years from the date of default on the lease agreement (in the event of a default) or termination of the lease (in the event of termination), or such additional time as the Board may permit under § 225.22(c)(1) of this part, as if the property were DPC property. During the period following default on, or expiration or termination of a lease, the lessor may lease the property on a short-term basis in a lease that does not conform to the requirements of this paragraph provided that the property is liquidated or re-leased in a conforming lease prior to the expiration of this period.

[7] This minimum lease term requirement is not intended to prohibit a bank holding company from acquiring personal property subject to an existing lease with a remaining maturity of less than 90 days, provided that, at the inception of the lease, such lease conformed with all of the requirements of this paragraph.

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Amendments to Regulations O and Y

Docket No. R-0747

To implement the requirements of Section 306 of the Federal Deposit Insurance Corporation Improvement Act

Effective May 18, 1992

[Enc. Cir. No. 10543]

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FEDERAL RESERVE SYSTEM

12 CFR Parts 215 and 225

[Regulations O and Y; Docket No. R-0747]

Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies and Change in Bank Control; Change of Effective Date and Republication of Rule

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Change of effective date and republication of rule.

SUMMARY: This document contains a change to the effective date and republication of a final rule that was published in the issue of Tuesday, May 19, 1992 (57 FR 21199). The final rule implements revisions to the Board's Regulations O and Y required by section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The effective date as published in the Federal Register was June 18, 1992. In order to permit small banks to take immediate advantage of authority contained in Regulation O to establish an aggregate insider lending limit at a higher level than that provided in section 306 of FDICIA, the Board has determined that the final rule is effective as of May 18, 1992.

EFFECTIVE DATE: The final rule is effective as of May 18, 1992.

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SUPPLEMENTARY INFORMATION:

Change of Effective Date and Republication of Final Rule

On April 22, 1992, the Board adopted amendments to Regulations O and Y to implement the requirements of section 306 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). The statutory requirements were effective May 18, 1992. Pursuant to section 306(n) of FDICIA, however, the section 306 requirements do not affect the validity of any extension of credit lawfully entered into on or before the effective date of the statutory amendments. Therefore, the requirements apply to all extensions of credit entered into May 19, 1992, or thereafter and all such extensions of credit must comply with the requirements of the statute, including the aggregate insider lending limit and the lending limit applicable to loans to directors and their related interests.

In connection with the implementation of the general aggregate insider lending limit, the Board exercised its discretion under FDICIA to revise Regulation O to permit banks with deposits of less than $100 million to establish a higher limit up to a maximum of two times the bank's unimpaired capital and unimpaired surplus. By press release dated May 7, 1992, and by notice published in the Tuesday May 19, 1992, issue of the **Federal Register**, the Board stated that the revisions to Regulations O and Y were to be effective mid-June 1992. In order to permit banks with deposits of less than $100 million to take immediate advantage of the regulatory authorization of a higher limit, the amendments to Regulations O and Y implementing section 306 of FDICIA are effective on May 18, 1992, not mid-June 1992, as previously published. Accordingly, this document changes the effective date of the final rule published May 19, 1992 in the **Federal Register.**

Under the Administrative Procedure Act (APA), a final agency rule generally becomes effective no sooner than 30 days following publication of the final rule in the **Federal Register.** 5 U.S.C. 553(d). The APA provides that an agency may dispense with the 30 day waiting period if the final rule grants or recognizes an exemption or relieves a restriction, or if the agency finds for good cause that it may dispense with the 30 day waiting period and publishes that finding in the final rule. *Id.* Courts have interpreted the good cause language to require that the agency find that a delay in the final rule's effective date would be contrary to an important public interest. See, *e.g., British American Commodity Options Corp.* v. *Bagley,* 552 F.2d 482 (2d. Cir. 1980).

The Board believes that dispensing with the 30 day waiting period is appropriate in this instance. First, the rule relieves a restriction imposed by section 306 of FDICIA. Under section 306, a member bank may not lend to an insider if the extension of credit, when aggregated with all of the banks's outstanding extensions of credit to its insiders, would exceed 100 percent of the bank's unimpaired capital and unimpaired surplus. FDICIA provides the Board discretion to permit banks with deposits of less than $100 million to establish a higher aggregate insider lending limit not to exceed two times a bank's unimpaired capital and unimpaired surplus. The final rule relieves a statutory restriction by permitting banks with deposits of less than $100 million to establish such higher limits under certain conditions.

Second, the Board believes there is good cause to make the final rule effective as of May 18, 1992. As noted, the statutory provisions that the final rule implements became effective May 18, 1992. The Board believes that an effective date of May 18, 1992, for the final rule is important to permit banks with deposits of less than $100 million to take immediate advantage of the higher aggregate insider lending limit provided in the final rule. In addition, an effective date of May 18, 1992, for the final rule will prevent confusion regarding interpretation of the statute that could arise if the final rule were to become effective significantly later than the statutory provisions.

The Board believes that persons affected by this rule have had adequate notice and opportunity to comment on both the substance of the final rule and the issues involved in consideration of the rule. The Board notes that notice of the proposal appeared in the **Federal Register** February 20, 1992 (57 FR 6077). In this respect, the Board believes that affected persons have also had adequate opportunity to take the steps necessary to comply with the substance of the final rule by the May 18, 1992 effective date. In addition, the Board notes that the statutory provision implemented by the final rule became effective May 18, 1992. Therefore, the transactions that are subject to, and the persons affected by, the final rule are subject to the requirements of section 306 as of May 18, 1992. Because the final rule is not more restrictive than the statute in any respect, a May 18, 1992 effective date for the final rule will not prejudice persons affected by the rule. Moreover, because the rule relaxes the aggregate lending limit as applied to small banks, an early effective date will benefit certain affected persons without prejudicing others.

This document does not modify any portion of the final rule as published previously, except that it changes the final rule's effective date from June 18, 1992, to May 18, 1992; adds an Effective Date paragraph immediately following the Regulatory Flexibility Act Analysis paragraphs in **SUPPLEMENTARY INFORMATION;** and, in the third sentence of the second paragraph under discussion heading of Grandfathering provision, adds the phrase "on or" after extension of credit, and in the fourth sentence modifies the second date

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referenced to May 19, 1992, or thereafter. The **SUPPLEMENTARY INFORMATION** portion and regulatory text of the final rule published at 57 FR 21199, May 19, 1992, with the modifications stated above, are republished for the convenience of the reader as follows:

Background

Section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) 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 control by an insider ("related interests"). The Board promulgated Regulation O in 1978 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 banks's capital and unimpaired surplus, up to $500,000);
2. Prohibits any extension of credit on preferential terms;
3. Limits the amount a bank may lend to each of its executive officers and principal shareholders and their related interests; [1] and
4. Prohibits the payments by a member bank of an overdraft of an executive officer or director on an account at the bank.[2]

On December 19, 1991, the President signed into law the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").[3] Section 306 of the FDICIA amends section 22(h) of the Federal Reserve Act. On February 20, 1992, the Board published for comment proposed revisions to Regulation O to implement the amendments of section 22(h) of the Federal Reserve Act made by FDICIA. The comment period expired on March 23, 1992. The FDICIA amendments take effect May 18, 1992.

Section 306 of FDICIA replaces the language of section 22(h) with the provisions of the Board's Regulation O. Section 306 also makes a number of substantive modifications to section 22(h). The most significant changes required by the provisions of FDICIA are as follows:

1. *New Aggregate Lending Limit.* Section 306 establishes a limit 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 unimpaired surplus.
2. *Lending Limit for Directors and Related Interests.* Section 306 extends to loans to directors (and their related interests) the same lending limit currently applicable to executive officers and principal shareholders (and their related interests) under section 22(h).[4] Previously, section 22(h) did not limit the amount directors and their related interests could borrow from their banks.
3. *Credit Standards.* Section 306 adds a requirement that, when lending to an insider, a bank must follow credit underwriting procedures that are "not less stringent than those applicable to comparable transactions by the bank with [persons outside the bank.]"
4. *Definition of Principal Shareholder.* Section 306 tightens the definition of principal shareholder for banks located in small communities. Formerly, section 22(h) defined a principal shareholder as a person who owned or controlled 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 was 18 percent. The 10 percent definition now applies to all banks, regardless of the size of the community where the bank is located.
5. *Definition of Member Bank.* Section 306 redefines the term "member bank" for the purposes of section 22(h) 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.
6. *Coverage of All Companies That Own Banks.* Section 306 amends section 22(h) to cover all companies that own banks, regardless of whether the company is technically a bank holding company.
7. *Prohibition on Knowing Receipt of Unauthorized Extensions of Credit.* Section 306 amends section 22(h) to prohibit insiders from knowingly receiving (or knowingly permitting their related interests to receive) any extension of credit not authorized by section 22(h).
8. *Reporting Requirement for Certain Credit.* Section 306 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 credit that is secured by shares of the insider's institution.
9. *Definitions.* Section 306 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.

The final rule adopted by the Board implements these statutory requirements and contains several technical revisions, discussed below, to conform Regulation O with section 306 and to correct existing ambiguities.

The proposal the Board published for comment sought only to implement the FDICIA amendments. The proposal did not modify the regulation where the statutory amendments track the present regulatory language.[5] The Board did not request comment on existing features of Regulation O, except as necessary to implement the FDICIA amendments.[6]

The Board received 268 written comments in response to notice of the proposal. Community or independent banks submitted the majority of comments. Other comments included several large banks and bank holding companies, individual bank directors, numerous state and national banking trade associations, several state banking superintendents, and four Federal Reserve Banks.

Discussion of Issues

1. Lending Limit Applicable to Individual Directors

The preponderance of the commenters, including community banks, state and national independent bankers' trade associations, and certain state banking supervisors, objected to the FDICIA requirement that the Regulation O individual lending limit be applied to loans to directors. These commenters observed that directors of community banks frequently control substantial local business enterprises, especially in small or rural communities. In this regard, the commenters stated, such directors provide to bank management important expertise and valuable credit and deposit relationships. The commenters asserted nearly unanimously that application of the Regulation O lending limit to directors would curtail the ability of banks to serve the credit needs of their directors (and the directors' related

[1] 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. This lending limit is subject to the exceptions set forth in section 5200 of the Revised Statutes (12 U.S.C. 84). These exceptions generally provide higher or no lending limits for loans secured by various kinds of obligations. Thus, for example, loans secured by obligations fully guaranteed by the United States are not subject to a lending limit.

[2] The overdraft prohibition does not apply to principal shareholders, unless the principal shareholder is also an executive officer or director. The prohibition also does not apply to the related interests of an executive officer or director. In addition, the prohibition does not apply to inadvertent overdrafts, as defined in Regulation O.

[3] Public Law No. 102-242, 105 Stat. 2236 (1991).

[4] See note 1, *supra.*

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

[6] The final rule amends the Board's Regulation Y to implement a loan reporting requirement created by the FDICIA that applies to executive officers and directors of certain bank holding companies.

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interests). The commenters concluded that the limit will force directors or prospective directors to choose between retaining or accepting a directorship and maintaining a customer relationship with the bank, thereby in turn depriving banks of either informed leadership or valuable customer relationships.

The final rule implements the director lending limit as proposed. FDICIA requires that the Board apply this limit to extensions of credit to directors and their related interests and gives the Board no discretion in applying this aspect of the statute. It should be noted, however, that directors and their related interests generally have long been subject to similar borrowing constraints by reason of the concentration of credit rules under the National Bank Act and state laws. See, *e.g.*, 12 U.S.C. 84; 12 CFR part 32. The section 22(h) lending limit incorporates the limits and exceptions of the concentration of credit rules under the National Bank Act. Thus, the section 22(h) lending limit generally permits each individual director and his or her related interests to borrow in aggregate amounts the equivalent of up to 15 percent of the bank's unimpaired capital and unimpaired surplus on an unsecured basis and an additional 10 percent on a secured basis. The exceptions provide higher limits for, or exclude from limitation altogether, various credit transactions, such as extensions of credit secured by obligations of the United States or guaranteed by a Federal agency, extensions of credit secured by bills of lading or warehouse receipts covering readily marketable staples, and extensions of credit secured by livestock or dairy cattle.

2. Limit on Aggregate Lending to Insiders

As amended by FDICIA, section 22(h) establishes a limit on the total amount a member bank may lend to its insiders and their related interests as a class. The statute generally restricts that amount to an amount that is no greater than the bank's unimpaired capital and unimpaired surplus. The Board is authorized, however, to set a more stringent general limit. The statute permits the Board to make an exception to this limit only for banks with deposits of less than $100 million and only 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." [7] The statute provides that the higher limit for banks with deposits of less than $100 million may not exceed 200 percent of the bank's unimpaired capital and unimpaired surplus.

The legislative history of FDICIA indicates that the aggregate limit was adopted in response to the significant insider lending at Madison National Bank and other failed institutions.[8] In this respect, the aggregate limit was designed as a prophylactic measure to limit the risks to the deposit insurance system of large concentrations of credit to institution insiders.

The final rule's general limit—100 percent of the member bank's unimpaired capital and unimpaired surplus—is the same as provided in the statute.[9] The Board requested specific comment regarding whether to provide an exception to the general limit for banks with deposits of under $100 million. The Board also requested comment on whether a 100 percent limit as applied to small banks would unduly restrict credit or limit the availability of directors. In connection with these requests, the Board requested that commenters supply specific data as to the effect of the aggregate limit.

The great preponderance of commenters, including community banks and bank trade associations, opposed the aggregate limit in principle. Every commenter that referred to the Board's discretion to make exceptions to the general limit for small banks urged the Board to raise that limit to 200 percent of unimpaired capital and unimpaired surplus for small banks. These commenters included community banks, larger banks, the American Bankers Association, and the Independent Bankers Association of America.

The commenters argued the same points discussed above with respect to the director lending limit. Commenters argued nearly unanimously that the aggregate limit, like the application of the director lending limit, would inhibit unduly the ability of community banks to serve the credit needs of their directors and the related interests of the directors. As a result, commenters contended, directors will be forced to choose between retaining a directorship or maintaining a customer relationship with the bank, thereby depriving the bank of either informed leadership or valuable customer relationships. Apart from anecdotal evidence, commenters did not provide specific information regarding the amount of lending by banks to their directors and related interests, or other specific information that would allow the Board to determine the effect of the aggregate limit on the availability of credit and directors.[10]

In light of the great concern evidenced by the comments of small banks, the Board has determined that an exception to the general aggregate lending limit for small banks is important to avoid constricting the availability of credit or directors in small communities. Accordingly, the Board has determined to exercise its discretion under FDICIA to permit small banks (*i.e.*, banks with total deposits under $100 million) to establish a higher aggregate lending limit for loans to executive officers, directors, and principal shareholders, and their related interests, where the board of directors of the bank has determined, based on its experience with loans to such persons and related interests, that a higher aggregate lending limit is consistent with prudent, safe, and sound banking practices. This higher limit must be considered and established by the bank's board of directors by resolution, and may not exceed a maximum amount of 200 percent of the bank's unimpaired capital and unimpaired surplus.

The Board has determined to permit small banks to establish this higher aggregate limit for a one-year period that will expire May 18, 1993. This one-year period will enable the Board, in consultation with the other federal banking agencies, to collect specific data on the lending practices of banks to insiders, including directors, in order to analyze the effect of a limitation on this lending on the ability of banks to attract qualified directors and to serve the credit needs of local communities. The Board will then revisit the issue of an appropriate limit for small banks.

[7] Federal Deposit Insurance Corporation Improvement Act of 1991, Public Law No. 102-242, sec. 306(d), 105 Stat. 2236, 2358 (1991).

[8] See S. Rep. No. 167, 102nd Cong., 1st Sess. 55 (1991).

[9] Under Regulation O, unimpaired capital and unimpaired surplus is the sum of (1) total equity capital as reported on the bank's most recent report of condition; (2) any subordinated notes and debentures approved as an addition to the bank's capital structure by the appropriate federal banking agency; and (3) any valuation reserves created by charges to the bank's income. Total equity capital includes retained earnings. See 12 CFR 215.2(h).

[10] Two community bank commenters submitted data regarding the percentage of capital and surplus represented by loans to directors or to other insiders. One demonstrated that loans to insiders, including directors, exceeded 100 percent of unimpaired capital and surplus. The second questioned the necessity of any limit, on the basis that its loans to insiders, including directors, fell far short of 100 percent.

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3. *Bank Holding Company Indebtedness Under the Aggregate Limit*

A. Section 23A

There larger holding companies commented that the application of the aggregate lending limit to transactions with holding company affiliates that are also covered by section 23A of the Federal Reserve Act [11] may produce inconsistent results. Under section 23A, a member bank's transactions with any one affiliate are limited to 10 percent of the bank's capital and surplus; an aggregate 20 percent limit applies to transactions with all affiliates.[12] However, several types of transactions that present little or no risk to the bank are excluded from the quantitative limits of section 23A. These transactions include loans that are fully secured by (i) the obligations of the United States or certain Federal agencies or (ii) segregated, earmarked deposit accounts.

The FDICIA aggregate lending limit does not provide for any exemptions. Three commenters observed that inclusion under the aggregate lending limit of holding company indebtedness, including indebtedness exempt from the quantitative limits of section 23A, could render unavailable a significant portion of the aggregate lending limit.

The commenters suggested that the Board address this problem by excluding from the FDICIA aggregate lending limit extensions of credit to parent holding companies and their nonbank subsidiaries.[13] These transactions would continue to be subject to the requirements of section 23A.

The Board declined to adopt this suggestion. The FDICIA aggregate lending limit by its terms applies to all extensions of credit by a bank to principal shareholders and their related interests, thereby covering extensions of credit to parent holding companies and the companies they control. The FDICIA aggregate limit provides no exclusion for loans to a parent holding company or its non-bank affiliates. In addition, unlike section 23A, section 22(h) does not provide the Board general exemptive authority. Thus, the statute requires that bank extensions of credit to parent holding companies and nonbank affiliates count toward to aggregate lending limit.

The Board intends to propose legislation to cure the inconsistent treatment of certain transactions under section 22(h) (as amended by section 306) and section 23A. In this respect, the Board believes that the best approach would be to exclude extensions of credit to parent holding companies and their non-bank affiliates from section 22(h) altogether on the basis that such transactions are controlled adequately by section 23A, which regulates comprehensively inter-affiliate transactions.

B. National Bank Act

One commenter requested that the Board exclude from the aggregate lending limit any extension of credit subject to the exceptions provided under the concentration of credit rules of the National Bank Act.[14] For the same reasons discussed with respect to section 23A, the Board declined to implement such an exemption. To address the problem of inconsistent treatment, the Board intends to propose legislation to grant to the Board specific authority to define exclusions from the section 22(h) definition of extension of credit. On the basis of such authority, the Board could revise Regulations O to exclude from the aggregate lending limit certain transactions that present little or no risk to the bank, including transactions that are exempt under the National Bank Act or section 23A.

4. *Definition of the Term "Member Bank" To Include Any Subsidiary of the Member Bank*

As amended by section 306, section 22(h) defines the term "member bank" specifically to include any subsidiary of the member bank. The definition is designed to codify Board policy that an extension of credit made by a subsidiary of a bank is considered to have been made by the bank itself. The purpose of the policy is to ensure that an extension of credit from a subsidiary of a member bank is subject to the same insider restrictions as an extension of credit from the member bank itself.[15]

Two commenters asserted that the definition would have the additional effect of constituting executive officers and directors of subsidiaries of banks as executive officers and directors of the parent bank. As a result, the commenters contended, extensions of credit to insiders of the subsidiaries of banks would become subject to requirements of Regulation O, including the aggregate lending limits.[16]

The commenters argued that the statutory amendment of the term member bank to include subsidiaries of the bank nullifies the regulatory distinction between insiders of subsidiaries of the bank and insiders of a bank or its parent and non-bank affiliates. The commenters urged the Board to clarify that Regulation O does not cover insiders of subsidiaries of banks (unless they are also insiders of the bank or its parent or non-bank affiliates).

The final rule retains the proposed definition of member bank, which specifically includes any subsidiary of the member bank. Prior to the enactment of FDICIA, Regulation O did not reach the insiders of such subsidiaries, unless an insider actually participated in the major policy-making functions of the bank.[17] Accordingly, the Board believes that the inclusion of subsidiary in the term member bank is not intended to modify the existing policy that Regulation O does not reach the insiders of subsidiaries of banks (unless an insider is a bank director or actually participates in major policy-making functions at the bank).

5. *Elimination of Higher Control Threshold for Principal Shareholders of Banks Located in Small Communities*

Prior to the enactment of FDICIA, section 22(h) defined a principal shareholder as 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 was 18 percent. FDICIA eliminated the exception for banks located in small communities. As a result, the 10 percent definition now applies to all banks, regardless of the size of the community where the bank is located.

Several commenters objected to this statutory modification and urged the

[11] 12 U.S.C. 371c

[12] Section 23A also applies qualitative restrictions to such transactions. For example, the transactions must be on terms and conditions that are consistent with safe and sound banking practices, and the member bank may not purchase low-quality assets from its affiliates.

[13] Under existing law and regulations, member bank extensions of credit to affiliated banks are exempt in many respects from the coverage of both Regulation O and section 23A

[14] 12 U.S.C. 84; 12 CFR part 32.

[15] See 138 Cong. Rec. S2059, S2077 (daily ed. February 21, 1992) (Statement of Sen. Riegle).

[16] The commenters observed that such a result appears to conflict with an existing provision of Regulation O, which excludes subsidiaries of banks from the definition of subsidiary. See 12 CFR 215.2(n). An effect of this exclusion has been to remove the insiders of subsidiaries of banks from the requirements of Regulation O.

[17] This is so because under section 215.2(n) of Regulation O subsidiaries of banks are not considered to be parent holding company subsidiaries.

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Board to preserve the exception. Because the Board has no discretion in the application of this statutory provision, the final rule eliminates the 18 percent exception.

6. Coverage of All Companies That Own Banks

Prior to the enactment of FDICIA, section 22(h) deemed insiders of bank holding companies to be insiders of the bank holding companies' subsidiary banks. This provision reflected the statutory presumption that insiders of the parent holding company are involved necessarily in the major decisions of bank subsidiaries. Section 306 amended section 22(h) in several places by replacing the term bank holding company with the term company. This change was intended to ensure that insiders of holding companies that are not technical bank holding companies are treated in the same manner as insiders of bank holding companies.[18]

One commenter, a law firm representing diversified financial holding companies, argued that this revision would work an especial hardship on such companies. The commenter asserted that, in contrast to the insiders of bank holding companies, many insiders of diversified financial holding companies have no responsibility for, or influence over, the operations of subsidiary banks. Instead, responsibility for subsidiary banks typically devolves to a small, readily identifiable group, with most insiders responsible for the company's primary business lines, such as manufacturing, retail sales, or insurance. Therefore, the commenter contended, the regulation as proposed would serve no purpose to the extent it would constitute as insiders persons who have no ability to influence the operations of subsidiary banks. The commenter suggested that Board revise Regulation O to implement a method to exclude from coverage insiders of diversified parent holding companies who do not supervise subsidiary banks.

The final rule does not include such an exclusion. As amended by section 306, section 22(h) presumes that insiders of parent holding companies exercise sufficient influence over subsidiary banks to be deemed bank insiders. In addition, FDICIA amended section 22(h) specifically to treat in the same fashion insiders of all companies that own banks—whether or not the company is technically a bank holding company. As noted above, the Board has no discretion to exclude such insiders from the coverage of section 22(h). Accordingly, the Board believes that implementation of the suggested exclusion would not be consistent with the terms of section 306.

7. Prohibition on Knowing Receipt of Any Extension of Credit Not Authorized by Section 22(h)

Section 306 amended section 22(h) to prohibit an insider from knowingly receiving an extension of credit not authorized by section 22(h). Several commenters requested that the Board refine the prohibition by including the Regulation O a provision permitting insiders to rely in good faith on a bank's statement that an extension of credit is authorized by section 22(h).

This prohibition applies only to knowing receipt of unauthorized extensions of credit. The Board believes that the reference to knowing receipt adequately protects insiders in the circumstances cited by the proponents of the good faith reliance safe-harbor.

8. Grandfathering Provision

FDICIA provides that amendments made by section 306 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 section 22(h) 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. Accordingly, May 18, 1992 is the effective date of the statutory provisions.

Several commenters sought guidance as to the effect of this statutory provision. The provision applies to the newly limited loans to directors and the aggregated loans to insiders. As applied to both categories, the provision requires that banks and insiders comply prospectively after the effective date of the statute (May 18, 1992). Extensions of credit made on or before the effective date are not required to comply with the single borrower limit made applicable to directors and their related interests or with the aggregate limit on loans to insiders and their related interests contained in Regulation O. All extensions of credit made after the effective date (*i.e.,* made May 19, 1992 or thereafter) must comply with all of the provisions of the statute and Regulation O. Banks would not be authorized to extend further credit in amounts that, when aggregated with outstanding loans to insiders, would exceed either limit.

9. General Review of Regulation O

The Independent Bankers Association of America requested that, within a year of the promulgation of this final rule, the Board review Regulation O in its entirety, including aspects of the regulation on which the Board did not seek comment in connection with the amendments discussed above. FDICIA mandates that the federal banking agencies conduct general reviews of the regulations implemented under the statutes they administer.[19] Accordingly, the Board will review Regulation O in its entirety and the effect of the regulation on bank operations and consider any modifications that are shown by experience to be necessary or appropriate to carry out the intent of Congress in this area or to prevent evasions of sections 22(g) and 22(h).

10. Technical Revisions

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

1. Modifies 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.
2. Replaces the term "bank" with the term "insured depository institution" where appropriate to reflect statutory usage.
3. Provides a dedicated definition of the term "foreign bank" that is the same as the existing definition that is provided in the definition of "member bank."
4. Replaces the term "capital stock" with the term "unimpaired capital" where appropriate to reflect statutory usage.
5. Adds a date specification to the calculation of valuation reserves for purposes of determining a member bank's unimpaired capital and unimpaired surplus under Regulation O.
6. Clarifies the definition of extension of credit on which a party may be liable.

Section-By-Section Analysis

The following describes the final rule's amendments of Regulation O.

Section 215.1(a)

The final rule adds a references to FDICIA.

Section 215.2(a)

The final rule replaces the term

[18] See 138 Cong. Rec. S2059, S2077 (daily ed. February 21, 1992) (Statement of Sen. Riegle).

[19] Federal Deposit Insurance Corporation Improvement Act of 1991, sec. 221, 105 Stat. 2236, 2305 (1991).

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"bank" with the term "depository institution" to reflect statutory usage.

Sections 215.2 (c) and (d) and 215.4(c); and Redesignated Section 215.2(b)

The final rule replaces the term "bank holding company" with the term "company" and removes the reference to the statutory definition of bank holding company.

Sections 215.2 (e) Through (l)

The final rule redesignates these paragraphs as paragraphs (g) through (n) to accommodate new paragraphs (e) and (f) of § 215.2.

Section 215.2(e)

The final rule creates a new paragraph (e) that relocates the existing Regulation O definition of the term "foreign bank." The definition, which remains unchanged, was previously a parenthetical part of the Regulation O definition of "member bank."

Section 215.2(f)

The final rule creates a new paragraph (f) that defines the term "insider."

Redesignated Section 215.2(h)

The final rule replaces the regulatory term "capital stock" with the statutory term "unimpaired capital" and adds a date specification to the definition of valuation reserves for the purposes of calculating a member bank's capital.

Redesignated Section 215.2(i)

The final rule defines the term "member bank" to include any subsidiary of the member bank.

Redesignated Section 215.2(1)

The final rule replaces the phrase "an individual or company" with the term "person" to reflect statutory usage. The final rule also strikes the sentence that implemented the control standard for determining "principal shareholder" of member banks located in communities with populations of less than 30,000 persons.

Redesignated Section 215.2(m)

The final rule adds the phrase "of a person" to the definition of "related interest" to reflect statutory usage.

Section 215.3(a)(4)

The final rule replaces the term "person" with the term "insider" to clarify that the definition applies when the party liable is a bank insider.

Section 215.3(a)(8)

The final rule adds the term "similar" to reflect statutory usage.

Section 215.3 (b)(2) and (b)(5)

The final rule modifies the regulatory references to conform with the reorganized regulation.

Section 215.4(a)(1)

The final rule 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. In addition, the proposal proposed to replace the term "repayment" with the term "default." The final rule retains the term "repayment."

Section 215.4(b) (2) and (3)

The final rule reorganizes § 215.4 by redesignating existing paragraphs (b)(2) and (b)(3) of § 215.4 as paragraphs (b)(3) and (b)(4) to accommodate new paragraph (b)(2).

Section 215.4(b)(2)

The final rule reorganizes section 215.4 by creating a new paragraph (b)(2) to contain the existing $500,000 limitation. The limitation provision is not modified substantively.

Section 215.4(c)

The final rule adds the term "directors" to the list of persons subject to the lending limit. This reflects the FDICIA amendment of section 22(h) that extends to loans to directors the section 22(h) lending limit.

Section 215.4(d)

The final rule redesignates existing paragraph (d) as paragraph (e) to accommodate new paragraph (d). New paragraph (d) implements the aggregate limit on extensions of credit to all insiders as a class mandated by FDICIA.

Section 215.5(a), Footnote 4

The final rule strikes the first sentence to reflect the FDICIA revisions that amend section 22(g) of the Federal Reserve Act to cover non-member insured banks. The final rule also modifies regulatory references to conform them with the reorganized regulation.

Section 215.5(c)(2)

The proposal proposed to add the phrase "the primary" to clarify that the amount limit under this paragraph applies only to an executive officer's primary residence. The final rule does not add the term "primary."

Section 215.5(d)

The final rule adds the phrase "in writing" after the term "condition" to clarify that the condition required by this paragraph must be in writing. The proposed rule also proposed to add the term "corresponding" before the phrase "category of credit." The final rule does not add the term "corresponding."

Sections 215.6 Through 215.10

The final rule redesignates these sections as §§ 215.7 through 215.11 to accommodate new § 215.6.

Section 215.6.

The final rule 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 215.11

The final rule redesignates § 215.11 as § 215.13 and adds a new § 215.12 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.

Redesignated Section 215.9.

The proposal proposed to add the term "corresponding" before the phrase "category of credit" in redesignated § 215.9. The final rule does not add term "corresponding."

Redesignated Section 215.13.

The final rule amends this section to refer to the appropriate civil penalty provisions of the Federal Reserve Act.

The following describes the final rule's amendment of Regulation Y.

Section 225.4(f)

The final rule 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 final rule implements additional restrictions on member banks' lending to their executive officers, directions, and

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principal shareholders that are required by section 306 of the FDICIA. The final rule also adds reporting requirements mandated by FDICIA that relate to certain credit to executive officers and directors of certain banks and bank holding companies.

The Board expects that these statutorily mandated requirements, such as the aggregate lending limit, will impose costs on banking organizations, including small banking organizations. As authorized by FDICIA, however, the Board has determined to permit banks total deposits of less than $100 million to establish a higher aggregate lending limit (not to exceed two times the bank's unimpaired capital and unimpaired surplus) under certain circumstances. The Board has determined to permit the higher limit for a one-year period in order to enable the Board to collect data for the purpose of assessing the effect of the aggregate lending limit on the ability of small banks to attract directors and to lend.

The final rule does not establish any new substantive, procedural, or reporting requirements that are not required by FDICIA, with the exception of a submission required of small banks that establish higher aggregate lending limits authorized by the regulation. The final rule requires that such small banks submit to the appropriate federal banking agency and to the Board of Governors the resolution that records the board of directors'consideration and adoption of any higher limit. This resolution must set forth the facts and reasoning that support the board of directors' decision, including a statement of the bank's lending to its insiders as a percentage of the bank's unimpaired capital and unimpaired surplus.

Effective Date

The provisions of 5 U.S.C. 553(d) generally prescribing 30 days prior notice of the effective date of a rule have not been followed in connection with the adoption of this amendment because adoption of the rule reduces a regulatory burden and because the Board has found good cause to dispense with 30 days prior notice. Section 553(d) grants a specific exemption from the deferred effective date requirements in these instances.

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 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 of 1991 (Pub. L. No. 102–242, 105 Stat. 2236 (1991)), the Board is amending 12 CFR part 215, subpart A, and 12 CFR part 225, subpart A, as follows:

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

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

Authority: Secs. 11(i), 22(g) and 22(h), Federal Reserve Act (12 U.S.C. 248(i), 375a, 375(b)(7)), 12 U.S.C. 1817(k)(3) and 1972(2)(F)(vi), and sec. 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102–242, 105 Stat. 2236 (1991)).

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

2. In part 215, the footnotes are removed or redesignated as shown in the following table:

Section and paragraph	Current No.	New No.
215.4(c)	3	removed
215.4(d)	4	3
215.5(a)	5	4
215.8	6	5
215.9	7	6
215.10(a)	8	7
215.10(b)	9	8

3. 12 CFR 215.1 is amended by revising paragraph (a) to read as follows:

§ 251.1 Authority, purpose, and scope.

(a) *Authority.* This subpart 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), 12 U.S.C. 1817(k)(3), and section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102–242, 105 Stat. 2236 (1991)).

* * * * *

4. 12 CFR 215.2 is amended by revising paragraphs (a), (c), and (d), redesignating paragraphs (e) through (l) as paragraphs (g) through (n), adding new paragraphs (e) and (f), and revising newly designated paragraphs (h), (i), (l), and (m) 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.

* * * * *

(c) *Director of a member bank* includes:

(1) Any director of a member bank, whether or not receiving compensation;

(2) Any director of a company of which the member bank is a subsidiary; and

(3) Any director of any other subsidiary of that company. An advisory director is not considered a director if the advisory director—

(i) Is not elected by the shareholders of the company or bank;

(ii) Is not authorized to vote on matters before the board of directors; and

(iii) Provides solely general policy advice to the board of directors.

(d)(1) *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: the officer has an official title; the title designates the officer an assistant; or the officer is serving without salary or other compensation.[1]

[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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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: The officer is excluded, by resolution of the board of directors 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 the officer does not actually participate therein.

(2) For the purpose of §§ 215.4 and 215.8 of this part, an executive officer of a member bank includes an executive officer of a company of which the member bank is a subsidiary; and any other subsidiary of that company, unless the executive officer of the subsidiary 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 does not actually participate in such major policymaking functions.

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

(f) *Insider* means an executive officer, director, or principal shareholder, and includes any related interest of such a person.

* * * * *

(h) 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] 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 an 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 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 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 reported on its most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3).

(i) *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. 1828(j)(2).

* * * * *

(l) *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.

(m) *Related interest* of a person means:

(1) A company that is controlled 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.

* * * * *

5. 12 CFR 215.3 is amended by revising paragraphs (a)(4), (a)(8), (b)(2) and (b)(5) 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 insider may be liable as maker, drawer, endorser, guarantor, or surety;

* * * * *

(8) Any other similar 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, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

(b) * * *

(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 § 215(4)(e) of this part):

* * * * *

(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 § 215.4(e) of this part, 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.

* * * * *

6. 12 CFR 215.4 is amended by revising paragraphs (a)(1), (b)(1) and (c), redesignating paragraphs (b)(2) and (b)(3) as paragraphs (b)(3) and (b)(4), respectively, adding a new paragraph (b)(2), redesignating paragraph (d) as paragraph (e), and adding a new paragraph (d) 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

* * * * *

(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 percent of the member bank's unimpaired capital and unimpaired surplus, unless:

[2] Where State law established 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.

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(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.

(2) 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.

* * * * *

(c) *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(h) 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.

(d) *Aggregate lending limit*—(1) *General limit.* A member bank may not extend credit to any insider unless the extension of credit is in an amount that, when aggregated with the amount of all outstanding extensions of credit by that bank to all of its insiders, does not exceed the bank's unimpaired capital and unimpaired surplus (as defined in § 215.2(h) of this part).

(2) *Members banks with deposits of less than $100,000,000.* A member bank with deposits of less than $100,000,000 may by resolution of its board of directors increase the general limit specified in paragraph (d)(1) of this section for the one-year period ending May 18, 1993, to a level not to exceed two times the bank's unimpaired capital and unimpaired surplus, if:

(i) The board of directors determines that such higher limit is consistent with prudent, safe, and sound banking practices in light of the bank's experience in lending to its insiders and is necessary to attract or retain directors or to prevent restricting the availability of credit in small communities;

(ii) The resolution sets forth the facts and reasoning on which the board of directors bases the finding, including the amount of the bank's lending to its insiders as a percentage of the bank's unimpaired capital and unimpaired surplus as of the date of the resolution;

(iii) The bank has submitted the resolution to the appropriate Federal banking agency (as defined in 12 U.S.C. 1813(q)) with a copy to the Board of Governors; and

(iv) The bank meets or exceeds, on a fully-phased in basis, all applicable capital requirements established by the appropriate Federal banking agency.

* * * * *

7. 12 CFR 215.5 is amended by revising newly designated footnote 4 in paragraph (a) and by revising paragraph (d) to read as follows:

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

(a) * * *[4] * * *

* * * * *

(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 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.

8. 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 on 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 part.

[4] Sections 215.5, 215.9, and 215.10 of this part implement section 22(g) of the Federal Reserve Act. For the purposes of those 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

9. A new 12 CFR 215.12 is added to read as follows:

§ 215.12 Reporting requirement for credit secured by certain bank stock.

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.

10. Newly designated 12 CFR 215.13 is revised to read as follows:

§ 215.13 Civil penalties.

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 subpart (other than § 215.11) is subject to civil penalties as specified in section 29 of the Federal Reserve Act (12 U.S.C. 504).

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

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

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831(i), 1843(c)(8), 1844(b), 3106, 3108, 3907 3909, 3310, and 3331–3351, and sec. 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102-242, 105 Stat. 2236 (1991)).

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

§ 225.4 Corporate practices.

* * * * *

(f) *Reporting requirement for credit secured by certain bank holding company stock.* 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, May 21, 1992.

Jennifer J. Johnson,

Associate Secretary of the Board.

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