FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10700** March 22, 1994]

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

Amendments to Regulation O

To All Depository Institutions, and Others Concerned in the Second Federal Reserve District:

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

> The Federal Reserve Board has announced approval of a final rule amending several provisions of Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks).
>
> The rule was effective February 18, 1994.
>
> The first amendment makes permanent an interim rule increasing Regulation O's aggregate lending limit for small, adequately capitalized banks from 100 percent of a bank's unimpaired capital and surplus to 200 percent.
>
> The second set of amendments is designed to reduce the burden and complexity of the regulation. These amendments clarify the "tangible economic benefit" rule, provide certain exceptions to the lending limit for insiders, permit banks to follow alternative recordkeeping procedures, and narrow the definition of "extension of credit."
>
> Additionally, the final rule implements technical amendments to Regulation O in order to make it more readily understandable and somewhat shorter.

Enclosed — for depository institutions in the Second Federal Reserve District and others who maintain sets of regulations of the Board of Governors — is the text of the amendments to Regulation O, which have been reprinted from the *Federal Register* of February 24; additional single copies may be obtained at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by contacting the Circulars Division (Tel. No. 212-720-5216). Questions regarding Regulation O may be directed to Donald E. Schmid, Manager, Domestic Banking Department (Tel. No. 212-720-6611).

WILLIAM J. MCDONOUGH,
President.

10700

Board of Governors of the Federal Reserve System

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

AMENDMENTS TO REGULATION O

Effective February 18, 1994

FEDERAL RESERVE SYSTEM

12 CFR Part 215

[Regulation O; Docket Nos. R–0800 and R–0809]

Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is revising Regulation O to permit the aggregate limit on lending to insiders by eligible, adequately capitalized small banks to be increased from 100 percent of unimpaired capital and surplus to 200. The Board also is revising Regulation O to permit banks to follow alternative recordkeeping procedures on loans to insiders of affiliates, to narrow the definition of "extension of credit," and to adopt certain exceptions to the general restrictions on lending to insiders and the special restrictions on lending to executive officers. Other minor revisions clarifying certain exemptions and conforming certain provisions to the enabling statutes are included as well.

EFFECTIVE DATE: Effective February 18, 1994.

FOR FURTHER INFORMATION CONTACT: Gregory Baer, Senior Attorney (202/452–3236), Gordon Miller, Attorney (202/452–2534), or Stephen Van Meter, Attorney (202/452–3554), Legal Division; Stephen M. Lovette, Manager of Policy Implementation (202/452–3469), or Mark Benton, Senior Financial Analyst (202/452–5205), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452–3544), Board of Governors of the Federal Reserve System, 20th & C Streets, NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

I. Background

The Board is making permanent, with certain additional qualifications, its interim rule permitting small, adequately capitalized banks to extend credit to insiders up to 200 percent of unimpaired capital and surplus, in circumstances where such lending is necessary to serve local credit needs or to attract directors. The Board also is adopting amendments to Regulation O (12 CFR part 215) designed to increase the ability of banks to make extensions of credit that pose minimal risk of loss, to eliminate recordkeeping requirements that impose a paperwork burden but do not significantly aid compliance with the regulation, and to remove certain transactions from the regulation's coverage consistent with bank safety and soundness. The above amendments are expected to increase the availability of credit, particularly in communities served by small banks, and to reduce the cost of compliance with the regulation.

In view of the extensive changes made to Regulation O as a result of this rulemaking, the Board is restating subpart A of Regulation O as amended, rather than separately describing each amendment.

The Board is making the rule effective immediately in order to prevent a lapse in the 200 percent lending limit available to eligible banks under the interim rule for loans to insiders, and to make all other provisions effective at the same time.

II. The 200 Percent Aggregate Lending Limit

Section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) restricts the amounts and terms of extensions of credit from a bank to executive officers, directors, and principal shareholders of the bank and its holding company affiliates and to any related interest of those persons (insiders). Section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) [1] amended section 22(h) to impose an aggregate limit on the amount a bank may lend to its insiders as a class. See 12 U.S.C. 375b(5). In general, the limit is equal to 100 percent of the bank's unimpaired capital and unimpaired surplus. The Board is authorized, however, to make exceptions to the general limit for banks with deposits of less than $100 million "if the Board determines that the exceptions are important to avoid constricting the availability of credit in small communities or to attract directors of such banks." 12 U.S.C. 375b(5)(C). The higher limit may not exceed 200 percent of the bank's unimpaired capital and unimpaired surplus. *Id.*

Effective May 18, 1992, the Board amended Regulation O, which implements section 22(h), to incorporate the aggregate lending limit added by FDICIA. The general limit on lending to insiders and their related interests—100 percent of the bank's unimpaired capital and unimpaired surplus—was adopted. The Board also decided as an interim measure to permit banks with deposits under $100 million to adopt a higher limit, not to exceed 200 percent of the bank's unimpaired capital and unimpaired surplus, for a period of one year to expire May 18, 1993. The interim period was intended to allow the Board to consult with the other federal banking agencies and collect data on the lending practices of banks in order to analyze the effect of the aggregate lending limit on the availability of credit and service of directors. See 57 FR 22417, 22420, May 28, 1992.

The Board subsequently extended the interim rule for six months, through November 18, 1993, in order to obtain public comments on whether the

[1] Pubic Law 102–242, Section 306, 105 Stat. 2236 (1991).

PRINTED IN NEW YORK, FROM *FEDERAL REGISTER*, VOL. 59, NO. 37, pp. 8831-8842

[Enc. Cir. No. 10700]

interim rule should be made permanent, modified, or permitted to expire. See 58 FR 28492, May 14, 1993. The Board thereafter extended the interim rule an additional three months, through February 18, 1994, in order to review the written comments, call reports of small banks, and relevant information from other governmental agencies. See 58 FR 61803, November 23, 1993.

The interim rule established requirements that a small bank had to meet in order to adopt a higher aggregate lending limit. Under that rule, the board of directors of the bank had to determine by resolution that a higher aggregate lending limit was consistent with prudent, safe, and sound banking practices in light of the bank's experience in lending to its insiders, and that a higher limit was necessary to attract or retain directors or to prevent restricting the availability of credit in small communities. The resolution had to set forth the facts and reasoning that supported this determination, including the amount of the bank's aggregate lending to insiders, expressed as a percentage of unimpaired capital and unimpaired surplus, as of the date of the resolution. The bank also was required to submit its resolution to the appropriate federal banking agency, with a copy to the Board. Finally, the bank had to meet or exceed all applicable capital requirements. See 12 CFR 215.4(d)(2).

In response to the notice of the extension of the interim rule, the Board received 147 written comments, with 144 respondents in favor of making the 200 percent limit permanent. Small banks subject to the rule submitted the large majority of comments. Other commenters included numerous state and national banking trade associations, several state banking superintendents and Federal Reserve Banks, individual bank directors, bank holding companies, and law firms.

Adverse comment focused on the relatively low level of use of the interim provision. Two of the three adverse commenters argued that a higher aggregate lending limit was not important to credit or director availability because very few banks had used the interim rule. One state banking commissioner noted that of the 88 small banks it supervised, only one had aggregate insider loans in excess of 60 percent of unimpaired capital and unimpaired surplus as of March 31, 1993.

Call report data reflected a similar low level of aggregate insider lending. As of September 30, 1993, of a total population of 7,435 banks with deposits of less than $100 million, only 17 reported loans to insiders in an amount greater than 100 percent of capital. A total of 131 banks reported insider loans greater than 60 percent of capital. Only 54 banks have notified the Board pursuant to the interim rule that they have adopted a higher aggregate lending limit.

In support of the proposed rule, sixty-two commenters stated that a higher aggregate lending limit was important in order that small banks not be forced to choose between refusing credit to qualified insiders and asking insiders to resign as directors. Several banks observed that this was a particular hardship because qualified directors typically are active businesspersons whose businesses have substantial yet healthy credit requirements.

Fifteen commenters observed that the aggregate lending limit was a particular hardship in small communities and rural markets because in those settings small banks were dependent on insiders as a loan source, insiders had fewer alternative credit sources, and insiders tended to be closely identified with their banks, making it difficult for them to seek credit from a competitor.

In order to demonstrate that the higher limit was being used and would have important benefits if made permanent, the Independent Bankers Association of America (IBAA) presented in its comment a survey of 8,057 small banks. Of 1,060 banks that responded to the survey, 152 reported that the general aggregate lending limit had prevented them from making a loan to an insider; 95 respondents reported that the aggregate lending limit had prevented them from naming an individual as a director; and 53 respondents reported that they had accepted a director resignation attributable to the aggregate lending limit.

Additional commenters presented a variety of reasons for the low level of use of the interim 200 percent limit: concern that the interim rule would be eliminated, thereby forcing banks to retract credit extended in reliance on it; historically low lending levels; loan participations as an alternative to approving a higher limit; and deferral of consideration of the issue by small banks whose insider loans had not matured since adoption of the interim rule. Some commenters also observed that the interim rule imposed detailed requirements and that some banks may have feared attracting additional regulatory scrutiny by adopting the interim rule.

After the close of the comment period, the General Accounting Office (GAO) provided to the Board a draft report on bank insider activities. The GAO reviewed banks that failed during 1990 and 1991 in order to determine whether insider practices contributed to the banks' failures. (The GAO did not evaluate any existing or proposed regulation in this area.) The GAO found that insider problems (which the GAO defined very broadly) were prevalent at failed banks, that banks with less than $100 million of assets were more likely than larger banks to be cited for insider problems, and that the most frequently cited violations were loans to insiders made in excess of lending limits and on preferential terms not available to the general public.

However, the GAO report did not establish a causal link between insider problems and bank failures. Rather, the GAO appeared to conclude that insider problems, as broadly defined by the GAO, were correlated with poor internal controls and underwriting practices. The GAO was not able to measure the actual level of insider lending at failed or troubled banks, and therefore was not able to address specifically the relationship of the actual level of insider lending to bank failures. The major GAO recommendations were for increased monitoring of insider lending and more effective follow-up on violations.

The Board has concluded that the concerns raised in the GAO report do not justify preventing qualified banks from utilizing a higher aggregate lending limit. If the higher limit should present safety and soundness problems at an institution, then the appropriate banking supervisor retains general authority to require a reduction in the level of insider loans. If problems should occur more generally, the Board retains authority to eliminate or reduce the exemption.

Although the 100 percent aggregate lending limit does not appear to be currently creating a widespread problem with credit or director availability, the Board has concluded that it does appear to pose important problems for banks in certain communities. Given the available data and the comments, the Board believes that the 100 percent limit is restricting the availability of credit and the recruitment of directors in communities where the proper certification can be made. In such circumstances, the Board believes that an eligible small bank should be permitted to establish a higher lending limit up to 200 percent of unimpaired capital and unimpaired surplus. Each eligible bank's board of directors will still be required to certify that the higher limit is necessary to avoid restricting credit or to assist in attracting directors

and is consistent with prudent, safe, and sound banking practices.

The Board emphasizes that, as was the case prior to FDICIA, borrowing by insiders will continue to be subject to scrutiny during the examination process, including an evaluation of whether such borrowing represents an inappropriate concentration of loans.

In the final rule, the Board has adopted three modifications to the proposed rule. First, the Board has provided that to qualify for the higher lending limit, a bank must be in satisfactory overall condition as determined in the most recent report of examination of the bank, as well as being adequately capitalized, as was already required in the interim rule. Second, a provision has been added clarifying that a bank operating above the 100 percent limit that subsequently becomes ineligible for the higher limit may retain its existing insider loans but may not extend credit that would maintain aggregate insider lending in excess of 100 percent of unimpaired capital and surplus. Third, banks are not be required to file the required resolutions with their primary regulator or the Board, as was required by the interim rule. The resolutions are to be made available for inspection during the examination process.

III. Recordkeeping Procedures

Section 215.8 of Regulation O currently requires that each bank maintain records necessary for compliance with the insider lending restrictions of Regulation O. Specifically, banks are required to maintain records (1) identifying all directors, officers, and principal shareholders of the bank and its affiliates and all related interests of those persons (collectively, "insiders"), and (2) specifying the amounts and terms of all credit extended to these insiders. Section 215.8 further requires each bank to request on an annual basis that its insiders and insiders of its affiliates identify their related interests. The list of insiders is then used by the bank to identify all existing or proposed extensions of credit covered by Regulation O, to monitor the amount thereof subject to the individual and aggregate lending limits, and to ensure that all appropriate approval procedures are followed.

Since adoption of the initial recordkeeping requirement, the annual survey has grown in size and complexity. Bank holding companies have become increasingly large and diversified, and commercial organizations have acquired credit card banks and limited purpose banks. Thus, for example, a small, grandfathered bank owned by a large diversified holding company may have hundreds of affiliates with thousands of officers and directors. Although the bank may have no contact with these officers and directors and companies controlled by them, it currently is required to collect information on all these parties. In another example, a CEBA credit card bank is prevented by law from making loans to anyone but individuals,[2] and is thus effectively prohibited from lending to insiders' related interests, but the current rule nonetheless requires the bank to conduct an annual survey of related interests.

On September 9, 1993, the Board published notice of proposed rulemaking and requested comment concerning alternative recordkeeping procedures that banks may follow to monitor loans to insiders of the bank and its affiliates. See 58 FR 47400. The Board proposed to allow each bank to decide on its own how to gather information on related interests, so long as its method was effective. For example, in the case of a nonbank credit card bank or other bank that does not make commercial loans, the bank could decide not to keep records on related interests. For banks that make commercial loans, two acceptable recordkeeping methods were identified: (1) The "survey" method currently required, under which all insiders are asked annually to identify all their related interests; and (2) the "borrower inquiry" method, under which the bank would (a) ask each commercial borrower as part of the loan application process whether it is a related interest of an insider of the bank, and (b) maintain a record of each affirmative response. Finally, the proposed rule sought comment on whether any other recordkeeping methods would be effective in monitoring compliance with Regulation O.

The draft GAO report, discussed above, urged the federal bank agencies to emphasize the importance of accurate and complete insi ler recordkeeping. Management recordkeeping failures, the GAO argued, were indicative of larger bank management problems, and management solutions in this area, the GAO reasoned, would contribute to the resolution of management's larger problems. The Board believes that the proposed recordkeeping amendments, which attempt to eliminate unnecessary recordkeeping and allow for alternative methods of recordkeeping, are consistent with the GAO's recommendations.

Commenters supported the recordkeeping amendments as a means of decreasing unnecessary paperwork burden. Commenters uniformly supported no longer requiring credit card banks and other institutions that do not make commercial loans to keep records on the related interests of insiders. No commenter proposed any general recordkeeping methods in addition to those identified in the rule.

A few commenters expressed concerns about the second recordkeeping option put forth in the proposed rule—the "borrower inquiry" method. Commenters noted that in some cases a corporate borrower might be unaware that it is a related interest of a bank insider and therefore might inadvertently misinform a bank's loan officer. For example, a corporate employee negotiating a loan may not know that one of his company's controlling shareholders is also a director of one of the lending bank's affiliates. Citing this possibility, several bank commenters supported the recordkeeping provision but requested that the Board specify that use of the borrower inquiry method would give a bank a "safe harbor" from criticism during an examination in the event that inaccurate certifications were accepted from borrowers. On a related point, two commenters sought assurance that internal controls consistent with the proposed recordkeeping alternatives would meet the compliance certification requirements of section 112 of FDICIA.

The Board believes protections currently exist to prevent intentional misreporting by borrowers under the borrower inquiry method. Intentional misreporting could bring criminal or civil penalties. First, a borrower that knowingly misstates whether it is a related interest of the lending bank is criminally liable. 18 U.S.C. 1014. Second, a bank insider to whom the corporate borrower is related and who is aware of the loan violates Regulation O if the insider permits the related interest to receive any extension of credit not authorized under Regulation O. 12 CFR 215.6.

The Board has also concluded that any unintentional misreporting should not be a matter of serious concern. While there could be cases in large multi-bank holding companies where a borrower and lender are genuinely ignorant of the relationship between them, there is no potential in those circumstances for an insider's status to improperly affect the credit decision.

The Board has decided to adopt the recordkeeping provisions, as proposed, with three amendments. First, in order to address concerns about inaccurate

[2] See 12 U.S.C. 1841(c)(2).

reporting, the Board has adopted an additional safeguard to prevent the occurrence of those reporting errors, both intentional and unintentional, that are likely to occur most frequently and that raise the greatest concern. The final rule establishes a minimum requirement that every bank, regardless of the recordkeeping method it selects, must conduct an annual survey to identify its own insiders (that is, its own executive officers, directors, and principal shareholders and their related interests, but not those of its holding company affiliates). Every bank is expected to check this short list before extending credit, even if it is employing the borrower inquiry method of recordkeeping for affiliates in lieu of the survey method. In addition to addressing possible violations of Regulation O, the limited survey and the short list it produces will be available for monitoring compliance with section 23A of the Federal Reserve Act.

As for concerns about a "safe harbor," the Board believes that an implicit safe harbor exists for banks electing either one of the two recordkeeping options included in the final rule, and that following either of these options would allow the necessary certification to be made for purposes of section 112 of FDICIA. Furthermore, under the enforcement guidelines, the federal banking agencies should not assess civil money penalties for an inadvertent or accidental violation of their rules.

Second, because the commenters did not identify any recordkeeping methods other than the two proposed by the Board, the Board has adopted a presumption in the final rule that a bank must use either one of the two identified methods unless it can demonstrate that another method is equally effective. The suitability of any alternative procedure for monitoring lending to insiders and their related interests must be determined, of course, on the basis of the effectiveness of the procedure in preventing violations of law and insider abuse. Any alternative recordkeeping procedure must sufficiently identify extensions of credit covered by Regulation O to ensure that proper monitoring of and compliance with insider lending restrictions is maintained.

Finally, the Board has made an explicit exemption from the requirement that a bank keep records of, or inquire about related interests of insiders of the bank or its affiliates, for banks that are prohibited from making commercial loans in the first place.[3] Related interests consist only of companies or other similar entities, as a result of which a bank that is prohibited from making commercial loans is prohibited from making loans to any company or other entity that may be a related interest. When such a prohibition exists, recordkeeping or inquiries with respect to related interests is unnecessarily burdensome.

IV. Definition of Extension of Credit

The Board proposed three amendments to the definition of "extension of credit" in Regulation O: a clarification of the "tangible economic benefit" rule; a new exception for the discount by a bank of obligations sold by an insider without recourse; and an increase in the threshold for treating credit card debt as an extension of credit. See 58 FR 47400, September 9, 1993.

A. "Tangible Economic Benefit" Rule

Regulation O provides that an extension of credit is deemed to be made to an insider when the proceeds of the credit are used for the tangible economic benefit of, or are transferred to, the insider. 12 CFR 215.3(f). These extensions of credit are thereby counted toward the lending limits of Regulation O.

Following the enactment of FDICIA, which expanded the lending limit provision of section 22(h) of the Federal Reserve Act to cover directors and their related interests, questions were raised more frequently regarding the scope and proper application of the tangible economic benefit rule. If interpreted literally, the tangible economic benefit rule would apply whenever a bank extended credit to any person, including a member of the general public with no other relationship to the bank, and the proceeds of the extension of credit were transferred to or used for the benefit of an insider or an insider's related interest. For example, as one commenter noted, loans on non-preferential terms to members of the general public to purchase homes from a builder who is a director of the bank would be treated as loans to the builder/director.

The tangible economic benefit rule is similar to a provision contained in section 23A of the Federal Reserve Act, and was adopted at a time when the Board was required by section 22(h) of the Federal Reserve Act to use the definition of "extension of credit" found in section 23A. See Public Law 95–630 Section 104, 92 Stat. 3644 (1978). The definition of extension of credit in section 22(h), however, is no longer tied to section 23A, and the Board is authorized to adopt appropriate definitions of terms in the statute. See 12 U.S.C. 375b(9)(D) and 375b(10). The Board therefore proposed to revise the tangible economic benefit rule to clarify that it was not intended to reach such transactions, by providing explicitly that the rule does not apply to an arm's-length[4] extension of credit by a bank to a third party where the proceeds of the credit are used to finance the bona fide acquisition of property, goods, or services from an insider or an insider's related interest.

Commenters supported the proposal, and no adverse comments were received. Three commenters objected to the requirement that any arm's-length loan satisfy the non-preferential provisions for insider loans found in § 215.4(a), labelling that requirement overly restrictive. The Board has retained the requirement, however, that loans be on non-preferential terms, in order to prevent banks from participating in commercial promotions that benefit the bank's insiders to the detriment of the bank.[5]

Continuing to be covered by the tangible economic benefit rule are extensions of credit to an insider's nominee and transactions in which the proceeds of the credit are loaned to an insider. The Board also notes that provisions of the definition of "extension of credit" outside the tangible economic benefit rule will continue to reach transactions in which an insider actually becomes obligated 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." 12 CFR 215.3(a)(8).

B. Discount of Obligations without Recourse

Regulation O includes within the definition of "extension of credit" any "discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, *whether with or without*

[3] For example, a nonbank credit card bank, in order to maintain its exception from the definition of "bank" in the Bank Holding Company Act, may not engage in the business of making commercial loans. See 12 U.S.C. 1841(c)(2)(E).

[4] In order to satisfy this requirement, the extension of credit to the general public must be on terms that would satisfy the standard set forth in § 215.4 of Regulation O if the extension of credit was being made directly to an insider or an insider's related interest.

[5] One other commenter sought clarification on the relationship between the tangible economic benefit rule and another rule in Regulation O that states that loans made by a bank to a partnership in which one or more executive officers of the bank hold a majority interest are to be attributed in full to each of the executive officers. 12 CFR 215.5(b). The introductory portion of § 215.5 has been revised to clarify the interplay between § 215.5 and the general provisions of Regulation O.

recourse." 12 CFR 215.3(a)(5) (emphasis added). At the time this provision was adopted, the Board was required by section 22(h) to include such items in the regulatory definition of extension of credit.[6] However, the current statutory definition does not require the inclusion of such items where the transaction is made without recourse to the transferor.[7] The Board proposed to delete this provision so as to exclude non-recourse transactions from Regulation O coverage. Transactions entered into with recourse to the transferor would continue to be covered under other provisions of the definition. See 12 CFR 215.3(a)(4) and (8).

The Board has adopted this amendment as proposed. Non-recourse transactions resemble a purchase of assets more than the lending of money, and the final rule conforms the treatment of these transactions to the treatment of other asset pruchases between a bank and its insiders. Moreover, these non-recourse transactions do not constitute "extensions of credit" to the transferor under the National Bank Act as interpreted by the Office of the Comptroller of the Currency. See 12 U.S.C. 84(b)(1); 12 CFR 32.2(a). These transactions will continue to be governed, however, by general standards of safety and soundness, prohibitions against fraud and abuse, and corporate fiduciary duties.[8]

Commenters supported the proposal, and no adverse comments were received. One commenter asked the Board to clarify whether limited or partial recourse transactions would be treated as extensions of credit. The Board believes that it is more appropriate to address the numerous possible recourse arrangements on a case-by-case basis.

C. Credit Card Plan Indebtedness

Regulation O exempts from the definition of "extension of credit," and thus from Regulation O's lending limits, indebtedness of $5,000 or less arising through any general arrangement by which a bank: (1) Acquires charge or time credit accounts; or (2) makes payments to or on behalf of participants in a bank credit card plan or other open-end credit plan. 12 CFR 215.3(b)(5). To qualify for the exemption, the indebtedness must be on market terms and must not involve prior individual clearance or approval by the bank other than for the purpose of determining the borrower's eligibility and compliance with any applicable dollar limit. *Id.*

The Board proposed to increase from $5,000 to $15,000 the threshold above which standard credit card loans to insiders would be counted as extensions of credit. This proposed increase reflected widespread increases by credit card issuers in pre-approved lending limits and, to some extent, inflation since the initial adoption of the $5,000 limit in 1979. The Board did not propose raising the limit for extensions of credit through overdraft plans, leaving that limit at $5,000. Extensions of credit through overdrafts in amounts up to $15,000 have not become routine.

Commenters supported the proposed increase. Many commenters, however, requested that the increase be expanded. Thirteen commenters suggested that the proposed $15,000 cap on the amount of excluded credit card debt either be eliminated, increased, indexed, or periodically reviewed. Two commenters requested that credit card debt be exempted from the cap on general purpose loans to executive officers.

Eight commenters requested that the overdraft limit be raised by an identical amount. Commenters reasoned that one extension of credit is the same as another and thus that no substantive difference exists between credit card loans and overdraft extensions of credit. Moreover, some overdraft protection plans are now tied directly to credit card lines of credit. Commenters also noted that the rationale that the credit card limit was being raised to compensate for inflation applied equally to overdraft protection.

The Board has decided to increase the credit card exemption from $5,000 to $15,000 and to maintain the overdraft limit at $5,000. Raising the limit could encourage insiders to view overdraft plans as a source of credit, rather than solely as protection against infrequent and unplanned events. The Board is not prohibiting payment of overdrafts over $5,000 pursuant to a permissible pre-approved overdraft plan, but merely providing that overdrafts over $5,000 are counted toward the individual and aggregate lending limits of Regulation O.

The Board believes that the proposed limit is an appropriate compromise between its concern to prevent insider lending abuse and the added convenience that even higher or indexed limits may provide. Commenters presented no evidence to support their argument that a cap on exempt credit card lending is no longer necessary. Finally, the Board believes that exempting credit card loans from the cap on general purpose loans to executive officers would be more properly addressed in the context of a more general review of executive officer lending restrictions.

V. Consumer Installment Paper

Pursuant to the authority granted it by the Housing and Community Development Act of 1992 (HCDA),[9] the Board proposed an exception to the aggregate lending limit for the discount of consumer installment paper from an insider with recourse, so long as the bank is relying primarily upon the creditworthiness of the maker of the paper and not on any endorsement or guarantee of the insider. Such transactions would continue to constitute extensions of credit subject to the aggregate lending limit if the maker of the consumer installment paper was an insider. See 58 FR 47400, September 9, 1993.

The legislative history of HCDA states that the Board should make a "zero-based review" of any exceptions it adopts.[10] The proposed exception is consistent with this directive. The Board has concluded that, where the bank is relying primarily upon the creditworthiness of the underlying maker, the accompanying extension of credit to an insider transferring the paper with recourse poses minimal risk of loss to the bank.[11] In addition like the previous three exceptions, the new exception is found in the National Bank Act,[12] and is incorporated as an

[6] The current definition of "extension of credit" in Regulation O was adopted in 1979, when the Board substantially amended the regulation in order to implement the Financial Institutions Regulatory Act of 1978 (FIRA), Public Law 95–630 Section 104, 92 Stat. 3644 (1978). 44 FR 12963, March 9, 1979. FIRA added section 22(h) to the Act, which in turn incorporated the definition of "extension of credit" contained in section 23A. At that time, section 23A's definition included the above-referenced provision concerning the discount of paper acquired with or without recourse. See Public Law 89–485 Section 12, 80 Stat. 241 (1966).

[7] The statutory cross-reference to section 23A was deleted from section 22(h) in 1982. See Public Law 97–230 Section 410, 96 Stat. 1520 (1982). FDICIA added a new definition of "extension of credit" to section 22(h), which applies whenever a member bank makes or renews a loan, grants a line of credit, or enters into any similar transaction as a result of which a person becomes obligated to pay money or its equivalent to the bank. See 12 U.S.C. 375b(9)(D). This definition does not cover all transactions, such as the purchase of assets, covered by section 23A.

[8] In addition, sections 23A and 23B of the Act may be applicable to such transactions if the insider or the insider's related interest is an affiliate, as defined in section 23A, of the lending bank.

[9] Public Law 102–550 Section 955, 106 Stat. 3672 (1992).

[10] See 138 Cong. Rec. S17,914–15 (daily ed. October 8, 1992).

[11] Although extensions of credit made in conformity with the proposed exception would not count toward a bank's aggregate lending limit, such extensions of credit would continue to be treated as extensions of credit under 12 CFR 215.3(4) (a) and (b) of Regulation O, as a safeguard against abuse of this exception.

[12] All interpretations by the Comptroller of the Currency of the exceptions contained in 12 U.S.C.

Continued

10700

exception to the individual lending limit in Regulation O. See 12 U.S.C. 84(c)(8); 12 CFR 215.2(h) and 215.4(c).

Commenters generally supported the new exception, and no adverse comments were received. Three commenters argued that the proposed requirement that a designated officer of the bank certify in writing that the bank is relying primarily upon the maker of the discounted paper was too burdensome because it did not accommodate itself to bulk transactions in which the bank may perform only a statistical sampling of a discounted loan portfolio. One commenter asked the Board to clarify that the discount of consumer lease paper was included in the provision. Six commenters suggested adoption of additional exceptions contained in the National Bank Act, and one commenter suggested an additional exception not included in the National Bank Act.

The requirement that a designated officer certify that the bank has followed appropriate underwriting procedures is found in the National Bank Act, and the Board has decided to maintain consistency with that Act.

Concerning consumer lease paper, the Board notes that an interpretative letter concerning the circumstances under which a lease transaction may be considered to be an extension of credit for purposes of Regulation O has previously been issued. See Interpretative Letter dated April 8, 1976. The Board believes that it would be more appropriate to provide further guidance as to the treatment of particular transactions under Regulation O on a case-by-case basis.

Additional exemptions found in the National Bank Act have not been adopted. Those are either limited exemptions, exemptions for credit secured by collateral that is not stable and liquid, or exemptions that would be difficult to administer in the Regulation O context. Other exemptions suggested by commenters would require statutory change.

VI. Loans to Executive Officers

The Board proposed three amendments to the rules governing extensions of credit by a bank to its executive officers: A new exemption to the limit for general purpose loans that are fully collateralized by certain categories of highly stable and liquid collateral; clarification that home mortgage loan refinancing, subject to certain limitations, is included in the category of home mortgage loans; and a restatement of the prior approval requirement in section 22(g) of the Federal Reserve Act. See 58 FR 47400, September 9, 1993.

A. General Purpose Loans

Section 22(g) of the Federal Reserve Act establishes a special additional rule for extensions of credit by a bank to its executive officers. In general, a bank's lending to each of its executive officers is limited to an amount equal to the greater of $25,000 or 2.5 percent of the bank's capital and unimpaired surplus, but not to exceed $100,000. 12 CFR 215.5(c). Qualifying home mortgage loans and educational loans are not counted toward this limit, although they do count toward the general individual and aggregate lending limits applicable to all insiders under § 215.4 of Regulation O. 12 CFR 215.5(c)(1) and (2). Also, unlike the general individual and aggregate lending limits, there has been no exception to the executive officer lending limit based on the manner in which the extension of credit is collateralized.

The Board proposed to create an exemption to the general purpose lending limit for loans to executive officers for loans fully secured by: (a) Obligations of the United States or other obligations fully guaranteed as to principal and interest by the United States; (b) commitments or guarantees of a department or agency of the United States; or (c) a segregated deposit account with the lending bank.

The Board previously has determined that extensions of credit collateralized in the manner described above pose minimal risk of loss to a bank. See 58 FR 26507, May 4, 1993. In view of this determination, the Board has concluded that it is consistent with safe and sound banking practices to increase the amount of credit that a bank may extend to its executive officers when the credit is secured as described above. Because such loans would continue to be subject to the prohibitions against preferential lending, the Board also believes that the proposed exception would not lend itself to evasions of the law or any other abuse.

Commenters supported the proposed exception. Six commenters suggested that additional categories of exempt extensions of credit be adopted. Nine commenters requested that the current $100,000 cap on general purpose loans be increased, and two commenters suggested that the cap be eliminated altogether. One commenter suggested that loans to an executive officer serving in a bona fide fiduciary capacity not be included as loans to the executive officer for purposes of 12 CFR 215.5(c).

The additional exceptions that have been proposed apply more readily to loans made in a commercial context rather than to personal loans. Section 215.5 primarily governs personal loans, however, and the additional proposals therefore are neither necessary nor appropriate. The Board also considers it more appropriate to reconsider the appropriate lending limit for executive officers in connection with a more general review of executive officer restrictions. Finally, the Board notes that the proper treatment under Regulation O of loans to an executive officer serving in a bona fide fiduciary capacity has previously been addressed. See I Fed. Res. Reg. Serv. 3–1048. The Board will provide any further guidance on this issue on a case-by-case basis.

B. Refinancing of Home Mortgage Loans

Section 22(g) of the Federal Reserve Act provides that a bank may make a loan to its executive officer, without restriction as to amount, if the loan is secured by a first lien on a dwelling that is owned by the executive officer and used by the executive officer as a residence after the loan is made. 12 U.S.C. 375a(2). Section 215.5(c)(2) of Regulation O implements this provision, and sets forth additional restrictions on such loans.

The Board proposed to revise the regulation to provide clearly that the refinancing of a home mortgage loan is included within this category to the extent that the proceeds are used to pay off the prior home mortgage loan or for one or more of the permissible purposes enumerated in 12 CFR 215.5(c)(2).

Comments were generally supportive. Two commenters asked the Board to clarify that the closing costs of a home mortgage refinancing are included as part of the qualifying portion of the loan. Two commenters requested that all proceeds of a home mortgage refinancing be included in this category.

The Board, as requested in the comments, has revised the regulation further to provide expressly that closing costs are included as part of the exempt portion of a home mortgage refinancing, and to make other clarifying changes. Inclusion within the exemption of proceeds of a refinancing that may be used for unrestricted purposes is prohibited by the enabling statute.

C. Prior Approval of Home Mortgage Loans

Section 22(g) provides that the board of directors of a bank must specifically approve in advance a home mortgage loan to an executive officer. 12 U.S.C.

84 are applicable to Regulation O to the extent that these exceptions are incorporated by reference into or otherwise adopted in Regulation O.

375a(2). Regulation O, however, does not set forth this requirement. The Board proposed that 12 CFR 215.5(c) be revised to conform to the enabling statute.

Comments upon this proposal were mixed. One commenter asked the Board to clarify that prior approval is required for all home mortgage loans regardless of size, notwithstanding the general provisions of Regulation O that require prior approval only for loans in excess of a calculated amount. See 12 CFR 215.4(b). Two commenters suggested that the Board rely on its rulemaking authority not to conform to the statute, and two commenters asked the Board to seek relief from this requirement from Congress.

The Board has adopted this provision substantially as proposed. As discussed above, the Board has added an introductory statement to § 215.5 to clarify that the requirements for extensions of credit to executive officers under that section, pursuant to section 22(g), are in addition to the general requirements for insiders set forth elsewhere in Regulation O. The Board lacks the authority to adopt a provision of Regulation O that does not conform to the statutory prior approval requirement. The additional comments are beyond the scope of this rulemaking.

VII. Conforming Definition of "Bank"

Subpart B of Regulation O partially implements the reporting requirements of title VIII of FIRA, as amended by the Garn-St. Germain Depository Institutions Act of 1982 [13] and FDICIA. 12 U.S.C. 1972(2)(G). Section 215.22 requires an executive officer or principal shareholder of a bank to report to the bank each year if the person or any related interest of the person borrowed during the prior calendar year from a correspondent bank of the bank.

As originally enacted, a correspondent bank was defined in title VIII of FIRA to include a bank as defined in the Bank Holding Company Act. Title VIII was subsequently amended to include in the definition a mutual savings bank, a savings bank, and a savings association as defined in section 3 of the Federal Deposit Insurance Act. 12 U.S.C. 1971 and 1972(H). The Board proposed to amend the definition of bank in subpart B of Regulation O to conform the rule to the statutory amendments. See 58 FR 47400, September 9, 1993.

Comments were favorable, and the Board has adopted this provision as proposed.

[13] Public Law 97-320, 96 Stat. 1469 (1982).

VIII. Technical Amendments

The Board has adopted a series of technical amendments to Regulation O that are designed to make the regulation more easily understandable and somewhat shorter. The amendments include a new definition of "affiliate," which makes the regulation read more clearly and allows various cross-references and footnotes to be eliminated. Because the technical amendments do not make any substantive change to the regulation, notice and comment on them was not required.

IX. Final Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires an agency to prepare a final regulatory flexibility analysis when the agency promulgates a final rule. Two of the requirements of a final regulatory flexibility analysis, a succinct statement of the need for and objectives of the rule, and a summary and assessment of issues raised by the public comments and of any changes made in the proposed rule as a result thereof (5 U.S.C. 604(b)), are contained in the summary and supplementary information above. No significant alternatives to the final rule were considered by the agency.

X. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1980, 44 U.S.C. 3507, and 5 CFR 1320.130, the Board, under authority delegated by the Office of Management and Budget, has reviewed its amendments to Regulation O. The Board has determined that the revisions do not significantly increase the burden of the reporting institutions. The changes are expected to reduce regulatory burden for some banks, particularly small community banks and rural banks, but the estimated effect on aggregate burden calculations is not deemed to be significant.

List of Subjects in 12 CFR Part 215

Credit, Penalties, Reporting and recordkeeping requirements.

For the reasons set forth in the preamble, the Board is amending 12 CFR part 215 as follows:

PART 215—LOANS TO EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL SHAREHOLDERS OF MEMBER BANKS (REGULATION O)

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

Authority: 12 U.S.C. 248(i), 375a(10), 375b(9) and (10), 1817(k) and 1972(2)(G)(ii); Pub. L. 102-242, 105 Stat. 2236.

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

2. 12 CFR part 215, subpart A, is amended by revising §§ 215.1 through 215.13, to read as follows:

§ 215.1 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), and section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102-242, 105 Stat. 2236 (1991)).

(b) *Purpose and scope.* This subpart A governs any extension of credit by a member bank to an executive officer, director, or principal shareholder of: The member bank; a bank holding company of which the member bank is a subsidiary; and any other subsidiary of that bank holding company. It also applies to any extension of credit by a member bank to: A company controlled by such a person; and a political or campaign committee that benefits or is controlled by such a person. This subpart A also implements the reporting requirements of 12 U.S.C. 375a concerning extensions of credit by a member bank to its executive officers and of 12 U.S.C. 1817(k) concerning extensions of credit by a member bank to its executive officers or principal shareholders, or the related interests of such persons.

§ 215.2 Definitions.

For the purposes of this subpart A, the following definitions apply unless otherwise specified:

(a) *Affiliate* means any company of which a member bank is a subsidiary or any other subsidiary of that company.

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

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

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

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

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

(i) The person is:

(A) An executive officer or director of the company or bank; and

(B) Directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company or bank; or

(ii)(A) The person directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company or bank; and

(B) No other person owns, controls, or has the power to vote a greater percentage of that class of voting securities.

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

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

(d) *Director of a member bank* means any director of a member bank, whether or not receiving compensation. An advisory director is not considered a director if the advisory director:

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

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

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

(e)(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] 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) Extensions of credit to an executive officer of an affiliate of a member bank (other than a company that controls the bank) shall not be subject to §§ 215.4, 215.6 and 215.8 of this part, provided that:

(i) The executive officer of the affiliate 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 affiliate and the member bank, and does not actually participate in such major policymaking functions; and

(ii) The executive officer is not otherwise subject to such requirements as a director or principal shareholder.

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

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

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

(i) *Lending limit.* The lending limit for a member bank is an amount equal to the limit of loans to a single borrower established by section 5200 of the Revised Statutes,[2] 12 U.S.C. 84. This amount is 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured, and 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 that comply with requirements of the appropriate Federal banking agency for addition to the member bank's capital structure and are reported on its most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3); 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).

(j) *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)(3)(B).

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

(l) *Person* means an individual or a company.

(m)(1) *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.

(2) A principal shareholder of a member bank does not include a company of which a member bank is a subsidiary.

(n) *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.

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

§ 215.3 Extension of credit.

(a) An extension of credit is a making or renewal of any loan, a granting of a

[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.

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

line of credit, or an extending of credit in any manner whatsoever, and includes:

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

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

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

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

(5) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for:

(i) Accrued interest; or

(ii) Taxes, insurance, or other expenses incidental to the existing indebtedness;

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

(7) 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) An extension of credit does not include:

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

(2) A receipt by a bank of a check deposited in or delivered to the bank in the usual course of business unless it results in the carrying of a cash item for or the granting of an overdraft (other than an inadvertent overdraft in a limited amount that is promptly repaid, as described in § 215(4)(e) of this part);

(3) An acquisition of a note, draft, bill of exchange, or other evidence of indebtedness through:

(i) A merger or consolidation of banks or a similar transaction by which a bank acquires assets and assumes liabilities of another bank or similar organization; or

(ii) Foreclosure on collateral or similar proceeding for the protection of the bank, provided that such indebtedness is not held for a period of more than three years from the date of the acquisition, subject to extension by the appropriate Federal banking agency for good cause;

(4)(i) An endorsement or guarantee for the protection of a bank of any loan or other asset previously acquired by the bank in good faith; or

(ii) Any indebtedness to a bank for the purpose of protecting the bank against loss or of giving financial assistance to it;

(5) Indebtedness of $15,000 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, 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) Indebtedness of $5,000 or less arising by reason of an interest-bearing overdraft credit plan of the type specified in § 215.4(e) of this part; or

(7) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, without recourse.

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

(d) For purposes of § 215.4 of this part, an extension of credit by a member bank is considered to have been made at the time the bank enters into a binding commitment to make the extension of credit.

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

(f) *Tangible economic benefit rule*—(1) *In general.* An extension of credit is considered made to an insider to the extent that the proceeds are transferred to the insider or are used for the tangible economic benefit of the insider.

(2) *Exception.* An extension of credit is not considered made to an insider under paragraph (f)(1) of this section if:

(i) The credit is extended on terms that would satisfy the standard set forth in § 215.4(a) of this part for extensions of credit to insiders; and

(ii) The proceeds of the extension of credit are used in a bona fide transaction to acquire property, goods, or services from the insider.

§ 215.4 General prohibitions.

(a) *Terms and creditworthiness.* No member bank may extend credit to any insider of the bank or insider of its affiliates unless the extension of credit:

(1) Is made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this part and who are not employed by the bank; and

(2) Does not involve more than the normal risk of repayment or present other unfavorable features.

(b) *Prior approval.* (1) No member bank may extend credit (which term includes granting a line of credit) to any insider of the bank or insider of its affiliates 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:

(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 insider of the bank or insider of its affiliates 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 (b).

(3) Approval by the board of directors under paragraphs (b)(1) and (b)(2) of this section is not required for an extension of credit that is made pursuant to a line of credit that was approved under paragraph (b)(1) of this section within 14 months of the date of the extension of credit. The extension of credit must also be in compliance with the requirements of § 215.4(a) of this part.

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

(c) *Individual lending limit*—No member bank may extend credit to any insider of the bank or insider of its affiliates 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(i) 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 of the bank or insider of its affiliates 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 such insiders, does not exceed the bank's unimpaired capital and unimpaired surplus (as defined in § 215.2(i) of this part).

(2) *Member banks with deposits of less than $100,000,000.* (i) A member bank with deposits of less than $100,000,000 may by an annual resolution of its board of directors increase the general limit specified in paragraph (d)(1) of this section to a level not to exceed two times the bank's unimpaired capital and unimpaired surplus, if:

(A) 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;

(B) 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;

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

(D) The bank received a satisfactory composite rating in its most recent report of examination.

(ii) If a member bank has adopted a resolution authorizing a higher limit pursuant to paragraph (d)(2)(i) of this section and subsequently fails to meet the requirements of paragraph (d)(2)(i)(C) or (d)(2)(i)(D) of this section, the member bank shall not extend any additional credit (including a renewal of any existing extension of credit) to any insider of the bank or its affiliates unless such extension or renewal is consistent with the general limit in paragraph (d)(1) of this section.

(3) *Exceptions.* (i) The general limit specified in paragraph (d)(1) of this section does not apply to the following:

(A) Extensions of credit secured by a perfected security interest in bonds, notes, certificates of indebtedness, or Treasury bills of the United States or in other such obligations fully guaranteed as to principal and interest by the United States;

(B) Extensions of credit to or secured by unconditional takeout commitments or guarantees of any department, agency, bureau, board, commission or establishment of the United States or any corporation wholly owned directly or indirectly by the United States;

(C) Extensions of credit secured by a perfected security interest in a segregated deposit account in the lending bank; or

(D) Extensions of credit arising from the discount of negotiable or nonnegotiable installment consumer paper that is acquired from an insider and carries a full or partial recourse endorsement or guarantee by the insider, provided that:

(*1*) The financial condition of each maker of such consumer paper is reasonably documented in the bank's files or known to its officers;

(*2*) An officer of the bank designated for that purpose by the board of directors of the bank certifies in writing that the bank is relying primarily upon the responsibility of each maker for payment of the obligation and not upon any endorsement or guarantee by the insider; and

(*3*) The maker of the instrument is not an insider.

(ii) The exceptions in paragraphs (d)(3)(i)(A) through (d)(3)(i)(C) of this section apply only to the amounts of such extensions of credit that are secured in the manner described therein.

(e) *Overdrafts.* (1) No member bank may pay an overdraft of an executive officer or director of the bank [3] on an account at the bank, unless the payment of funds is made in accordance with:

(i) A written, preauthorized, interest-bearing extension of credit plan that specifies a method of repayment; or

(ii) A written, preauthorized transfer of funds from another account of the account holder at the bank.

(2) The prohibition in paragraph (e)(1) of this section does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of $1,000 or less, provided:

(i) The account is not overdrawn for more than 5 business days; and

(ii) The member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances.

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

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

The following restrictions on extensions of credit by a member bank to any of its executive officers apply in addition to any restrictions on extensions of credit by a member bank to insiders of itself or its affiliates set forth elsewhere in this part. The restrictions of this section apply only to executive officers of the member bank and not to executive officers of its affiliates.

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

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

(c) A member bank is authorized to extend credit to any executive officer of the bank:

(1) In any amount to finance the education of the executive officer's children;

(2) With the specific prior approval of the board of directors, in any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, provided:

(i) The extension of credit is secured by a first lien on the residence and the residence is owned (or expected to be owned after the extension of credit) by the executive officer; and

(ii) In the case of a refinancing, that only the amount thereof used to repay the original extension of credit, together with the closing costs of the refinancing, and any additional amount thereof used for any of the purposes enumerated in this paragraph (c)(2), are included within this category of credit;

(3) In any amount, if the extension of credit is secured in a manner described in § 215.4(d)(3)(i)(A) through (d)(3)(i)(C) of this part; and

(4) For any other purpose not specified in paragraphs (c)(1) through (c)(3) of this section, if the aggregate amount of extensions of credit to that executive officer under this paragraph does not exceed at any one time the higher of 2.5 per cent of the bank's capital and unimpaired surplus or $25,000, but in no event more than $100,000.

(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.

§ 215.6 Prohibition on knowingly receiving unauthorized extension of credit.

No executive officer, director, or principal shareholder of a member bank or any of its affiliates 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.

§ 215.7 Extensions of credit outstanding on March 10, 1979.

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

(b) If a member bank is unable to bring all extensions of credit outstanding on March 10, 1979, into compliance as required by paragraph (a) of this section, the member bank shall promptly report that fact to the Comptroller of the Currency, in the case of a national bank, or to the appropriate Federal Reserve Bank, in the case of a State member bank, and explain the reasons why all the extensions of credit cannot be brought into compliance. The Comptroller or the Reserve Bank, as the case may be, is authorized, on the basis of good cause shown, to extend the March 10, 1980, date for compliance for any extension of credit for not more than two additional one-year periods.

§ 215.8 Records of member banks.

(a) *In general.* Each member bank shall maintain records necessary for compliance with the requirements of this part.

(b) *Recordkeeping for insiders of the member bank.* Any recordkeeping method adopted by a member bank shall:

(1) Identify, through an annual survey, all insiders of the bank itself; and

(2) Maintain records of all extensions of credit to insiders of the bank itself, including the amount and terms of each such extension of credit.

(c) *Recordkeeping for insiders of the member bank's affiliates.* Any recordkeeping method adopted by a member bank shall maintain records of extensions of credit to insiders of the member bank's affiliates by:

(1) *Survey method.* (i) Identifying, through an annual survey, each insider of the member bank's affiliates; and

(ii) Maintaining records of the amount and terms of each extension of credit by the member bank to such insiders; or

(2) *Borrower inquiry method.* (i) Requiring as part of each extension of credit that the borrower indicate whether the borrower is an insider of an affiliate of the member bank; and

(ii) Maintaining records that identify the amount and terms of each extension of credit by the member bank to borrowers so identifying themselves.

(3) *Alternative recordkeeping methods for insiders of affiliates.* A member bank may employ a recordkeeping method other than those identified in paragraphs (c)(1) and (c)(2) of this section if the appropriate Federal banking agency determines that the bank's method is at least as effective as the identified methods.

(d) *Special rule for non-commercial lenders.* A member bank that is prohibited by law or by an express resolution of the board of directors of the bank from making an extension of credit to any company or other entity that is covered by this part as a company is not required to maintain any records of the related interests of the insiders of the bank or its affiliates or to inquire of borrowers whether they are related interests of the insiders of the bank or its affiliates.

§ 215.9 Reports by executive officers.

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

§ 215.10 Reports on credit to executive officers.

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

§ 215.11 Disclosure of credit from member banks to executive officers and principal shareholders.

(a) *Definitions.* For the purposes of this section, the following definitions apply:

(1) *Principal shareholder of a member bank* means any person[4] other than an insured bank, or a foreign bank as defined in 12 U.S.C. 3101(7), that, directly or indirectly, owns, controls, or has power to vote more than 10 percent of any class of voting securities of the member bank. The term includes a person that controls a principal shareholder (e.g., a person that controls a bank holding company). Shares of a bank (including a foreign bank), bank holding company, or other company owned or controlled by a member of an individual's immediate family are presumed to be owned or controlled by the individual for the purposes of determining principal shareholder status.

(2) *Related interest* means:

(i) Any company controlled by a person; or

(ii) Any political or campaign committee the funds or services of which will benefit a person or that is controlled by a person. For the purpose of this section and subpart B of this part, a related interest does not include a

[4] The term "stockholder of record" appearing in 12 U.S.C. 1972(2)(G) is synonymous with the term "person."

bank or a foreign bank (as defined in 12 U.S.C. 3101(7)).

(b) *Public disclosure.* (1) Upon receipt of a written request from the public, a member bank shall make available the names of each of its executive officers and each of its principal shareholders to whom, or to whose related interests, the member bank had outstanding as of the end of the latest previous quarter of the year, an extension of credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such person and to all related interests of such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus of $500,000, whichever amount is less. No disclosure under this paragraph is required if the aggregate amount of all extensions of credit outstanding at such time from the member bank to the executive officer or principal shareholder of the member bank and to all related interests of such a person does not exceed $25,000.

(2) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(c) *Maintaining records.* Each member bank shall maintain records of all requests for the information described in paragraph (b) of this section and the disposition of such requests. These records may be disposed of after two years from the date of the request.

§ 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.

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

Subpart B—[Amended]

§ 215.21 [Amended]

3. Section 215.21 is amended by removing "1841(c)" where it appears in paragraph (a) and adding in its place "1971 and 1972" and by removing footnote 10 and redesignating footnotes 11 and 12 as footnotes 5 and 6.

§ 215.22 [Amended]

4. Section 215.22 is amended by removing "12 CFR 226.2(p)" where it appears in paragraph (c)(1)(ii) and adding in its place "12 CFR 226.2(a)(12)".

By order of the Board of Governors of the Federal Reserve System, February 15, 1994.

Dated: February 15, 1994.

William W. Wiles,

Secretary of the Board.

[FR Doc. 94–3860 Filed 2–18–94; 3:20 pm]

BILLING CODE 6210–01–P