BANK POLICY INSTITUTE , GREGG ROZANSKY

Proposal and Comment Information

Title: Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies (Reg O and Y), R-1896

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Bank Policy Institute Comment Letter - attached

BANK POLICY INSTITUTE

November 4, 2026

Via electronic submission
Board of Governors of the Federal Reserve System
Attention: Benjamin W. McDonough, Secretary
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1896; RIN 7100-AH27

Federal Deposit Insurance Corporation
Attention: Jennifer M. Jones, Deputy Executive Secretary
550 17th Street NW
Washington, DC 20429
RIN 3064-AG26

Re: Notices of Proposed Rulemaking: Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies (Federal Reserve); Extensions of Credit to Insiders (FDIC)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the notice of proposed rulemaking issued by the Federal Reserve to modernize Regulation O, which governs extensions of credit by member banks to their insiders (the "Federal Reserve Proposal"),[2] and the related notice of proposed rulemaking issued by the FDIC to make conforming adjustments to its regulations on extensions of credit to insiders (the "FDIC Proposal,"[3] and, together with the Federal Reserve Proposal, the "Proposals").

Sections 22(g) and 22(h) of the Federal Reserve Act and their implementing regulation, Regulation O, provide safeguards for banks against insider self-dealing and related risk by imposing limitations and conditions on extensions of credit by banks to their executive officers, directors, principal shareholders, and related interests. These restrictions serve the important purpose of

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1 The Bank Policy Institute is a nonpartisan public policy, research, and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

2 Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies, 91 Fed. Reg. 49526 (Aug. 4, 2026) (hereinafter, the "Federal Reserve Proposal").

3 FDIC, Extensions of Credit to Insiders, 91 Fed. Reg. 50730 (Aug. 6, 2026) (hereinafter, the "FDIC Proposal").

minimizing risks to banks from conflicted insider transactions. Regulation O's general framework and various thresholds, however, have not been comprehensively updated in over three decades and therefore fail to take into account developments in stock ownership patterns in banking organizations. The passage of time has led to the unnecessary capture of passive share ownership and numerous transactions that do not advance the objective of the rule, and has made compliance unduly burdensome. It is both timely and appropriate for the agencies to revisit a regulatory framework whose requirements were last substantially revised when the economic and stock ownership landscape was markedly different.

The Bank Policy Institute supports the Federal Reserve's effort to modernize Regulation O and the FDIC's companion proposal to update its parallel insider-lending requirements. Modernization should appropriately calibrate important insider-lending safeguards to reflect current economic and stock ownership conditions, market practices, and the evolving structure of the banking industry without limiting productive credit arrangements that do not create the risks that Regulation O is designed to avoid or imposing unnecessary compliance burdens that divert institutional resources from the banking industry's core mission of serving customers and communities. It should also avoid the prohibition or restriction of transactions that do not create a realistic risk of the dangers at which the statute is directed. Updating and indexing Regulation O's dollar-based thresholds and providing permanent relief permitting banks to extend credit to portfolio companies the securities of which are held by certain companies that sponsor, manage, and advise passive investment funds ("Fund Complexes") are sensible reforms.

The Bank Policy Institute appreciates the efforts of the Federal Reserve and FDIC, as well as the OCC, to reduce unnecessary regulatory burden. Those efforts enable banks to direct their compliance programs and personnel to the areas of real need and, by reducing unnecessary expense, enable banks to operate more efficiently. In that context, we note that certain proposed changes, as described below, would increase regulatory burden by imposing new requirements. As a general matter, the Bank Policy Institute submits that new requirements that increase regulatory burden should only be imposed if there is a demonstrable need for such a change. Moreover, such new requirements should not be adopted unless that demonstrable need has been described in the rulemaking process so that there is sufficient opportunity for notice and comment.

Although the Bank Policy Institute welcomes the overall direction of the Proposals, the Bank Policy Institute submits that certain aspects would benefit from modifications to achieve the stated goals more effectively and efficiently. In particular, some of the Federal Reserve Proposal's changes would create operational burdens that outweigh any incremental reduction in risk, introduce unnecessary complexity into the Regulation O compliance framework, and increase compliance costs. The Bank Policy Institute believes that certain adjustments would strengthen the final rules while preserving the core protections that Sections 22(g) and 22(h) are intended to provide.

In addition to this letter, the Bank Policy Institute has provided further comments on the Federal Reserve Proposal in a companion letter. That companion letter discusses certain Regulation W aspects of the proposal and considerations related to the valuation of derivative exposures for both Regulation O and Regulation W.

I. Summary of Recommendations

a. Principal Recommendations

- **Correspondent Bank Insiders:** The Federal Reserve should **not** adopt the proposed correspondent bank insider recordkeeping requirements, even as safe harbors, and should instead reaffirm the current "any reasonably prudent method" standard for ensuring compliance with the prohibition on lending to insiders of respondent and correspondent banks.

- **Dollar-Based Threshold Adjustments and Indexing:** The Federal Reserve should increase the Regulation O dollar-based thresholds and index their level to nominal gross domestic product ("GDP") going forward. The Bank Policy Institute supports the proposed increases to the thresholds but recommends that the Federal Reserve further increase the executive officer "other purpose" lending limit to $2 million.

- **Treatment of Overdrafts:**

    - The Federal Reserve should eliminate the dollar limit on the exception from the prohibition on paying overdrafts to an executive officer or director in the proposed Section 215.21, provided that such overdrafts are inadvertent, processed without preference, and promptly repaid.

    - The Federal Reserve should retain appropriate overdraft exceptions from the definition of "extension of credit" in the proposed Section 215.3 and add a qualified custodial overdraft exception. The Federal Reserve should also confirm that overdrafts covered by those exceptions do not trigger other Regulation O requirements.

- **Qualified Fund Complex Framework:** The Federal Reserve should provide permanent relief for Fund Complex ownership of banks, as it has proposed to do, but should not incorporate the Regulation Y presumption of control criteria into the definition because they are a poor fit for determining whether a Fund Complex's ownership is passive. Here and elsewhere, we believe that an understandable interest in inter-regulation harmonization must be circumscribed by the different objectives of different regulations and their enacting statutes. In addition, the Federal Reserve should:

    - Confirm that banks and their principal shareholders (even if such shareholders are not qualified fund complexes, as that term is defined under the Federal Reserve Proposal) may continue to rely on the passivity commitments relied upon by the regulators to establish eligibility for the qualified fund complex exception;

    - Not penalize banks for actions by a Fund Complex that are outside of a bank's control and place responsibility for assessing qualified fund complex status on Fund Complexes, rather than banks;

- Broaden the definition of "qualified fund complex" to include companies that are affiliated with bank holding companies or savings and loan holding companies;

- Confirm that principal shareholders that do not meet the definition of a "qualified fund complex" may request individualized relief for their related interests within the Federal Reserve's statutory authority;

- Count separately managed accounts toward a Fund Complex's ownership only if the Fund Complex has full discretion over the accounts; and

- Consider a tailored exception for direct extensions of credit to qualified fund complexes, supported by an express determination that such transactions pose minimal risk and by appropriate conditions, including arm's-length terms and safeguards against influence over lending decisions.

- **Treatment of Derivatives and Securities Financing Transactions ("SFTs"):** The Federal Reserve should:

  - Affirm the use of the current credit exposure to value derivative contracts under Regulation O and Regulation W;

  - Explicitly allow banks to use any methodology allowed under the current or future capital rules to value SFT exposures;

  - Confirm that cash used to reduce a credit exposure may be held in an omnibus account for multiple insiders or transactions;

  - Allow banks to net exposures from equity derivatives and total return swaps for the purposes of valuation; and

  - Apply the proposed requirement for a bank to decompose a basket or index for which it provides credit protection to identify specific insider exposures only when the basket or index is sufficiently small or concentrated.

- **Attribution Criteria for Extensions of Credit to Spouses:** The Federal Reserve should amend its proposed test for attributing extensions of credit to a spouse of an insider to the insider in order to reflect more enlightened concepts of spousal independence and avoid creating unnecessary and intrusive burdens on spouses of insiders. In addition, the Federal Reserve should not adopt a separate concept of "related interest of a spouse" for purposes of attributing credit to the insider.

- **Attribution Criteria for Extensions of Credit to Trusts and Estates:** The Federal Reserve should apply the "related interest" concept only to trusts and estates where an insider has actual control, and reserve the application of the tangible economic benefit rule for attribution for situations where proceeds are actually transferred to or used for the insider's benefit. The Federal Reserve should also:

- Apply the tangible economic benefit rule only to present beneficiaries of trusts and estates (or situations where the insider is also the trustee);

- Not presume that a trustee controls a trust;

- Not adopt the proposed presumption regarding whether a settlor, appointer, or beneficiary of a trust controls the trust; and

- Not treat estates for which an insider is not a beneficiary as a "related interest" of the insider.

- **Home Mortgage Exception for Extensions of Credit to Executive Officers:** The Federal Reserve should not adopt the proposed condition requiring an executive officer to live in the property at least three months of each year to benefit from the home mortgage exception from the general prohibition on insider lending, which would require ongoing monitoring over the life of the mortgage and could result in a violation of Regulation O if, in a later year, the executive officer does not meet the residency requirement despite satisfying all other conditions.

- **Treatment of Lines of Credit:** The Federal Reserve should adopt a limited exception for certain standardized, automated approvals, credit line increases, and changes in terms from the proposed board prior approval requirement for new extensions of credit. In addition, the Federal Reserve should not require board approval of a draw on a line of credit to an insider when the applicable aggregate threshold is exceeded unless and until the line of credit is renewed, extended, or materially amended.

- **Treatment of Transition Loans:** The Federal Reserve should:

  - Apply a transition period for purposes of including transition loans in a bank's calculation of the individual and aggregate lending limits and for calculation of the limits on extensions of credit to executive officers;

  - Confirm that board approval is not required for transition loans in excess of the board prior approval threshold for extensions of credit to insiders unless and until the loans are renewed, revised (other than through a minor revision), or extended;

  - Apply the additional restrictions on extensions of credit to executive officers only prospectively;

  - Eliminate the automatic expiration of transition treatment after 14 months for transition loans that are lines of credit, unless and until the line of credit is materially modified; and

  - Provide uniform transition treatment for all types of insiders.

- **Links Between Regulation O and Regulation W:** Because Regulation O and Regulation W serve different purposes, their application and interpretation need not be linked, and

the Federal Reserve should not treat our comments on, or absence of comment regarding, any aspect of Regulation O as indicative of our view regarding any parallel changes to or elements of Regulation W.

- **FDIC Proposal:** The FDIC should increase the dollar-based thresholds and index the thresholds to nominal GDP going forward.

- **Effective Date of Proposals:** The Bank Policy Institute recommends that the Federal Reserve and FDIC adopt a common effective date for their final rules at least one year after publication, permitting but not requiring early compliance (*i.e.*, allowing banks to apply the increased thresholds and qualified fund complex framework immediately). Because the existing interim relief for Fund Complexes provided by the Federal Reserve is scheduled to expire on January 1, 2027, the Federal Reserve should also extend that relief so that it remains in effect until the final rules become effective.

b. Additional Recommendations to Modernize Regulation O

- **Regulation O Compliance Grace Period:** The Federal Reserve should provide a grace period for principal shareholders once they trip the presumption of control, regardless of the reason for triggering the presumption of control. The length of the grace period should reflect whether the principal shareholder intends to cure the triggering event or implement compliance and should run from the date the principal shareholder notifies the bank.[4]

- **Secondary Market Purchases of Extensions of Credit:** The Federal Reserve should treat arm's-length secondary market acquisitions of extensions of credit similarly to transition loans. In addition, it should value acquired extensions of credit based on the outstanding principal amount and any additional committed amount.

- **Market Terms Standard for Asset Purchases and Sales:** The Federal Reserve should confirm that "comparable transactions" under the proposed "market terms" standard are transactions with similarly situated non-insiders, rather than any non-insider. In addition, the Federal Reserve should:

    - Not prohibit asset purchases or sales with insiders on terms more favorable to the bank than market terms; and

    - Provide that implementing and adhering to policies requiring market terms satisfies Regulation O's documentation requirements for asset purchases and sales.

[4] As discussed below, the responsibility for monitoring and promptly notifying banks of changes in a principal shareholder's status should rest with the principal shareholder, which has the greatest visibility into its ownership positions and relationships, rather than with the bank, which lacks access to such information.

- **Changes to the Definition of "Extension of Credit":**

  - **Credit Card Exception:** The Federal Reserve should modernize the credit card exception definition, replace the term "general public" in the credit card exception with "similarly situated customers," and confirm that the credit card exception is available separately for an insider and each of an insider's related interests.

  - **Modifications to Extensions of Credit:** The Federal Reserve should adopt its proposed clarifications regarding modifications to extensions of credit.

  - **Scope of "Expenses Incurred on Behalf of the Bank":** The Federal Reserve should clarify that the exception for "expenses incurred on behalf of the bank" may include personal purchases made under a bank product testing program, subject to reasonable limits.

- **Alter Ego Determination:** The Federal Reserve should adopt a uniform standard for determining alter ego status, based on Delaware law.

- **Safe Harbor for Directors and Executive Officers of Affiliates:** The Federal Reserve should maintain and modernize the safe harbor allowing directors and executive officers of affiliates to be exempted from certain Regulation O provisions, and should clarify that exempt officials are excluded consistently from Regulation O requirements arising solely from their affiliate positions.

- **Definition of "Executive Officer":** The Federal Reserve should remove "vice president" from the titles presumed to confer executive officer status.

- **Disclosure Requirements for Extensions of Credit:** The Federal Reserve should eliminate the public disclosure requirement for extensions of credit to insiders and should align the regulatory text with the Federal Reserve Proposal's explanatory discussion to clarify that the disclosure requirement for extensions of credit secured by shares of a bank holding company applies only when the extension of credit is secured by shares of a bank or bank holding company that are not publicly traded.

- **Regulatory Burden:** The Federal Reserve should reduce the paperwork burden imposed by Regulation O.

Part I: Principal Recommendations

I. Correspondent Bank Insiders

The Bank Policy Institute recommends that the Federal Reserve retain the existing "any reasonably prudent method" standard for compliance with the correspondent bank insider lending restrictions (referred to as the "correspondent bank insider lending prohibition") in 12 U.S.C. § 1972(2). The Federal Reserve should not adopt the proposed recordkeeping requirements, even as a safe harbor. Instead, it should reaffirm that banks may use documented controls tailored to their lending activities and correspondent relationships, including reliance on targeted inquiries when a proposed transaction raises a question under the substantive restrictions.

Under the Federal Reserve Proposal, (1) a bank would be required to send an annual survey to its correspondent or respondent banks requesting that they provide a list of their insiders and maintain records of the amount and terms of extensions of credit to such insiders (the "survey method"); (2) a borrower, when borrowing from the bank, would need to indicate whether the borrower is an insider of the bank's correspondent or respondent bank, and the bank would need to maintain records of the amount and terms of extensions of credit to such insiders (the "borrower inquiry method"); or (3) the bank would need to employ a method "at least as effective" as the first two methods.[5] The Federal Reserve Proposal would codify a safe harbor for only the first two methods.[6] As a practical matter, limiting the safe harbor to the first two methods would discourage banks from utilizing a more efficient, proven, and reasonable alternative.

a. The Federal Reserve has not identified any concerns with the "any reasonably prudent method" standard for compliance that applies today.

The existing framework rests on an express determination by the Federal Reserve. In 2007, following the repeal of the statutory correspondent bank reporting requirements, the Federal Reserve explained that banks could select "any reasonably prudent method," including requesting information about a borrower's correspondent bank relationships when preferential credit is contemplated.[7] The Federal Reserve also explained that the eliminated reporting provisions had not contributed significantly to the effective monitoring of insider lending or prevention of insider abuse.[8]

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5 Federal Reserve Proposal, at 49566–67. The Federal Reserve Proposal would also explicitly incorporate the correspondent bank insider lending prohibition into Regulation O. *See id.* at 49544, 49566.

6 *See* Federal Reserve Proposal, at 49550.

7 Federal Reserve Proposal, at 49544 n.130 (citing Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks, 72 Fed. Reg. 30470, 30472 (Final Rule) (June 1, 2007)).

8 The former correspondent bank reporting regime was repealed in 2006.

Until 2006, Regulation O included reporting and disclosure requirements for certain correspondent bank insider lending relationships, implementing then-applicable statutory requirements. *See* Pub. L. No. 95-630, 92 Stat. 3692–93 (1978) (formerly codified at 12 U.S.C. § 1972(2)(G)); *see also* Federal Reserve, FDIC, Loans to Executive Officers, Directors, and Principal Shareholders, 44 Fed. Reg. 13035 (Proposed Rule) (Mar. 9, 1979); Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks, 44 Fed. Reg. 67973 (Final Rule) (Nov. 28, 1979).

Congress removed the relevant statutory reporting requirements and authorization for the federal banking agencies to require correspondent bank-related disclosures in 2006, as part of an effort to reduce regulatory burden by relieving banks of "requirements that [had] become obsolete or unnecessary." S. Rep. No. 109-256, at 1 (2006) (stating the "Purpose of the Legislation"); *see also* H.R. Rep. No. 109-356, pt. 1, at 50 (2005) (noting that the legislation "makes important changes to banking statutes to significantly reduce the burden of outdated and unnecessary laws and regulations on banks . . ."). *See* Pub. L. No. 109-351, 120 Stat. 1978 (2006).

The Federal Reserve had "proposed and supported" eliminating the statutory reporting requirements because the federal banking agencies had not found them "particularly useful in monitoring insider lending or preventing insider abuse." Federal Reserve Bank of New York, Board Approves Interim Rule on Section 601 of Financial Services Regulatory Relief Act of 2006, Invites

Many banks currently comply with the requirements of Regulation O by prohibiting preferential lending generally. Proposed extensions of credit on non-market terms can be identified through a bank's review of credit policy exception requests, at which point the bank can conduct further diligence regarding the borrower's relationships with correspondent banks before approving the exception.[9] These policies apply in combination with a bank's standardized underwriting, pricing, and approval processes, which are generally designed to ensure that all borrowers receive credit on a consistent basis with non-preferential terms. This exception-based approach directs compliance resources where they matter most: when a departure from market terms or standard credit criteria is under consideration.

The Federal Reserve has not explained why the proposed recordkeeping requirements would be more effective than its current policy and banks' existing controls, which focus compliance attention on the substantive question of whether lending is on market terms and are tailored to the risks of preferential lending. Absent a clear demonstration that the current system has enabled violations, the additional regulatory burden is unjustified.

b. The proposed correspondent bank recordkeeping requirements are not necessary in the modern banking environment.

The statutory correspondent bank insider lending prohibition was adopted in a banking environment that differed in important respects from the one prevailing today.[10] At the time, correspondent relationships were often more localized, relationship-based, and dependent on personal interactions among bank executives.[11] Since that time, the U.S. banking industry has undergone significant consolidation. Large banks today, as in the past, may maintain relationships with hundreds of correspondent banks. However, management of these relationships has become increasingly centralized and standardized, minimizing the risk of preferential lending to insiders of correspondent banks.

Public Comment, Circular No. 11828 (Dec. 7, 2006), *available at* https://www.newyorkfed.org/banking/circulars/11828.html.

These statutory changes led the Federal Reserve to remove the corresponding regulatory requirements in their entirety (then contained in Subpart B of Regulation O). Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks, 71 Fed. Reg. 71472 (Interim Rule) (Dec. 11, 2006); Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks, 72 Fed. Reg. 30470 (Final Rule).

9 A bank may not generally have access to sensitive personally identifiable information that could be necessary to identify a borrower as a correspondent bank insider, such as a Social Security number, date of birth, and address, which correspondent banks often refuse to provide on a proactive basis, due to privacy concerns. However, in the context of processing an exception from a general policy prohibiting preferential lending, a lending bank could conduct a more detailed inquiry through the credit account application to confirm that the borrower is not a correspondent bank insider.

10 The correspondent bank insider lending prohibition was originally adopted in 1978. Pub. L. No. 95-630, 92 Stat. 3690 (1978) (codified at 12 U.S.C. § 1972(2)).

11 Congressional hearings and investigations from the 1970s found that insiders often obtained loans on preferential terms from banks at which the insider's bank maintained a correspondent account and that "[a]t times, such accounts [] appeared to be little more than a means of securing loans for bank insiders . . . ." H.R. Rep. No. 95-1383, at 13 (July 20, 1978).

At the same time, banks have developed standardized underwriting, pricing, approval, governance, and internal-control frameworks designed to produce consistent, risk-based credit outcomes. Lending personnel also generally operate separately from the personnel who manage correspondent banking relationships. These developments significantly reduce the possibility that a correspondent banking relationship could be used to obtain preferential credit for an insider. Particularly in light of these changes in banking industry dynamics, it is not necessary to prescribe specific and burdensome new recordkeeping requirements in order to ensure compliance with the statutory prohibition on correspondent bank insider lending.

c. The proposed recordkeeping requirements would create unnecessary obligations that would impose unworkable operational and compliance burdens.

The Federal Reserve acknowledges that these proposed methods are similar to those with regard to loans to insiders of the bank's affiliates,[12] but does not explain why these same methods—and the significant burden they impose on banks—should be applied with respect to insiders of a bank's correspondent and respondent institutions. Insiders of a bank and its affiliates have a direct, if often tenuous, ability to influence a bank's lending decisions. Any ability by insiders of a correspondent bank to influence lending decisions would be at most indirect and involve highly unusual circumstances.

For banks with extensive correspondent banking relationships, the survey method would effectively necessitate the collection and maintenance of non-public personal information regarding potentially thousands of directors, executive officers, principal shareholders, and their related interests.[13] When this information changes, as it inevitably and frequently does, it would be practically impossible for banks to keep records current.

Maintaining an accurate and complete list of a bank's own insiders is a responsibility within the bank's control and achievable with reasonable effort. The same cannot be said for identifying correspondent banks' insiders, for which a bank must rely on receiving affirmative responses from its network of correspondent banks. Our members have found that it can be difficult to obtain timely, accurate, and complete responses from third parties. Correspondent banks and their insiders are not subject to a bank's or its parent company's governance processes, certification requirements, or internal controls, and may therefore not be wholly responsive to the bank's requests for information.

In addition, insiders of large banks may be uncomfortable with the dissemination of their personal information to hundreds of correspondent banks. These concerns may limit correspondent banks' willingness to provide personal information about their directors and executive officers. Although principal shareholders of publicly traded banking organizations are publicly identified under the beneficial ownership reporting requirements of the Securities Exchange Act of 1934, their related interests rarely, if ever, are. A bank's disclosure of those related interests to the bank's correspondent banks could therefore result in the dissemination of confidential information.

The borrower inquiry method would require a bank to build the inquiry into its technology and lending systems and pose it to all borrowers, including those seeking credit cards, mortgages, and auto

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12 Federal Reserve Proposal, at 49544.

13 In addition to the burden of initial collection, the ongoing obligation to reconcile and monitor insider information against current and prospective bank lending customers would require substantial systems development and manual review while producing limited compliance value.

loans. Borrowers may not understand the Regulation O analysis necessary to determine whether they are insiders or related interests of any of the lending bank's potentially hundreds of correspondent banks, which would likely lead to under- and over-reporting. In contrast to inquiries concerning a bank's own insiders, the lending bank has little ability to independently confirm a borrower's status with respect to correspondent banks. Implementing such a broad inquiry would impose significant costs with unclear compliance benefits.

Consequently, neither proposed safe-harbor method provides a reliable means of producing complete and current information with respect to correspondent bank insiders. Moreover, the proposed recordkeeping requirements would divert finite compliance resources toward maintaining personal data on potential customers, who may never seek credit, let alone on preferential terms. This misdirection of resources would distract from the core objective of preventing preferential treatment.

d. The Federal Reserve should therefore reaffirm the "any reasonably prudent method" standard.

The Federal Reserve should replace the proposed requirement that a bank use the survey method, borrower inquiry method, or a method "at least as effective" as those methods with the existing "any reasonably prudent method" standard, which permits each bank to design a compliance approach tailored to its particular facts, circumstances, and control environment. The Federal Reserve should also specify that a bank may satisfy the "any reasonably prudent method" standard by conducting the inquiry as to whether a prospective borrower (or current borrower seeking a loan modification) is an insider of a correspondent or respondent bank at the time the decision is being made whether to extend preferential credit.

e. If the Federal Reserve retains the survey and the borrower inquiry methods, it should identify them as nonexclusive safe harbors and replace the "at least as effective" standard with the "any reasonably prudent method" standard.

As discussed above, the survey method and borrower inquiry method themselves may produce incomplete or outdated information and impose substantial operational burdens, and therefore should not define the benchmark against which other reasonable approaches are measured. Moreover, the "at least as effective" standard would create uncertainty about how banks must demonstrate comparable effectiveness, and would discourage approaches that more efficiently mitigate preferential lending risk. Because only the survey method and the borrower inquiry method would receive safe harbor protection under the Federal Reserve Proposal, and because a bank using any other method would bear the burden of demonstrating that its approach is at least as effective as those methods, banks would face significant supervisory and compliance risk in relying on an alternative, even one that is more efficient, proven, and reasonable. Banks would therefore effectively be compelled to adopt one of the two safe harbor methods, notwithstanding their limitations. If the Federal Reserve retains the survey method and the borrower inquiry method, it should maintain them as nonexclusive safe harbors. In addition, it should replace the "at least as effective" standard with the "any reasonably prudent method" standard. The "any reasonably prudent method" standard would allow banks to tailor their controls to their unique circumstances, including by conducting targeted inquiries when preferential credit is contemplated, without requiring them to demonstrate equivalence to methods that banks may not find reliable.

II. Dollar-Based Threshold Adjustments and Indexing

a. The Bank Policy Institute supports the proposed increases to the Regulation O thresholds but recommends further increasing the executive officer "other purpose" lending limit to $2 million.

We support the Proposals' increases to the dollar-based thresholds in Regulation O to adjust for economic growth and inflation since 1994.[14] These updates are necessary because, as the Federal Reserve Proposal notes, nominal GDP has increased fourfold since 1994.[15] The current thresholds impose significant burdens on banks and their boards of directors by subjecting transactions of diminishing economic significance to heightened restrictions and approval requirements. The increased thresholds would appropriately reflect the original calibration of regulatory requirements by adjusting for nominal GDP growth since the thresholds were last updated, while banks would remain subject to Regulation O's core safeguards: comparable terms, no more than normal repayment risk, and individual and aggregate lending limits.[16]

For the executive officer "other purpose" lending limit, however, we recommend increasing the initial dollar-based threshold to $2 million, rather than $400,000, subject to indexing going forward in the same manner as the other thresholds. Although the proposed increase accounts for nominal GDP growth since 1994, the Federal Reserve should also reconsider the underlying calibration for this threshold. A $400,000 aggregate limit would continue to constrain ordinary financing arrangements, including home equity lines and securities-based loans, even where supported by substantial collateral and the borrower's repayment capacity. A $2 million limit would better reflect contemporary borrowing needs, while preserving Regulation O's safeguards concerning non-preferential terms, repayment risk, board approval, and lending limits.[17]

b. The Bank Policy Institute supports nominal GDP indexing.

Nominal GDP captures both inflation and real economic growth, whereas the consumer price index ("CPI"), an alternative metric identified in the Federal Reserve Proposal, captures only price levels, making nominal GDP the better measure of the economic scale of insider transactions.[18] Indexing only

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14 Federal Reserve Proposal, at 49528; FDIC Proposal, at 50732. The FDIC Proposal is discussed in further detail below.

15 Federal Reserve Proposal, at 49556.

16 Federal Reserve Proposal, at 49555–56. The Bank Policy Institute would also support the alternative of eliminating the dollar-based thresholds and relying exclusively on thresholds set as a percentage of a bank's unimpaired capital and unimpaired surplus, because it would reduce the burdens associated with updating the dollar-based thresholds and would result in calibration for banks of varying sizes. Adopting a size-based calibration of the maximum threshold would reflect that the risk posed by any one extension of credit varies depending on a bank's size. *See id.* at 49529 (Question 2). For the same reason, the Bank Policy Institute would support other approaches that would vary the size of the maximum threshold based on the size of the bank.

17 Potential risks to banks associated with increasing the "other purpose" lending limit would be mitigated by the continued applicability of the capital-based threshold, which will constrain lending relative to a bank's size.

18 *See* Federal Reserve Proposal, at 49529 (Question 5), 49553–54.

for inflation would allow the thresholds to become more restrictive relative to the size of the economy as real economic activity grows. We therefore support indexing the dollar-based thresholds based on nominal GDP rather than CPI.[19]

The Bank Policy Institute also supports the Federal Reserve Proposal's approach of not reducing the dollar-based thresholds when cumulative nominal GDP growth is negative.[20] Although indexing appropriately allows the thresholds to keep pace with the growth of the economy, reducing thresholds during periods of economic contraction would be procyclical, tightening credit availability precisely when borrowers are most in need of it, and could subject existing extensions of credit to lower limits or require prior approval for new extensions of credit. If the Federal Reserve nonetheless considers permitting threshold reductions, any reduction should apply only prospectively, and extensions of credit made in compliance with the thresholds in effect at the time they were made should be grandfathered.

c. The Bank Policy Institute supports the five-year frequency.

We support the five-year frequency for updating the dollar-based thresholds.[21] This frequency will appropriately balance administrative burden on both the Federal Reserve and the banking industry with ensuring that the thresholds remain current.

We also support the Federal Reserve's proposal to publish a GDP growth adjustment and adjusted thresholds every five years.[22] The final rule should also explain what will happen if the Federal Reserve does not publish the GDP growth adjustment and adjusted thresholds in a timely manner. For example, the Federal Reserve could adopt a backstop provision similar to the one the FDIC adopted in 12 C.F.R. § 314.1(f),[23] such that there is an automatic adjustment of the thresholds using the Federal Reserve Proposal's prescribed nominal GDP methodology and rounding conventions in the event the Federal Reserve does not publish an updated threshold within 30 days of the five-year deadline.

III. Treatment of Overdrafts

a. The Bank Policy Institute recommends the elimination of the dollar limit on the exception from the prohibition on paying overdrafts to an executive officer or director in the

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19 The Bank Policy Institute has consistently supported GDP-based indexing over CPI-based indexing. *See, e.g.*, Letter from Bank Policy Institute to Federal Deposit Insurance Corporation, Re: Notice of Proposed Rulemaking—Adjusting and Indexing Certain Regulatory Thresholds, RIN 3064-AG15, at 3–5 (Sept. 26, 2025).

20 Federal Reserve Proposal, at 49529 (Question 6).

21 Federal Reserve Proposal, at 49529 (Question 8), 49564.

22 Federal Reserve Proposal, at 49564.

23 The FDIC backstop provides: "In the event, for any reason, a final rule is not published in the Federal Register in a year in which an adjustment is made under this section, the thresholds specified in paragraph (c) of this section will adjust as provided in this section and be effective on October 1, notwithstanding the lack of a final rule published in the Federal Register." 12 C.F.R. § 314.1(f).

proposed Section 215.21, provided that such overdrafts are inadvertent, processed without preference, and promptly repaid.

The Federal Reserve Proposal would retain Regulation O's exception from the prohibition on paying overdrafts to executive officers or directors, provided that aggregate overdrafts on the accounts of the accountholder are inadvertent, within a specified dollar limit, and repaid within five business days, with bank fees assessed to the executive officer or director that are the same as would be charged to another customer of the bank in similar circumstances.[24] However, the Federal Reserve would increase the dollar limit for the exception from the current $1,000 to $4,000.

The Bank Policy Institute supports the retention of the exception, but recommends that the Federal Reserve eliminate the associated dollar limit. Inadvertent overdrafts are not naturally constrained by a particular dollar amount. They typically arise from unintended, short-term misalignment of account inflows and outflows, often from multiple automated or electronic transactions, or unavoidable delays in expected inflows. For example, a large wire or ACH debit may settle unexpectedly, or a fraud investigation or payment-processing issue may temporarily affect available balances. Although a bank may knowingly pay a transaction under its ordinary policies, the accountholder's funding shortfall may still be inadvertent. The same operational event can produce overdrafts of different amounts depending on the size of the underlying transaction, and the amount alone does not establish preferential treatment. A static dollar limit thus distinguishes among similar inadvertent events based on transaction size, a concern that increasing the limit does not resolve.

Requirements for inadvertence, prompt repayment, and non-preferential treatment, rather than a dollar limit, are appropriate safeguards against insider abuse. Prompt repayment of inadvertent overdrafts mitigates self-dealing concerns. Additionally, the preferential treatment prohibition requires banks to process an incoming debit transaction that exceeds the funds on deposit in a customer's account based on policies applied equally to all similarly situated customers. To further reduce the risk of insider abuse of bank policies to pay overdrafts, the time allowed to repay the overdraft could be shortened from five to three business days.

If the Federal Reserve retains the dollar limit for the inadvertent overdraft exception, the Bank Policy Institute recommends that the threshold be applied separately to each account of an executive officer or director, rather than to the aggregate amount of inadvertent overdrafts across all of the executive officer or director's accounts. Aggregation would require banks to identify and link overdrafts across multiple accounts, significantly increasing operational complexity with potentially limited incremental protection against insider abuse. The exception would remain appropriately limited because each overdraft must be inadvertent, processed under bank policies applied equally to all similarly situated customers, and promptly repaid.

b. Inadvertent Overdrafts in the Definition of "Extension of Credit"

i. The Federal Reserve should retain appropriate overdraft exceptions from the definition of "extension of credit" in the proposed Section 215.3 and confirm that overdrafts covered by those exceptions do not trigger other Regulation O requirements.

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[24] Federal Reserve Proposal, at 49565–66.

The Federal Reserve Proposal would delete the inadvertent overdraft exception from the definition of "extension of credit."[25] Instead, the Federal Reserve should retain an exception for inadvertent overdrafts that are processed on a non-preferential basis and repaid promptly and add a separate exception for qualified custodial overdrafts, as described below. These exceptions should generally cover, respectively, inadvertent overdrafts involving consumer and other accounts and ordinary-course custodial overdrafts involving institutional and corporate accounts.[26]

As noted, inadvertent overdrafts may result from operational errors, unexpected settlement timing, and short-term misalignment or delays during ordinary course payment processing. Although a bank determines whether to pay a transaction that would overdraw an account, an inadvertent overdraft may not be identified sufficiently in advance to obtain board approval or avoid a technical breach of an applicable limit. These risks are particularly acute where an insider already has extensions of credit outstanding, such as extensions of credit to related interests. Because those exposures must be aggregated for purposes of the prior board approval threshold, even a small, unanticipated overdraft could require prior board approval or create a technical violation where prior board approval cannot be timely obtained.[27]

An inadvertent overdraft that is promptly repaid on non-preferential terms should therefore be excluded from the definition of "extension of credit" with respect to all insiders, including principal shareholders and their related interests, as well as executive officers and directors. Treating inadvertent overdrafts as extensions of credit would continue a disproportionate compliance burden without furthering the bank protection and anti-self-dealing purposes of Regulation O. The Bank Policy Institute therefore recommends that the Federal Reserve retain the inadvertent overdraft exception to the definition of "extension of credit," adopt the qualified custodial overdraft exception described below, and confirm that overdrafts covered by either exception do not trigger prior board approval requirements or breach applicable insider lending limits, including the additional limits on credit to executive officers where applicable.[28]

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25 *See* Federal Reserve Proposal, at 49538, 49562; *compare with* 12 C.F.R. § 215.3(b)(2).

26 The exception from the definition of "extension of credit" is relevant to all insiders, not just executive officers and directors, because it implicates compliance with Regulation O's lending limits and board prior approval requirements for insiders that are not subject to the general prohibition on payment of overdrafts.

27 The process for obtaining board approval even for planned transactions can be complex. A bank's board meets on a schedule and materials must be prepared and sent to the board in advance. The unexpected character of an inadvertent overdraft heightens the difficulties associated with seeking board approval for an extension of credit in excess of the threshold. Although advances under a qualifying line of credit approved by the board within the preceding 14 months do not require separate approval, an inadvertent overdraft may arise outside such an arrangement. *See* 12 C.F.R. § 215.4(b)(3); Federal Reserve Proposal, at 49564.

28 Adopting this exception would not authorize payment of an overdraft that would be prohibited by proposed 12 C.F.R. § 215.21.

ii. The Federal Reserve should add a "qualified custodial overdraft" exception to the definition of "extension of credit."

The Federal Reserve Proposal requests comment on whether the Federal Reserve should adopt an exception to the definition of "extension of credit" for qualified custodial overdrafts.[29] We support adopting a "qualified custodial overdraft" exception in the definition of "extension of credit."

The Bank Policy Institute proposes that a "qualified custodial overdraft" could mean an overdraft that arises in the ordinary course of business in connection with payment transactions, settlement services, or futures, derivatives, and securities clearing, provided that (i) the credit is repaid within three business days after it arises, (ii) the bank has established and maintains procedures reasonably designed to manage the credit exposure in a safe and sound manner, and (iii) the bank does not reasonably believe the recipient will have difficulty repaying the overdraft. This relief will allow banks to provide custodial, settlement, and clearing services to clients that are insiders—particularly principal shareholders and their related interests—without imposing the unnecessary complexity of managing overdraft limits and board approval requirements where potential overdrafts do not pose a meaningful risk to the bank as a result of insider abuse.

Although the Federal Reserve Proposal poses the adoption of the qualified custodial overdraft exception as an alternative to the inadvertent overdraft exception from the definition of an extension of credit, the Bank Policy Institute supports its adoption in addition to maintaining the inadvertent overdraft exception. The two exceptions serve different purposes and are complementary.

IV. Qualified Fund Complex Framework

a. The Bank Policy Institute supports providing relief to banks in respect of principal shareholders that are Fund Complexes.

The Bank Policy Institute strongly supports the Federal Reserve's intent to provide permanent regulatory relief for ownership by Fund Complexes. The Federal Reserve Proposal appropriately acknowledges the need for relief from the literal terms of Regulation O to account for Fund Complexes' passive ownership of banks and other portfolio companies.[30] This relief is appropriate because the investment relationship between passive Fund Complex investors and their portfolio companies presents limited risk of the conflicts of interest and self-dealing that Regulation O targets. As the Federal Reserve Proposal acknowledges, the "portfolio companies of these fund complexes have been accumulated largely as passive investments and the fund complexes are not actively engaged in the management of their portfolio companies."[31] Consequently, the "relationship between the portfolio companies of passive fund complexes and a bank for which the passive fund complex is a principal shareholder generally does not give rise to the type of conflict of interest and self-dealing issues that section 22(h) and Regulation O were designed to address."[32] Without adequate permanent relief, banks,

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29 Federal Reserve Proposal, at 49538 (Question 38).

30 *See* Federal Reserve Proposal, at 49530.

31 Federal Reserve Proposal, at 49530.

32 Federal Reserve Proposal, at 49530. At the time the statute was enacted, passive investment funds were still in their infancy and their investments were, at most, far below the principal shareholder threshold. *See* Brendan O'Connell, *A Pillar of Modern Finance Turns 50*, CFA Institute (July 2021),

many Fund Complexes, and the numerous other companies in those Fund Complexes' portfolios would experience significant challenges. In particular, the application of Regulation O's lending limits could constrain thousands of portfolio companies' ability to obtain credit.[33] In addition, without permanent relief from Regulation O, passive Fund Complexes' ownership positions in banks and other portfolio companies would create an unnecessary and significant compliance burden for many Fund Complexes, banks, and other companies in Fund Complex portfolios.

Although the Bank Policy Institute therefore supports the Federal Reserve's effort to provide relief, we have identified several concerns with the proposed codification that should be remedied in any final rule.

b. Use of the Presumption of Control Criteria

A significant way in which the proposed definition of "qualified fund complex"[34] differs from the joint statement issued by the Federal Reserve, OCC, and FDIC to provide interim relief for certain Fund Complexes ("Joint Statement"), and the agencies' subsequent extensions of the relief, is the incorporation of the Regulation Y presumptions of control.[35] The proposed rule would require, among

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available at https://rpc.cfainstitute.org/blogs/enterprising-investor/2021/a-pillar-of-modern-finance-turns-50#. Congress, therefore, had no reason to consider the need for an exception.

33 As the Federal Reserve Proposal notes, Fund Complexes "are principal shareholders of approximately 66 banks, and . . . might be presumed to control approximately 2047 portfolio companies." Federal Reserve Proposal, at 49554 (figures are calculated as of Q4 2025). Further, each of the 66 banks may have lending relationships with any of these portfolio companies.

34 The Bank Policy Institute notes that there is a discrepancy in how the qualified fund complex definition is set forth in the Federal Reserve Proposal explanatory discussion as compared to the proposed regulatory text. The explanatory discussion states the requirement as "[t]he fund complex is not (and is not affiliated with) a depository institution or holding company supervised and regulated by the Board, FDIC, or OCC (regulated company)." Federal Reserve Proposal, at 49531. The proposed regulatory text states the requirement as "[the qualified fund complex] is not, and is not affiliated with, a bank holding company (as defined in § 225.2 of this chapter) or savings and loan holding company (as defined in § 238.2 of this chapter)." Federal Reserve Proposal, at 49561. If the Federal Reserve does not adopt the changes to the proposed definition that we recommend in this letter, we recommend that the Federal Reserve adopt the provision as proposed in the regulatory text, as the statement in the explanatory text may inadvertently exclude certain fund complexes, such as those that are affiliated with a national trust company that is not otherwise a bank for purposes of Section 3 of the Bank Holding Company Act.

35 *See* FDIC, Federal Reserve, OCC, Statement Regarding Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations, SR 19-16, OCC Bulletin 2019-65, FDIC FIL-85-2019 (Dec. 27, 2019), *available at* https://www.fdic.gov/news/inactive-financial-institution-letters/2019/fil19085a.pdf (rescinded); FDIC, OCC, OCC and FDIC Statement Regarding the Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Insider Lending Restrictions and Related Reporting Requirements, OCC Bulletin 2025-47, FDIC FIL-61-2025 (Dec. 18, 2025), *available at* https://www.occ.gov/news-issuances/bulletins/2025/bulletin-2025-47a.pdf; Federal Reserve, Statement Regarding Status of Certain Investment Funds and their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations, SR 25-6 (Dec. 19, 2025), *available at* https://www.federalreserve.gov/supervisionreg/srletters/SR2506a1.pdf.

other things, that a qualified fund complex not meet any of the conditions that would give rise to a presumption of control under Regulation Y (12 C.F.R. § 225.32), rather than relying on the control criteria previously developed in the Joint Statement.[36]

i. The Regulation Y presumption of control criteria are a poor fit for determining whether Fund Complexes, and index funds in particular, are passive.

Harmonization across regulations should account for the different objectives of those regulations and their underlying statutes. In this case, the presumption of control criteria are particularly misaligned with the behavior of index funds, because an investment strategy designed to track an index is inconsistent with an intent to control the companies included in that index.[37] Index funds generally buy and sell stock to track an index, rather than pursue a strategy of influencing an investee company's management.[38] Although index funds may vote shares and engage with management, those activities do not, by themselves, establish an ability or intent to influence bank lending decisions. As the Federal Reserve Proposal acknowledges, index funds "typically include prospectus and investment objectives stating that the fund does not seek to acquire control over management decisions of companies held by the fund," and their buy and sell decisions aim to "closely mirror the risk and return characteristics of underlying third-party indices."[39] Accordingly, ordinary business relationships that could trigger a Regulation Y presumption of control present a much reduced potential for exercising control where the investor is an index fund than in other investing relationships.

Certain of the criteria would sweep in a wide range of ordinary business relationships that do not indicate a Fund Complex's ability or incentive to influence lending. In particular, even at the 5 percent ownership level, the presumption of control is triggered if an investor company has any "limiting contractual rights," a term that is broadly described in Regulation Y, with respect to an investee bank or any of its subsidiaries.[40] This presumption could unintentionally sweep in certain ordinary course, market standard relationships that an investor company may have with a bank. For example, corporate trust arrangements often include a provision that gives the client a consent right or other ability to restrict the bank's ability to sell or otherwise dispose of its corporate trust business. This

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36 Federal Reserve Proposal, at 49561.

37 The Federal Reserve Proposal would define "index fund" as "a fund that has an investment objective of tracking the risk and return characteristics of a previously specified third-party broad-based index by holding all, or a representative and preset sample of, the securities of the index in approximately the same proportions as their representation in the index and uses rules-based investing to track that broad-based market index in order to replicate the risk and return characteristics of the broad-based market index. A third-party broad-based market index provides investors with a performance indicator of the overall applicable securities market, is not focused on any specific industries or sectors, and is not published or managed by the investment fund, its investment advisor, or any of their respective affiliates." Federal Reserve Proposal, at 49531 n.49.

38 Because their purchases and sales of an investee company's shares are driven by the composition of the index they track and fund flows, index funds also could not make implicit or explicit threats to buy or sell shares as a means of gaining effective control. *See* Federal Reserve, Control and Divestiture Proceedings, 85 Fed. Reg. 12398, 12407 (Mar. 2, 2020) (hereinafter, the "Control Rule Preamble").

39 Federal Reserve Proposal, at 49531 & n.44.

40 12 C.F.R. § 225.32(d)(5).

restriction could trigger the literal presumption of control under Regulation Y.[41] However, the restriction serves to protect the client against the transfer of the fiduciary relationship to an unacceptable successor and does not, by itself, give the client (here, the Fund Complex or its subsidiaries) influence over the bank's lending decisions. Moreover, certain Fund Complexes engage in a broad array of businesses, including the provision of services as vendors. These relationships could contain covenants that may not neatly fall within one of the "safe harbored" rights in Regulation Y that do not constitute limiting contractual rights,[42] creating uncertainty, which in turn could affect long-standing commercial relationships.

The Federal Reserve has previously recognized that its control standards must account for the distinct statutory purposes of different regulations, including Regulation O. In fact, the Federal Reserve declined to extend its 2020 revisions to the Regulation Y control presumptions to Regulation O, as well as the Change in Bank Control Act regulations, upon which the current Regulation O principal shareholder framework is based.[43] In the 2020 final rule, the Federal Reserve noted that some commenters recommended that the Federal Reserve apply the proposed control standards in other regulations, including to Regulation O. The Federal Reserve declined to follow these recommendations and responded that the regulations the commenters referenced, including Regulation O, "arise[] out of different provisions of law and [are] intended to address different concerns in specific contexts."[44] In these circumstances, the Federal Reserve should not reverse its prior position without a compelling explanation.

ii. In addition, incorporating the Regulation Y presumption of control criteria would introduce unnecessary cost and complexity to the eligibility analysis.

The tiered Regulation Y presumptions would require a tailored review whenever a Fund Complex's ownership crosses the relevant voting-securities-ownership thresholds, because different control criteria apply at each level.[45] Unlike an intentional, one-time investment by a strategic investor, ownership percentages held by passive Fund Complexes can fluctuate daily based on factors that may be outside of their control (*e.g.*, customer inflows and outflows or issuer inclusion in a particular index). The tiered Regulation Y presumptions were not designed for such an inherently dynamic investing structure. In addition, even if a relationship does not give rise to a presumption of control, requiring constant evaluation of control criteria that can change at any time would introduce a significant compliance burden. Further, if banks limit their ordinary course relationships to avoid triggering these presumptions, this could disrupt established customer and service relationships. The application of the Regulation Y presumptions of control may also affect the decisions a bank would otherwise make.

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41 *See* 12 C.F.R. § 225.31(e)(5)(i)(D).

42 *See* 12 C.F.R. § 225.31(e)(5)(ii).

43 *See* Control Rule Preamble, at 12401; J. Virgil Mattingly, *Insider Lending Restrictions and Reporting Requirements under the Financial Institutions Regulatory and Interest Rate Control Act of 1978, as Amended*, 3 Ann. Rev. Banking L. 21, 43 n.92 (1984) ("[t]he presumptions of control established in Regulation O are patterned after the presumptions established under the Change in Bank Control Act").

44 Control Rule Preamble, at 12401.

45 *See* 12 C.F.R. § 225.32(d)–(f).

The rebuttable presumptions of control under Regulation Y may also disproportionately affect small and mid-sized banks. For example, if a Fund Complex owns 5 percent or more of a class of voting securities of a bank, the Fund Complex and the bank would need to monitor their transactions and business relationships to ensure they do not generate a designated percentage of the total revenues or expenses of the bank, even if such transactions and relationships are arm's-length.[46] The applicable percentage of revenues or expenses may translate into a substantially lower absolute dollar amount for a smaller bank, making ordinary course relationships more likely to trigger a presumption of control.

Even an inadvertent loss of qualified fund complex status could have severe consequences for a Fund Complex, the banks in its portfolio, and its other portfolio companies.[47]

iii. The Federal Reserve should therefore incorporate the Joint Statement's control criteria into the qualified fund complex definition.

In light of these issues, the Federal Reserve should incorporate the control criteria it has previously developed and laid out in the Joint Statement into the qualified fund complex definition, rather than incorporating the Regulation Y presumption of control criteria. This approach would reflect the realities of the passive Fund Complex investors that have received relief under the Joint Statement (*i.e.*, passive index fund investors). In addition, both Fund Complexes and banks have relied on the existing criteria and system for providing relief since 2019, and have established processes for monitoring their continued satisfaction of the criteria. Changing the existing factors now would require banks, as well as Fund Complexes, to add new criteria to their processes without a compelling reason for doing so. For a broader range of passive investors, the Federal Reserve could provide an application-based process that considers investor-specific passivity safeguards. Any use of the Regulation Y presumptions in that process should account for the same limitations discussed above.

iv. If the Federal Reserve maintains the Regulation Y criteria, the Federal Reserve should confirm that the criteria apply only with respect to the relevant regulated company.

The proposed presumption of control criteria, by their terms, could be read to require compliance with respect to *every* regulated company in the Fund Complex's portfolio, while the criteria in the Joint Statement apply only with respect to the applicable bank. That interpretation would create a situation in which banks would be unable to ensure compliance with the literal terms of the rule, as banks do not have sufficient information to determine whether a Fund Complex has triggered the presumption of control with respect to its ownership of other banks. Even more broadly, the proposed regulatory text may be ambiguous as to whether the Regulation Y presumption of control analysis applies with respect to the bank's relationships with each portfolio company controlled by a Fund Complex investor or only with respect to the Fund Complex investor itself.[48] Applying the presumption

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46 12 C.F.R. § 225.32(d)(4).

47 As discussed in greater detail below, the Federal Reserve Proposal describes loss of qualified fund complex status as having immediate consequences across the Fund Complex's portfolio banks and for existing and future extensions of credit to portfolio companies. *See* Federal Reserve Proposal, at 49532.

48 For example, if a Fund Complex that is a principal shareholder has passive portfolio company investments in 1,000 companies, would the presumption of control analysis need to be performed with respect to the relationship between each of the portfolio companies and the bank to determine

of control analysis with respect to each portfolio company would impose a near-impossible obligation on banks. Such an approach may also capture many relationships that have little to no relation to a Fund Complex's ability to influence a bank's lending decisions. For example, a portfolio company of a passive Fund Complex that is a principal shareholder of a bank may have substantial business relationships with the bank, even where the Fund Complex does not seek to influence that relationship and is subject to safeguards restricting its ability to do so.[49] The Federal Reserve should therefore confirm that the intended application of the proposed presumption of control criteria is with respect to only the applicable bank, and not any other regulated company, much less any portfolio company.

c. The Federal Reserve should confirm that banks and their principal shareholders may continue to rely on the passivity commitments relied upon by the regulators to establish eligibility for the qualified fund complex exception.

Replacing existing passivity commitments with the Regulation Y criteria would unsettle established reliance interests without a demonstrated need to reassess materially unchanged arrangements. Under the current Federal Reserve statement, specified passivity commitments given in connection with a general counsel legal opinion[50] support the conclusion that a Fund Complex meets the eligibility criteria with respect to its investment in the bank.[51] In its revisions to Regulation Y in 2020, the Federal Reserve stated that it "[did] not intend to revisit existing structures that were previously reviewed by the Federal Reserve System and have not changed materially," such as control letters from the Federal Reserve's General Counsel.[52] Applying the Regulation Y criteria even if a Fund Complex has previously received a non-control determination could undermine those reliance interests and

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whether the portfolio company's relationship could give rise to a presumption of control through the application of the attribution rule?

49 *See* 12 C.F.R. § 225.32(e)(3)(ii). For this relationship to trigger a presumption of control with respect to the bank, the Fund Complex would also need to "control" the portfolio company.

50 *See, e.g.*, Letter from Mark E. Van Der Weide, General Counsel, Federal Reserve, to Anne E. Robinson, Managing Director, General Counsel & Secretary, The Vanguard Group, Inc. (Nov. 26, 2019), *available at* https://www.federalreserve.gov/supervisionreg/legalinterpretations/bhcchangeincontrol20191126a.pdf; Letter from Mark E. Van Der Weide, General Counsel, Federal Reserve, to William J. Sweet, Jr., Skadden, Arps, Slate, Meagher & Flom LLP (Dec. 3, 2020), *available at* https://www.federalreserve.gov/supervisionreg/legalinterpretations/blackrock-letter-20201203.pdf; Letter from Mark E. Van Der Weide, General Counsel, Federal Reserve, to Robert J. Rhatigan, Dechert LLP (May 6, 2021), *available at* https://www.federalreserve.gov/supervisionreg/legalinterpretations/virtus-letter-20210506.pdf.

51 The Joint Statement notes that the federal banking agencies will presume a Fund Complex "meets the eligibility criteria with respect to its investment in the bank if the [Fund Complex] has provided passivity commitments to the Board . . ." Federal Reserve, Statement Regarding Status of Certain Investment Funds and their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations, at 2 n.6; *see also* FDIC, OCC, OCC and FDIC Statement Regarding the Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Insider Lending Restrictions and Related Reporting Requirements, at 2 n.10.

52 Control Rule Preamble, at 12409.

unexpectedly remove a determination on which some Fund Complexes and their investee banks currently rely.

The purposes of Regulation O are better served by reliance on passivity commitments because, as discussed above, Regulation Y's presumption of control criteria are a poor fit in the context of Fund Complex and index fund investing. Regulation O is intended to protect banks against preferential lending and conflicts of interest involving insiders, including insiders who do not control the bank. This concern is mitigated by passivity commitments that restrict an investor's ability to exercise such influence. In particular, passivity commitments expressly prohibit the investor from attempting to influence the bank's loan, credit, or investment decisions or policies, and also bar or severely limit the investor from seeking or accepting board representation, soliciting proxies, or otherwise exercising or attempting to exercise a controlling influence over the bank's management or policies. Because passivity commitments preclude any attempt by a Fund Complex to influence a bank's lending decisions, their existence should resolve the concerns at which the application of the proposed qualified fund complex definition is directed. Passivity commitments are effective for both Fund Complexes and other types of institutional investors. And although other types of institutional investors have a distinct structure from Fund Complexes, passivity commitments also work to ensure that their investments are passive in nature and that the investor does not exercise control over bank lending.

Reliance on passivity commitments would continue to effectively mitigate Regulation O's insider dealing concerns without the same cost and complexity that incorporating Regulation Y's presumption of control criteria would entail.

The Federal Reserve should therefore continue to allow banks and their principal shareholders, including both Fund Complexes and other institutional investors, to rely on qualifying passivity commitments given in connection with non-control determinations under the Bank Holding Company Act and relief from the Change in Bank Control Act notice requirement, and should preserve relief for existing recipients that continue to comply with the conditions on which that relief was granted.

d. The Federal Reserve should not penalize banks for actions by a Fund Complex that are outside of the bank's control and should instead resolve issues with the Fund Complex directly.

The Federal Reserve Proposal describes a potential loss of relief following a Fund Complex's attempt to influence a portfolio bank's lending decisions, with immediate consequences for outstanding credit at each bank for which the Fund Complex is a principal shareholder.[53] The scenario of a then-qualified fund complex attempting to influence a bank lending decision contemplates behavior by the Fund Complex that is outside the control of the bank in which the Fund Complex has invested. In addition, the proposed consequences of the Fund Complex's actions could apply to other banks within a Fund Complex's portfolio that are completely removed from the relevant attempt to influence lending of a particular bank (*i.e.*, were not even recipients of a Fund Complex's attempt to influence lending). Banks should not be suddenly and dramatically penalized as a result of a Fund Complex's unilateral actions. Instead of penalizing banks for actions of a Fund Complex, the Federal Reserve could resolve any identified issues with the Fund Complex directly.

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53 *See* Federal Reserve Proposal, at 49532.

e. The Federal Reserve should place responsibility for assessing status as a qualified fund complex on the Fund Complexes, not on the banks.

Fund Complexes likely maintain significant ownership positions in many banks and other portfolio companies, and they will have to collect information from across their investment funds to confirm their status as qualified fund complexes. Expecting each bank to duplicate Fund Complexes' analysis repeatedly to monitor the Fund Complexes' continued eligibility would be wasteful and unnecessary. In addition, banks would not have access to information that is as reliable and comprehensive as the information available to the Fund Complexes. Fund Complexes have the greatest visibility into their ownership positions and relationships with all their portfolio companies. Such information, including investment fund-by-investment fund ownership amounts, may not be publicly available. Fund Complexes also have the best understanding of their own operations, such as which investment funds in the Fund Complex share "the same or substantially the same investment objective and asset composition" and thus should be aggregated for purposes of paragraph (2) of the qualified fund complex analysis.[54] Banks therefore should not be required to maintain records demonstrating a Fund Complex's status as a qualified fund complex; rather, this responsibility should reside with the Fund Complex itself.

Specifically, the Bank Policy Institute recommends that the final rule clearly allocate responsibilities as follows: (1) the Fund Complex should be responsible for calculating its relevant ownership percentages, determining whether it is a principal shareholder under Regulation O, and determining its eligibility for relief; (2) the Fund Complex should be responsible for notifying the relevant banks that it is a principal shareholder, its eligibility for relief, the list of its Regulation O subject entities, and any future changes to its status, list, or eligibility; and (3) banks should be permitted to rely on such notices from the Fund Complexes, and the final rule should provide banks with a reasonable grace period following receipt of any such notice to come into compliance if the Fund Complex is no longer eligible, during which the bank would not be held accountable for noncompliance with respect to entities or changes of which the bank has not yet been notified by the Fund Complex.

f. The "qualified fund complex" definition should be broadened in scope to include companies that are affiliated with a bank holding company or savings and loan holding company.

Under the Federal Reserve Proposal, a "qualified fund complex" would be defined to exclude any company that is affiliated with a bank holding company or a savings and loan holding company.[55] The proposed definition for "qualified fund complex" thus would not provide relief for Fund Complexes that are affiliated with a bank holding company or savings and loan holding company (*e.g.*, funds offered through a banking organization's investment management arm). However, many such bank-affiliated Fund Complexes are passive investors in their holdings of securities of other banks and other portfolio companies. Subjecting these firms' portfolio companies to Regulation O's requirements without any form of relief presents compliance burdens for banks and investment firms, poses complications for their portfolio companies' access to credit, and places bank holding companies and savings and loan holding companies at a competitive disadvantage relative to Fund Complexes that are not affiliated with such organizations, even though the passive investment relationship between the firms and the banks

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54 *See* Federal Reserve Proposal, at 49561–62.

55 *See* Federal Reserve Proposal, at 49561.

and portfolio companies does not present the type of conflict of interest that Regulation O seeks to avoid.[56] The Bank Policy Institute therefore recommends that the Federal Reserve revise the definition of "qualified fund complex" to include Fund Complexes affiliated with a bank holding company or savings and loan holding company.

g. In addition to the proposed codification of the qualified fund complex relief, the Federal Reserve should confirm that principal shareholders that do not meet the definition of a "qualified fund complex" may request individualized relief within the Federal Reserve's statutory authority.

The proposed codification does not specify a process for requesting individualized relief for passive investors that fall outside the qualified fund complex definition. As a result, the proposed codification does not allow the Federal Reserve to accommodate unique circumstances relating to shareholders that do not meet all the eligibility requirements for status as a qualified fund complex but are still passive. For example, investment funds that make active portfolio selection choices but have passive relationships with their portfolio companies and other institutional investors that agree to maintain passive relationships with banks pursuant to passivity commitments would not be covered by the qualified fund complex exception.

The same policy rationale underlying the proposed qualified fund complex relief may apply to these other passive investors. Where an investor is not in a position to influence a bank's lending policies or decisions, portfolio companies that are treated as related interests solely by operation of Regulation O's rebuttable presumption of control[57] generally do not present the self-dealing risks that Section 22(h) was intended to prevent. Applying Regulation O to extensions of credit to portfolio companies may therefore impose significant compliance burdens and reduce credit availability without a corresponding policy benefit.

The Bank Policy Institute therefore recommends that the Federal Reserve establish a process for granting individualized relief within its statutory authority, and that principal shareholders that do not meet the definition of a qualified fund complex be permitted to request relief, which the Federal Reserve would grant where appropriate. The Federal Reserve could allow Fund Complexes and other passive investors that do not meet the qualified fund complex definition to request and be approved for relief. This would allow the Federal Reserve to evaluate applications based on factors set out in Regulation O and require passivity commitments from investors seeking relief. This approach would allow for a broader range of entities to seek relief even if they do not fall under the proposed definition of a "qualified fund complex," provided that they do not pose the type of insider risks that Regulation O aims to prevent. Adopting a supplemental application-based process would allow the Federal Reserve to respond to changes in investment practices and fact patterns that are difficult to anticipate through codification.

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[56] In addition, under Regulation Y (and Regulation LL), a Fund Complex that is affiliated with a bank holding company or savings and loan holding company is permitted to hold shares of a bank without being deemed to control that bank, so long as the shares are held in good faith in a fiduciary capacity and certain other conditions are met. *See* 12 U.S.C. § 1841(a)(5)(A); 12 C.F.R. §§ 225.2(c)(1)(i), 225.12(a), 238.22(i).

[57] 12 C.F.R. § 215.2(c)(2).

h. Separately managed accounts should be counted toward a Fund Complex's ownership only if the Fund Complex has full discretion over the accounts.

The Federal Reserve Proposal's definition of "investment fund" would include "collective investment trusts, separately managed institutional accounts, and other pooled investment vehicles."[58] As a result, separately managed institutional accounts would count toward a Fund Complex's ownership or control over a bank or portfolio company's stock.

A separately managed account's inclusion in the definition of "investment fund" should not, by itself, determine whether its holdings are attributed to the Fund Complex. Attribution should depend on the Fund Complex's actual authority to own, control, or vote the securities. The Federal Reserve should exclude holdings for which the client retains the relevant authority and the Fund Complex lacks such authority, and clarify the treatment of accounts in which investment and voting authority are allocated to different persons.

Moreover, in its implementation of this approach, the Federal Reserve should distinguish in the definitions between "investment funds" and "separately managed accounts" by providing a separate definition of "separately managed account." Providing separate definitions will avoid future confusion about whether the Federal Reserve recognizes separately managed accounts as distinct from investment funds for purposes of Regulation O, as well as in other contexts.

i. The Federal Reserve should consider a tailored exception for direct extensions of credit to qualified fund complexes that pose minimal risk.

As described above, the passive nature of Fund Complex investing generally does not give rise to the type of conflict of interest and self-dealing issues that Section 22(h) and Regulation O were designed to prevent. The safeguards required for qualified fund complex status may also reduce the risk of preferential lending directly to the Fund Complex. Direct borrowing nevertheless presents risks that should be evaluated separately from lending to portfolio companies. The Federal Reserve should therefore consider a tailored regulatory exception for direct extensions of credit to qualified fund complexes, supported by an express determination that such transactions pose minimal risk and by appropriate conditions, including arm's-length terms and safeguards against influence over lending decisions.[59]

V. Treatment of Derivatives and SFTs

a. The Federal Reserve should explicitly affirm the use of the current credit exposure to value derivative contracts under Regulation O and Regulation W.

The Federal Reserve Proposal would tie the Regulation O valuation methodology for derivative contracts to the valuation methodologies permitted under the capital rules.[60] The Federal Reserve Proposal also notes the possibility of adopting the proposed methodologies for valuing derivative

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58 *See* Federal Reserve Proposal, at 49561 ("Investment fund").

59 *See* 12 U.S.C. § 375b(9)(D)(ii) (authorizing the Federal Reserve to make exceptions to the definition of "extension of credit" for transactions that the Federal Reserve determines pose minimal risk).

60 Federal Reserve Proposal, at 49534–35.

contracts for purposes of Regulation W.[61] The proposed approach diverges from the valuation methodology permitted for purposes of Section 23A/Regulation W, as discussed in the preamble to the 2020 final rule establishing Margin and Capital Requirements for Covered Swap Entities ("Margin Rule Preamble").[62] In particular, the Margin Rule Preamble stated that, for purposes of Section 23A, "bank-affiliate derivatives generally can be valued at the bank's current exposure to the affiliate."[63] The proposed valuation methodology is inappropriate for the purposes of both Regulation O and Regulation W and is not sufficiently justified or explained in the Federal Reserve Proposal. The Bank Policy Institute therefore recommends that the Federal Reserve not adopt these proposed changes to Regulation O, or any similar changes to Regulation W, and instead explicitly endorse the use of the current credit exposure valuation for derivative contracts. The Bank Policy Institute's concerns with the proposed valuation methodology are set forth in detail under separate cover.[64]

b. The Federal Reserve should explicitly allow banks to use any methodology allowed under the current or future capital rules to value SFT exposures.

The Federal Reserve Proposal would tie the Regulation O valuation methodology for SFTs to the valuation methodologies permitted under the capital rules.[65] The Bank Policy Institute supports the flexibility to use any methodologies used under the capital rules today, including both standardized collateral haircuts and the use of internal models.[66] Although the federal banking agencies' March 2026 proposal would revise the bank capital rules, including by eliminating the use of internal models to determine the exposure at default for SFTs for purposes of determining regulatory capital,[67] the Bank Policy Institute recommends that the Federal Reserve continue to permit the use of methodologies permitted under the *current* capital rules for purposes of Regulation O, in addition to any methodologies permitted pursuant to future revisions to the rules.

Absent any identified reason for change, banks should be able to rely on the methodologies to value SFTs that they have developed and that work well for them. Allowing banks to use any methodology permitted under the current or future capital rules would provide flexibility to allow banks to continue to rely on their existing methodologies, including the use of models approved by their

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61 Federal Reserve Proposal, at 49533.

62 OCC, Federal Reserve, FDIC, Farm Credit Administration, Federal Housing Finance Agency, Margin and Capital Requirements for Covered Swap Entities, 85 Fed. Reg. 39754 (July 1, 2020) (hereinafter, the "Margin Rule Preamble").

63 Margin Rule Preamble, at 39764.

64 The other issues discussed in this section also create Regulation W concerns. Subsections (b), (d), and (e) of this section are also discussed from a Regulation W perspective in the Bank Policy Institute's separate letter.

65 Federal Reserve Proposal, at 49535.

66 *See* 12 C.F.R. §§ 217.37(c), 217.132(b)(2)(iii); *id.* §§ 3.37(c), 3.132(b)(2)(iii); *id.* §§ 324.37(c), 324.132(b)(2)(iii).

67 OCC, Federal Reserve, FDIC, Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations, 91 Fed. Reg. 14952, 14964 (Mar. 27, 2026).

primary federal regulator.[68] At the same time, incorporating the ability to use the collateral haircut approach in the capital rules would provide an option for banking organizations to value SFTs in a simple, standardized manner.

The Bank Policy Institute also supports the addition of the simple approach for U.S. government-related collateral, which recognizes the strong collateral value of such securities.

Finally, the Bank Policy Institute notes that the appropriate methodology for valuing SFTs for purposes of Regulation O may differ from the methodology used for purposes of Regulation W, given the distinct statutory authorities involved, as further discussed in our separate letter and in Section XI of Part I of this letter. In addition to our separate letter discussing certain Regulation W aspects of the Federal Reserve Proposal and considerations related to the valuation of derivative exposures for both Regulation O and Regulation W, the Bank Policy Institute plans to provide further comments on the Regulation W approach for valuing SFTs in its response to the Federal Reserve's specific Regulation W proposal.

c. The Federal Reserve should confirm that cash used to reduce a credit exposure may be held in an omnibus account for multiple insiders, including related insiders, and/or multiple transactions, rather than an account that is segregated and earmarked for a specific insider and a specific transaction.

The Federal Reserve's proposed rule "would permit a bank to offset any resulting credit exposure arising from a derivative or derivative netting set with the value of cash held in a segregated, earmarked deposit account with the member bank for the sole purpose of securing credit transactions between the member bank and the insider that is identified as such."[69] This language suggests that collateral may be required to be segregated on an insider-by-insider basis and not held in an omnibus account, which is standard industry practice for receipt of cash to offset derivatives exposures, including for non-insider, unaffiliated clients. The Bank Policy Institute therefore recommends that the Federal Reserve confirm that cash held in an omnibus account may be used to reduce credit exposures arising from multiple derivative transactions involving multiple counterparties, as the current industry practice is sufficient to protect the cash used, while offering significant operational efficiencies for banks.

d. The Federal Reserve should allow banks to net exposures from equity derivatives and total return swaps for the purposes of valuation.

The Federal Reserve Proposal would treat equity derivatives and total return swaps that are functionally similar to a guarantee as guarantees for purposes of valuing exposures to both the

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68 Continuing to permit the use of internal models (as allowed under the current capital rules) is also consistent with the approach used by the OCC in its lending limit regulation, which allows banks to value SFTs using models approved by the relevant federal banking agency, even if not permitted under the capital rules. *See* 12 C.F.R. § 32.9(c)(1)(i)(A)(2).

69 Federal Reserve Proposal, at 49534. The Bank Policy Institute notes that the proposed regulatory text does not include an explicit statement that banks may offset any resulting credit exposure arising from a derivative or derivative netting set with the value of cash, though a similar statement is included in the proposed Section 215.5(d)(2) for the purpose of calculating the simplified amount for a securities financing transaction. *See id.* at 49563–64. The Federal Reserve should include an explicit statement about the use of cash to offset credit exposures in the final regulatory text.

counterparty and the underlying obligor on the instruments.[70] The proposed valuation could mean that exposures from these products could not be netted and that banks would be required to value them at 100 percent of the notional component referencing the insider security to the extent the bank is "short" the exposure or providing downside protection. This framework is at odds with how banks manage these products, which typically involves multiple offsetting transactions to reduce overall exposure to a particular instrument or security. For example, a standard booking model recognized under the OCC's framework governing permissible derivatives activities is one in which national banks are perfectly matched on the transaction with two identical offsetting transactions that result in no net risk exposure.[71] These hedging techniques have long been recognized by the agencies in multiple frameworks.[72]

Preventing banks from netting exposures arising from equity derivatives and total return swaps against other derivative exposures increases the burden of providing such products and potentially reduces banks' ability to engage in this kind of transaction with market participants. The Bank Policy Institute therefore recommends that the Federal Reserve allow firms to recognize like-for-like offsets between long and short derivative exposures, including exposures from transactions with different counterparties.[73]

e. The Federal Reserve should apply the proposed requirement for a bank to decompose a basket or index for which it provides credit protection to identify specific insider exposures only when the basket or index is sufficiently small or concentrated.

The Federal Reserve Proposal states that "[w]here the securities issued by a bank's insider(s) represent only a portion of the reference assets [in an equity derivative or total return swap], the valuation would be limited to the amount of the guarantee provided by the bank with respect to the obligations of its insider(s)."[74] The Bank Policy Institute notes that banks are among the largest participants in derivatives involving credit protection on broad-based baskets and indices consisting of large numbers of constituent securities. In these cases, decomposing the basket or index to isolate exposure to insiders or affiliates would be complex and burdensome and contrary to how such products are viewed by our members' customers (*i.e.*, broad-based baskets and indices are viewed as exposure to the basket or index as a whole, not the individual constituents). In addition, there is limited risk of a bank offering preferential treatment to insiders in the context of providing broad-based credit protection, given that the purpose of the relationship is to provide protection against the whole basket

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70 Federal Reserve Proposal, at 49534.

71 12 C.F.R. § 7.1030(b)(2), (c)(3), and (c)(4).

72 *E.g.*, 12 C.F.R. §§ 44.5, 248.5, 351.5 (exempting risk-mitigating hedging activities from Volcker Rule proprietary trading prohibition).

73 Moreover, the Bank Policy Institute recommends that the Federal Reserve allow firms to net all long and short exposures arising from these products (to the extent consistent with the relevant derivatives and market risk frameworks and provided that these products are held in a bona fide market making or hedging capacity under the Volcker Rule). This treatment would ensure that Regulation O does not treat one side of a market making transaction punitively and disincentivize banks from actively hedging instruments where the hedge would otherwise be treated as a guarantee.

74 Federal Reserve Proposal, at 49534.

or index. The proposed treatment of baskets and indices is thus unduly burdensome and unnecessary to serve the purposes of Regulation O. The Federal Reserve Proposal also would not appropriately recognize diversification and hedging in respect of index positions as provided in aspects of the capital rules.[75] The proposed treatment could ultimately push banks out of the index derivatives business, due to the substantial additional cost associated with managing exposures in connection with the underlying derivatives.

The Federal Reserve should therefore require decomposition of a basket or an index only when that basket or index is sufficiently small or concentrated; for instance, decomposition could be required for an index that would be a "narrow-based security index" as defined in the Commodity Exchange Act or Securities Exchange Act of 1934,[76] or that falls below a threshold number of constituent securities. At a minimum, the Federal Reserve should allow netting of such exposures, for the reasons discussed in the preceding section.

VI. Attribution Criteria for Extensions of Credit to Spouses of Insiders

The Federal Reserve Proposal includes a specialized application of the tangible economic benefit rule for extensions of credit to spouses and their related interests.[77] Under the proposed application of the tangible economic benefit rule, an extension of credit to a related interest of a spouse of an insider would be treated as having been made to the insider unless (1) the spouse or the spouse's related interest is independently creditworthy, (2) repayment of the extension of credit is not predicated on the insider's income or assets, (3) the insider does not have a financial or ownership interest in the company, and (4) the insider does not participate in the management of the company.[78] This approach presumes a degree of financial interdependence between spouses that does not reflect more modern and enlightened concepts of spousal independence, under which spouses maintain separate careers, finances, and business interests.

a. The proposed test for attributing extensions of credit to a spouse of an insider to the insider should be amended to recognize a more modern understanding of spousal independence and avoid creating unnecessary and intrusive burdens on spouses of insiders.

The proposed codification of the Federal Reserve's previous interpretations could expand substantially the information banks must collect regarding a spouse's business interests. Identifying an insider's own related interests does not necessarily identify all companies controlled by the insider's spouse or establish whether the insider has any financial interest in, or participates in the management of, those companies.

Under the proposed codification, a loan to a spouse or to a related interest of a spouse would be presumed to be an extension of credit to the insider, unless the bank establishes that the loan

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75 *See, e.g.*, 12 C.F.R. §§ 3.22(h), 217.22(h), 324.22(h) (calculation of net long position under the deductions framework); 12 C.F.R. §§ 3.210, 217.210, 324.210 (calculation of specific risk for purposes of the market risk capital framework).

76 *See* 7 U.S.C. § 1a(35); 15 U.S.C. § 78c(a)(55)(B); 17 C.F.R. § 41.1(e).

77 Federal Reserve Proposal, at 49563.

78 Federal Reserve Proposal, at 49563.

satisfies the conditions set forth in the proposed test. This framing effectively creates a need to obtain additional information regarding spouses' finances and business interests, even where those interests are maintained independently of the insider. Insiders may lack access to this information, particularly where marital finances are separate.

The Bank Policy Institute recommends that the Federal Reserve reduce these additional information-gathering burdens, including by avoiding default attribution based solely on the marital relationship. Instead, extensions of credit to a company in which the spouse has an interest should be attributed to the insider where the company meets the definition of a related interest of the insider, the bank is relying on the insider's creditworthiness or ability to repay the bank, or the proceeds are transferred to or used for the tangible economic benefit of the insider. To the extent any information collection regarding a spouse's business interests remains necessary, the Federal Reserve should permit banks to rely on an insider's representations regarding the insider's financial or ownership interest in, and participation in the management of, companies in which the insider's spouse has an interest, rather than requiring banks to independently identify and monitor all of the spouse's business interests.

b. The Federal Reserve should not adopt a separate concept of "related interest of a spouse" for purposes of attributing credit to the insider.

The existing related interest framework and generally applicable attribution rule should govern extensions of credit to companies controlled by an insider's spouse. These rules govern the insider's control of the borrower and the transfer or use of loan proceeds for the insider's benefit, without treating the marital relationship itself as sufficient grounds for attribution. The concept of "related interest of a spouse" does not further the aims of Regulation O more than this simpler approach would.

c. If the related interest of a spouse concept is retained, the Federal Reserve should amend the criteria for determining whether an extension of credit to a related interest of a spouse of an insider should be treated as an extension of credit to the insider.[79]

Under the Federal Reserve Proposal, a loan to a spouse-controlled company in which an insider has even a passive one percent ownership interest would be treated as an extension of credit to the insider, even if the insider has no authority over the company.[80] The sweep of the proposed codification

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79 If the Federal Reserve determines to drop the concept of related interests of insiders' spouses, then the generally applicable related interest and attribution rules should continue to apply, including where the bank relies on the insider's repayment obligation or the proceeds are transferred to or used for the insider's tangible economic benefit.

80 The Federal Reserve Proposal does not reference Federal Reserve interpretation 3-1081.1 regarding loans to a spouse of an executive officer in a community property state, which permits such loans not to be treated as loans to an executive officer in some circumstances. That interpretation distinguishes attribution to the executive officer personally from treatment of the borrowing business as the executive officer's related interest. Although the additional restrictions on loans to executive officers did not apply in the circumstances described, general Regulation O requirements continued to apply to the loan to the related interest. *See* Federal Reserve, Board Rulings and Staff Opinions Interpreting Regulation O, 3-1081.1, "EXTENSION OF CREDIT" – Loans to Spouse of Executive Officer in Community Property State, *available at* https://www.federalreserve.gov/frrs/regulations/board-rulings-and-staff-opinions-interpreting-regulation-o.htm#17.

is thus overly broad with respect to the related interests of the spouses of insiders. Applying this criterion would also require banks to determine whether the insider holds any interest, however small, in each company in which the insider's spouse has an interest, compounding the information-gathering burdens described above. In addition, the proposed approach does not appreciate that in contemporary marriages, spouses may make separate business and financial decisions. Accordingly, the requirements for the spouse or borrowing company to be independently creditworthy and for repayment of the extension of credit not to be predicated on the insider's income or assets, together with the generally applicable related interest and tangible economic benefit rules, should be sufficient to protect against the kind of insider risks that Regulation O is intended to prevent.

The scope of the proposed codification is also overly broad with respect to the requirement that the insider not be involved in management of the company. This criterion captures any participation by an insider in the management of a company that is a related interest of the insider's spouse, rather than participation in the capacity of a director or executive officer combined with a minimum ownership interest, without distinguishing routine operational responsibilities or occasional advice from participation that gives the insider control over the company. The Bank Policy Institute recommends that the Federal Reserve narrow the fourth criterion so that participation that does not involve control does not, by itself, trigger attribution, while preserving application of the generally applicable tangible economic benefit rule.

VII. Attribution Criteria for Extensions of Credit to Trusts and Estates

a. The Federal Reserve should apply the "related interest" concept only to trusts and estates where an insider has actual control, and reserve the application of the tangible economic benefit rule for attribution for situations where proceeds are actually transferred to or used for the insider's benefit.

Under the proposed tangible economic benefit and trust control rules, an extension of credit to a trust in which an insider holds a 25 percent or greater beneficial interest could be attributed to an insider as a result of the application of the tangible economic benefit rule, even though the insider lacks the governance powers necessary to be presumed to control the trust under the proposed Regulation O standard of control.[81] Attributing a loan to the trust to an executive officer under the tangible economic benefit rule could subject that loan to the executive officer lending restrictions, which generally do not apply to related interests.[82] The Bank Policy Institute recommends that the Federal Reserve apply the related interest framework where an insider controls a trust or estate, while preserving the general tangible economic benefit rule for proceeds actually transferred to or used for the insider's benefit.[83]

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81 *See* Federal Reserve Proposal, at 49539, 49563.

82 *See* Federal Reserve Proposal, at 49548 (discussing the proposed application of executive officer restrictions to certain related interests that are alter egos of executive officers and lack independent means of repayment).

83 The lending limits rules provide a useful analogous framework. Under 12 C.F.R. Part 32, a trust or estate is treated as a separate person, and an extension of credit to it is attributed to another person only where the proceeds are used for that person's direct benefit or where a common enterprise exists. *See* 12 C.F.R. §§ 32.2(b), (r); 32.5(a)–(c). Part 32 does not automatically attribute an extension of credit to a beneficiary based solely on the beneficiary's percentage interest, much less a contingent interest. Although the purposes of the two regimes are not identical, this more tailored

A beneficial interest alone should not automatically result in attribution of the entire extension of credit, and, as discussed in further detail below, contingent beneficial interests should be excluded from attribution altogether. If the Federal Reserve determines to maintain the beneficial interest threshold, it should not reduce the threshold below 25 percent and should clarify how the percentage is determined for discretionary interests, successive interests, and interests subject to conditions.

In addition, an extension of credit to a trust or estate should not give rise to a violation of Regulation O based on the insider's beneficial interest unless the insider knows of the extension of credit and the insider's status as the beneficiary of the trust or estate. Moreover, banks should be permitted to rely on information provided by their insiders regarding their relationships with and interests in trusts, absent knowledge or information that would reasonably call the accuracy or completeness of that information into question.

b. Contingent beneficial interests in trusts and estates should not, standing alone, trigger attribution under the tangible economic benefit rule.

A contingent beneficiary of a trust or estate may have no role in its management, and a contingent beneficiary's entitlement to trust or estate property depends on the occurrence of a condition that may never be satisfied. A contingent beneficiary may have no present right to income or principal, may never receive property from the trust or estate, and indeed may have no actual knowledge of being named as a beneficiary of a trust or estate, substantially attenuating the economic interest that the proposed rule assumes would motivate the insider to influence the bank's lending decisions. In those circumstances, the existence of a contingent interest does not by itself establish that credit to the trust or estate provides the insider with a tangible economic benefit. Moreover, the Federal Reserve Proposal would otherwise capture actual economic benefits. For instance, the proposed Section 215.3(e)(1) would continue to attribute an extension of credit to an insider "to the extent" the proceeds are transferred to or used for the insider's tangible economic benefit. The Bank Policy Institute therefore recommends that the Federal Reserve exclude contingent beneficiaries from automatic attribution based solely on their beneficial interests by deleting "or contingent" from proposed Section 215.3(e)(2) so that it includes only present beneficial interests.[84]

The Federal Reserve states that the proposal would codify the Federal Reserve's previous interpretation of the tangible economic benefit rule under which some extensions of credit to a trust or estate are deemed to have been made to a beneficiary of the trust or estate, citing to a 1980 staff letter (the "Petersen Letter").[85] The Petersen Letter, in concluding that an "extension of credit by a member bank to the estate or trust would be considered made to the director-beneficiary if the director-beneficiary has a 25 percent or more present *or contingent* interest in the estate or trust," did not directly explain why a contingent interest would create the "danger of a conflict of interest between the officer's duty to the bank and his/her personal enrichment."[86] Rather, the Federal Reserve in the

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framework demonstrates that the concerns regarding indirect benefit and aggregation can be handled without categorically treating every loan to a trust or estate as a loan to a beneficiary holding a 25 percent interest.

84 *See* Federal Reserve Proposal, at 49563.

85 *See* Federal Reserve Proposal, at 49539. *See* Letter from Neal L. Petersen, General Counsel of the Federal Reserve, to John P. Amershadian (May 23, 1980) (hereinafter, the "Petersen Letter").

86 Petersen Letter, at 3–4 (emphasis added).

Petersen Letter noted that its position was "consistent" with a 1974 staff letter (the "Allison Letter") discussing a situation in which an executive officer of a bank was the trustee of a trust, the beneficiary of which was the executive officer's mother.[87] The Allison Letter noted: "If the mother's interest, or any part thereof, passes at her death to her son, the trustee, the Legal staff would take the position that § 22(g) prohibits the loan. The staff feels that any personal interest in the income or assets of the trust, even a future interest, inevitably creates the danger of a conflict between the officer's duty to the bank and his personal enrichment."[88] The Allison Letter's conclusion was specific to an officer-trustee, who combined fiduciary authority over the trust with a potential future beneficial interest. Although the Petersen Letter extended attribution to present or contingent interests of 25 percent or more, its reliance on the Allison Letter does not adequately explain why the same categorical treatment is appropriate for remote contingent beneficiaries who have no fiduciary authority, no present right to distributions, and potentially no knowledge of their interests. Consistent with the facts underlying the Allison Letter, contingent interests should be excluded from attribution unless the beneficiary is also a trustee of the trust or estate.

c. The Federal Reserve should not presume that a trustee controls a trust.

The Federal Reserve Proposal would include a rebuttable presumption that a person controls a trust if the person is a trustee of the trust, which the Federal Reserve characterizes as overturning an interpretation in the Petersen Letter. That letter, however, distinguished direct attribution of a loan to a director from treatment of a trust as the director's related interest and recognized that a sole trustee or co-trustee could, but not necessarily does, control a trust. The relevant question is therefore whether trustee status alone should give rise to a presumption of control regardless of the trustee's actual authority.[89]

A trustee may possess certain governance authority without having any economic interest in the trust. Moreover, trustees are subject to fiduciary duties and restrictions against self-dealing under applicable trust law. Trustee status alone therefore does not necessarily indicate that the trustee has the ability or incentive to influence a bank's lending decisions for personal benefit. Although those fiduciary duties do not themselves preclude control, they reinforce the need to consider the nature and scope of the trustee's authority. Trustees also may have materially different powers depending on the terms of the trust, including where a trustee is subject to the direction or concurrence of another fiduciary.[90] The Federal Reserve should therefore not presume that all trustees have the same actual authority over a trust.

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87 Petersen Letter, at 3–4. *See* Letter from Theodore E. Allison, Secretary, Federal Reserve, to Frank C. Galloway (Oct. 1, 1974).

88 Allison Letter, at 2.

89 *See* Petersen Letter, at 2–3; Federal Reserve Proposal, at 49547.

90 Although arising in the distinct context of a bank or company holding voting shares of a bank in a fiduciary capacity under the Bank Holding Company Act, Federal Reserve guidance similarly recognizes that the actual allocation of authority among trustees and other fiduciaries matters. For example, the Federal Reserve has concluded that a co-trustee that cannot act without another trustee's agreement does not have "sole discretionary authority" to exercise voting rights over bank shares held in trust, and has recognized similar limitations where a trustee's voting authority is subject to a trust protector, administrator, or court order. Federal Reserve, Frequently Asked

At a minimum, the presumption should be limited to trustees with discretionary authority over material investment or distribution decisions and should expressly exclude directed trustees and trustees performing only ministerial functions, as well as co-trustees whose powers are similarly limited. The final rule also should clarify how a trustee may rebut the presumption based on limitations imposed by the trust instrument or applicable law.

d. If the Federal Reserve adopts a trustee-control presumption, it should provide appropriate transition relief.

The proposed presumption could bring additional trust relationships within Regulation O and require banks to reassess existing extensions of credit. Accordingly, outstanding extensions of credit to trusts that become related interests solely because of the new trustee-control presumption should be treated as transition loans under proposed Section 215.4(b).[91] Such extensions of credit could be counted against applicable lending limits when determining whether additional credit may be extended, but should not require repayment, unwinding, or retroactive compliance solely because the new presumption takes effect. The final rule should clarify when subsequent renewals, revisions, extensions, and advances under existing lines of credit would trigger compliance. The Federal Reserve also should provide banks with at least 12 months after the final rule's effective date before requiring compliance with the new trustee-control presumption to identify trustee relationships, survey affected insiders, and update their Regulation O databases.

e. The Federal Reserve should not adopt the proposed presumption regarding whether a settlor, appointer, or beneficiary of a trust controls the trust.

The powers included in the proposed criteria are all rights, but the significance of these rights depends on their scope and the conditions governing their exercise. For example, a settlor, appointer, or beneficiary may have the authority to remove a trustee and the ability to limit the trustee's power to purchase, sell, change, or exchange trust assets, but may not have the authority to appoint the replacement. Further, such removal and restrictive rights may be subject to restrictions, such as the occurrence of specified conditions.[92] Although unrestricted removal authority combined with broad investment veto rights may confer substantial influence, narrowly confined protective rights do not necessarily confer comparable authority over the trust's management or policies. If the final rule does include a control presumption for settlors, appointers, and beneficiaries, the presumption should not apply where removal is limited to specified cause and any replacement must be an independent

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Questions About Regulation Y, 12 C.F.R. § 225.2, Q5; *see also* 12 U.S.C. § 1841(a)(5)(A) (providing that bank shares are not deemed acquired in a fiduciary capacity where the acquiring bank or company has "sole discretionary authority to exercise voting rights"). This guidance does not resolve whether a fiduciary controls a trust under Regulation O, but supports considering the fiduciary's actual authority rather than status alone.

91 Federal Reserve Proposal, at 49563.

92 For example, a trustee may be removable only for cause, or the settlor, appointer, or beneficiary may be required to appoint an independent fiduciary as a replacement. Similarly, an investment restriction may prevent specified investments without giving the holder any affirmative authority to select or direct investments.

fiduciary, or where the investment restrictions are limited protective provisions that do not confer material discretion over the trust's investment decisions.

f. Estates for which an insider is not a beneficiary should not be considered a "related interest" of the insider.

The Federal Reserve Proposal notes that "an estate generally would not be treated as a related interest of an insider because an estate often more closely resembles an individual than a company," but that "an estate can be treated as a company for purposes of Section 22(h) and Regulation O if it takes on characteristics of a company or is part of an association."[93] Even in the unusual case where an estate more closely resembles a company than an individual (*e.g.*, because it is long-lived or takes on other characteristics of a company),[94] an estate should not be treated as an insider's related interest solely because the insider serves as executor without a beneficial interest. An executor is bound by fiduciary duties to administer the estate in the interests of its beneficiaries.[95] Those duties support distinguishing service in a fiduciary capacity from a personal beneficial interest, particularly where the executor's authority is constrained materially.[96]

VIII. Home Mortgage Exception for Extensions of Credit to Executive Officers

a. The Federal Reserve should not adopt the proposed condition requiring the executive officer to live in the property at least three months each year.

The Federal Reserve Proposal would revise Regulation O's implementation of the home mortgage exception from the general prohibition on making extensions of credit to executive officers.[97] The Federal Reserve Proposal would clarify one condition and add two conditions to the exception that are aimed at "further ensur[ing] the exception is used only for a residence."[98] These revisions include (1) clarifying that the exception applies only to a single residence of the executive officer, (2) adding a requirement for the executive officer to live in the property at least three months each year, and

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93 Federal Reserve Proposal, at 49548 & n.154.

94 *See* Petersen Letter, at 2 n.2.

95 *See* Uniform Probate Code § 3-703(a).

96 The final rule also should not presume that a person who is an executor of an estate controls any company controlled by the estate simply because the person serves as the executor of the estate. A person's role as an executor does not necessarily establish that the executor has authority to exercise control over the estate. For example, the estate may have other co-executors, or the executor's authority may be limited by the governing will, applicable law, or a court order. The Petersen Letter framed its conclusion concerning an executor's principal-shareholder status conditionally, referring to circumstances in which the executor or co-executor controls the estate. Petersen Letter, at 2 (noting that "[i]f . . . the executor or co-executor controls the estate," the executor would be considered a principal shareholder of banks with respect to which the estate holds more than 10 percent of any class of voting shares). It would therefore be inappropriate to presume control solely on the basis of executor status without considering material limitations on the executor's authority.

97 Federal Reserve Proposal, at 49543.

98 Federal Reserve Proposal, at 49543.

(3) adding a requirement that the property not be a property for investment purposes. These conditions would supplement the existing conditions that (4) 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 (5) refinancing proceeds included in this category of credit are limited to repayment of the original extension of credit, closing costs, and amounts used to purchase, construct, maintain, or improve the residence.[99]

The proposed time-based residency requirement goes beyond what is needed to serve the statutory purposes of 12 U.S.C. § 375a(2). Requiring that the property actually be used as the executive officer's residence satisfies the statutory purpose without imposing a fixed annual occupancy requirement. A bank should be able to determine whether a property is used as the executive officer's residence based on the executive officer's written affirmation to that effect, and such an affirmation should be sufficient for the bank to rely on the exception, absent information that would reasonably call its accuracy into question. Moreover, the risks of self-dealing or loss to the bank are already mitigated by the existing safeguards: the extension of credit must be on non-preferential terms, secured by a first lien, and the exception may be used for only one property owned by the executive officer.

Under the current rule, the exception is available for a second home so long as the executive officer uses the property as a residence and does not use the exception for any other property.[100] The Federal Reserve's published guidance does not specify a numerical minimum period of occupancy. The amount of time an executive officer resides at a home may reasonably vary from year to year because of business travel, illness, caregiving responsibilities, or temporary displacement during repairs. For example, an executive officer may be transferred to another office for a year-long temporary assignment, during which time the executive officer would not live in their primary residence. In addition, an executive officer may temporarily move out of their primary residence due to extensive renovation. Imposing a minimum time requirement would create unnecessary inquiries, recordkeeping burdens, and illogical outcomes without meaningfully advancing the statutory purpose. A property does not cease to be a residence solely because the executive officer spends fewer than three months there in a particular year. An additional occupancy threshold would impose compliance burdens without a demonstrated corresponding benefit.

We therefore recommend that the Federal Reserve not adopt the proposed time-based residency condition. The requirement that the property be used as the executive officer's residence, combined with existing safeguards, would adequately ensure the exception is used only for a residence without imposing the administrative burden of monitoring and documenting time spent at the property over the life of the mortgage. In addition, if an executive officer were not to spend the minimum amount of time at the residence in subsequent years, despite initial plans and meeting the other conditions, this circumstance alone would not necessarily increase the risk to the bank and should not result in a violation of Regulation O.

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99 Federal Reserve Proposal, at 49543, 49565; 12 C.F.R. § 215.5(c)(2).

100 Federal Reserve, Frequently Asked Questions about Regulation O, 12 C.F.R. § 215.5 (Additional restrictions on loans to executive officers of member banks), Q1, *available at* https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-o-frequently-asked-questions.htm#P5%20Q1; *see also* Federal Reserve Proposal, at 49543 n.120 (acknowledging that a second home may qualify and citing the Board's earlier removal of "primary" from the residence exception).

The Federal Reserve Proposal also requested comment on whether the Federal Reserve should instead interpret "residence" to mean "the place where an executive officer is most likely to be found or where he or she spends the majority of the year."[101] This approach is even more restrictive than the proposed three-month requirement and would effectively limit the exception to a primary residence, eliminating the flexibility for second homes recognized in the Federal Reserve's existing guidance.[102] The Bank Policy Institute therefore opposes the adoption of this more restrictive requirement.

If the Federal Reserve nonetheless determines to adopt any changes to the home mortgage exception, the final rule should apply such changes only prospectively to extensions of credit made after the effective date of the final rule and should grandfather extensions of credit made in compliance with the existing exception prior to that date.

IX. Treatment of Lines of Credit

a. The Federal Reserve should adopt a limited exception for certain standardized, automated approvals, credit line increases, and changes in terms from the proposed board approval requirement for new extensions of credit.

Under the Federal Reserve Proposal, prior board approval could be required for an extension of credit—including a credit line increase, maturity extension, or adjustment to an interest rate term or other material term—when the applicable aggregate threshold is exceeded. Banks may automatically approve certain loans or increases to credit lines where such loans or increases are approved under standardized underwriting criteria and terms that are broadly applied to similarly situated customers, including indirect automobile and equipment loans and increases to revolving credit line limits such as credit cards. In addition, banks may automatically adjust the terms of all such loans for similarly situated customers. Such automatic and standardized loans and increases and adjustments should not be subject to the proposed prior board approval requirement for extensions of credit. These actions represent programmatic decisioning that is applied uniformly to similarly situated customers.[103] They involve no insider-specific discretion or preferential treatment, and therefore present limited risk of the conflicts of interest and self-dealing that prior board approval is intended to prevent. Such loans are also already

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101 Federal Reserve Proposal, at 49543 (Question 64).

102 In its 1992 amendments to Regulation O, the Federal Reserve declined to require that a residence be a primary residence to qualify for the home mortgage exception. *See* Federal Reserve, Regulation O—Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Regulation Y—Bank Holding Companies and Change in Bank Control, 57 Fed. Reg. 6077 (Proposed Rule) (Feb. 20, 1992) (proposing to limit the home mortgage exception to "primary residences"); Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies and Change in Bank Control; Change in Effective Date and Republication of Rule, 57 Fed. Reg. 22417, 22423 (Final Rule) (May 28, 1992) (omitting the "primary" modifier from the exception in the final rule).

103 The Federal Reserve noted these characteristics of credit card lending in adopting the original credit card exception in Regulation O. *See* Federal Reserve, Loans to Executive Officers of Member Banks, Permissible Loans, 32 Fed. Reg. 4124, 4125 (Proposed Rule) (Mar. 16, 1967) ("Because of their impersonal nature, indebtedness of the types described in the proposed [credit card exception] are not regarded as falling within the general intent of [S]ection 22(g) of the Federal Reserve Act."); Federal Reserve, Loans to Executive Officers of Member Banks, Exemption of Certain Indebtedness, 32 Fed. Reg. 7584 (Final Rule) (May 24, 1967).

reviewed as part of banks' standard credit risk processes, just as they are for other customers, and therefore do not pose unique credit risk to the bank. The Federal Reserve should recognize these special situations by creating a limited exception from the prior board approval requirement. The exception should apply only where the action follows pre-established, objective underwriting and pricing criteria that are applied to non-insiders, without an insider-specific override, and the extension remains subject to all other applicable requirements of Regulation O.

b. The Federal Reserve should not require board approval of a draw on a line of credit to an insider when the applicable aggregate threshold is exceeded unless and until the line of credit is renewed, extended, or materially amended.

The Federal Reserve Proposal would retain the existing requirement for prior board approval for each draw on a line of credit to an insider when the applicable aggregate threshold is exceeded, unless the board has approved the line of credit within the preceding 14 months.[104] In addition, the Federal Reserve Proposal would require transition loans that are lines of credit to comply with all applicable requirements of Regulation O within 14 months after the borrower becomes an insider,[105] even if the bank remains contractually obligated to fund advances under the existing commitment.

We recommend against requiring prior board approval (or reapproval, as the case may be) of a line of credit or a draw on a line of credit to an existing insider, unless and until the line is renewed, extended, or materially amended, provided that the line of credit was consistent with the requirements of Regulation O at the time of origination. As long as a line was granted on terms that were approved by the board, and the loan is reviewed as part of the bank's standard credit risk processes, the passage of 14 months alone should not require renewed approval of advances within the approved commitment and on the approved terms. Moreover, where the bank has already committed to the facility and its terms, the reapproval may create legal risks (*e.g.*, breach of contract) for the bank or involve terms that are outside the bank's control to change, especially in cases involving third-party consents. For transition lines, the Federal Reserve should similarly preserve transition treatment for advances the bank is contractually obligated to fund under an existing commitment, until the commitment is renewed, extended, or materially amended.

X. Treatment of Transition Loans

a. The Federal Reserve should apply a transition period for purposes of including transition loans in a bank's calculation of the individual and aggregate lending limits and for calculation of the limits on extensions of credit to executive officers.

We support the Federal Reserve's proposal to specify that transition loans that are not lines of credit need not conform to Regulation O unless and until such extensions are renewed, revised, or extended.[106] However, the Federal Reserve Proposal would specify that the amount of transition loans must be included in the calculation of the individual and aggregate lending limits "*as soon as the*

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104 Federal Reserve Proposal, at 49546–47, 49564; *see also* 12 C.F.R. § 215.4(b)(3); Federal Reserve Proposal, at 49547 (Question 79) (requesting comment on the advantages and disadvantages of the 14-month reapproval requirement).

105 Federal Reserve Proposal, at 49546, 49563.

106 Federal Reserve Proposal, at 49546.

borrower becomes an insider."[107] To allow banks to manage the effect of counting transition loans, including potential restrictions on further lending, we recommend that the Federal Reserve apply a time-based transition period (*e.g.*, 14 months) for purposes of including the amount of the transition loans in a bank's calculation of such limits. A transition period would provide banks time to adjust their lending relationships and avoid abrupt restrictions on otherwise permissible lending solely because a borrower becomes an insider.

b. The Federal Reserve should confirm that board approval is not required for transition loans in excess of the board prior approval threshold for extensions of credit to insiders unless and until the loans are renewed, revised (other than through a minor revision), or extended.

We understand the proposed Section 215.4(b) to provide that transition loans, other than lines of credit following the expiration of the applicable 14-month period, are not subject to the board prior approval requirement unless and until they are renewed, revised, or extended, provided that the bank did not enter into the transaction in contemplation of the borrower becoming an insider and includes the amount of the extension of credit toward the applicable quantitative limits for purposes of determining whether a future extension of credit would comply with those limits, subject to the transition period recommended above.[108] This treatment is consistent with the Federal Reserve Proposal's statement that transition loans "need not conform to Regulation O" until they are renewed, revised, or extended,[109] as well as the Federal Reserve's existing Regulation O FAQs.[110] To avoid uncertainty, the Federal Reserve should confirm this interpretation in the preamble to the final rule. The Federal Reserve should also confirm that a minor revision to a transition loan does not trigger the board prior approval requirement. For this purpose, a minor revision should mean any revision that does not change the amount, interest rate, or schedule of payment of the extension of credit, or the restrictions on or representations by the borrower.

c. The Federal Reserve should apply the additional restrictions on extensions of credit to executive officers only prospectively.

The Federal Reserve Proposal requests comment on whether extensions of credit made to an insider that is not an executive officer should become immediately subject to the additional restrictions applicable to executive officers when the insider becomes an executive officer.[111] The same issue arises whenever a borrower becomes an executive officer, whether or not the borrower was previously an insider. The Bank Policy Institute recommends that the quantitative limits, conditions for exceptions from those limits, and other restrictions in the proposed Section 215.20 apply only to new extensions of credit made after the borrower becomes an executive officer. Extensions of credit made before that time should not be required to conform to those restrictions unless and until they are renewed, revised

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107 Federal Reserve Proposal, at 49546 (emphasis added).

108 *See* Federal Reserve Proposal, at 49563.

109 Federal Reserve Proposal, at 49546.

110 Federal Reserve, Frequently Asked Questions about Regulation O, In General, Q2, *available at* https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-o-frequently-asked-questions.htm#P1%20Q2.

111 Federal Reserve Proposal, at 49546 (Question 75).

(other than through a minor revision), or extended. In addition, the executive officer should be permitted to continue using a previously existing line of credit in accordance with its terms, and a draw pursuant to the bank's existing commitment should not, standing alone, cause the line to lose its transition treatment. Consistent with the Federal Reserve Proposal, this treatment would not apply to an extension of credit made in contemplation of the borrower becoming an executive officer.

For example, a new executive officer may have more than one mortgage loan from the bank or may have outstanding credit card or other lines of credit that exceed the limit for extensions of credit that do not qualify for an exception. Those extensions of credit were made before the borrower became an executive officer and therefore before the borrower could exercise influence in that capacity over the bank's lending decisions. Requiring the bank or the executive officer to terminate, sell, refinance with another institution, or reduce those extensions of credit solely because the borrower became an executive officer would impose substantial burdens without remedying any preferential treatment in the original lending decision and could be detrimental to both the bank and the executive officer. The Federal Reserve should therefore provide that the additional restrictions applicable to executive officers apply prospectively to extensions of credit made, renewed, revised, or extended after the borrower becomes an executive officer.

d. The Federal Reserve should eliminate the automatic expiration of transition treatment after 14 months for transition loans that are lines of credit, unless and until the line of credit is materially modified.

The Federal Reserve Proposal would require transition loans that are lines of credit to comply with the requirements of Regulation O within 14 months after the borrower becomes an insider,[112] including board approval where the applicable threshold is exceeded. We recommend against automatically ending transition treatment for lines of credit after 14 months. Rather, reapproval and compliance with Regulation O should only be required when there are material changes in terms and conditions of the loan, such as an increase in commitment, extension of maturity, or a negotiated change to the interest rate, excluding adjustments pursuant to the facility's existing terms, consistent with the treatment of other transition loans under Regulation O.

Although the Federal Reserve Proposal expresses concern that some lines of credit could retain transition treatment indefinitely,[113] many lines of credit have a stated maturity or are subject to periodic renewal. For those facilities, transition treatment would end upon renewal or a material modification rather than continue indefinitely. It is therefore unnecessary to require additional approvals with respect to insider transitions if no material changes are being made to a line of credit's terms and conditions. Existing contractual protections, including applicable default and termination provisions, would continue to protect the bank according to their terms. Further, requiring reapproval does not meaningfully reduce risk of conflicted insider transactions, because the lending decision was made at origination, *i.e.*, when funds were advanced or the commitment was made, not when a person becomes an insider or upon expiration of the transition period. The bank has already committed to the facility and its terms, and so reapproval may create legal risks (*e.g.*, breach of contract) for the bank or involve terms that are outside the bank's control to change. The 14-month period for bringing a facility into compliance may also be insufficient for complex credit facilities (*e.g.*, syndicated loans and multi-tranche

112 Federal Reserve Proposal, at 49546, 49563.

113 Federal Reserve Proposal, at 49547.

facilities) that involve third-party lender consent. In these circumstances, removing the automatic expiration of transition treatment after 14 months is appropriate.

At a minimum, the Federal Reserve should confirm that a new insider may continue to draw on a line of credit originated before the person became an insider during the 14-month transition period without board prior approval, provided that there is no material change in the key terms of the line of credit. And if it determines to retain a reapproval requirement, the Federal Reserve should confirm that the bank may reapprove the extension of credit based on the existing terms of the facility without requiring re-underwriting or re-documenting the extension of credit, to avoid imposing excessive burden on the bank.

e. The Federal Reserve should provide uniform transition treatment for all types of insiders.

The Federal Reserve Proposal asks for feedback on whether the rule should provide transition treatment for the requirements of Regulation O that apply only to certain types of insiders.[114] The Bank Policy Institute supports a uniform transition-loan treatment across insider types.[115] A preexisting loan should retain transition treatment regardless of the type of insider that the borrower later becomes, as long as the loan is not made in anticipation of insider status.

XI. Links Between Regulation O and Regulation W

a. The Federal Reserve should not treat the Bank Policy Institute's comments on, or silence regarding, any aspect of Regulation O as indicative of our views regarding parallel changes to or elements of Regulation W.

The Federal Reserve Proposal would more closely link Regulation O with Regulation W in several respects.[116] The Bank Policy Institute acknowledges that Regulation O and Regulation W share certain operational concepts and that greater consistency between them can, where appropriate, promote clarity and reduce unnecessary compliance burdens. However, Regulation O and Regulation W ultimately have distinct statutory authorities and frameworks, notwithstanding their overlapping protective purposes. Regulation O is designed to prevent insider abuse by restricting extensions of credit to a bank's insiders, whereas Regulation W protects banks against risks arising from transactions with affiliates through quantitative limits and other prudential requirements, including restrictions on transaction terms. Given their distinct statutory frameworks and scope, the application and interpretation of the two regulations should not be automatically linked. The Federal Reserve itself has recognized this distinction in prior rulemakings.[117] Accordingly, the Federal Reserve should not treat our

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114 Federal Reserve Proposal, at 49546 (Question 75).

115 Federal Reserve Proposal, at 49546–47.

116 *See, e.g.*, Federal Reserve Proposal, at 49534 (proposing to value credit derivatives in which a member bank provides credit protection to an insider with respect to an obligation of the insider in the same manner as under Regulation W), 49535 (proposing to apply the Regulation W principles for various types of extensions of credit), 49536–37 (proposing to mirror certain Regulation W definitions in Regulation O).

117 *See, e.g.*, Federal Reserve, Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates, 59 Fed. Reg. 8831, 8834 (Feb. 24, 1994)

comments on, or silence regarding, any aspect of the Federal Reserve Proposal relating to Regulation O as indicative of our views with respect to Regulation W.

Concepts from one regulation should only be incorporated into the other where there is a sound conceptual basis for doing so under the receiving regulation's statutory framework, and alignment should not be an end in itself. Otherwise, alignment could lead to unintended consequences. Banks have long-standing and separate controls and procedures built around each existing framework, and changing definitions and methodologies in either regulation for the sole purpose of alignment could increase compliance burdens without meaningfully reducing the risks that the frameworks are intended to mitigate. Any changes should be targeted at specific, well-supported enhancements. In addition, the Federal Reserve should ensure that any linkages it codifies between the two regulations enhance clarity, rather than create additional complexity.

XII. FDIC Proposal

a. The Bank Policy Institute supports increasing the FDIC's dollar-based thresholds.

The FDIC proposes to increase the dollar-based cap used in calculating the threshold for extensions of credit to executive officers not otherwise specifically authorized from $100,000 to $400,000 under 12 C.F.R. § 337.3(c)(2), and the dollar-based cap used in calculating the threshold for extensions of credit to insiders requiring prior board approval from $500,000 to $2,000,000 under 12 C.F.R. § 337.3(b).[118] These increases align with those proposed by the Federal Reserve. Because the FDIC applies Regulation O (except for certain provisions that apply only to member banks) to insured nonmember banks to the same extent and in the same manner as if they were member banks, the Bank Policy Institute recommends increasing the FDIC's thresholds in the same manner as the Federal Reserve increases its thresholds.[119] Alignment avoids divergent treatment of similarly situated institutions based solely on their primary federal regulator.

b. The Bank Policy Institute supports the use of indexing going forward.

We support the FDIC's proposal to automatically adjust the dollar-based thresholds in 12 C.F.R. § 337.3 every five years using nominal GDP, consistent with the methodology proposed by the Federal Reserve in its proposal.[120] This proposal provides FDIC-supervised institutions with more predictability and prevents different treatment of banks based solely on the bank's primary federal regulator. Consistent with our recommendation to the Federal Reserve, we also recommend that the FDIC make

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(noting that a particular definition in Section 22(h) was no longer tied to Section 23A and that the Federal Reserve was therefore "authorized to adopt appropriate definitions of terms in the statute").

118 FDIC Proposal, at 50732–33, 50737–38.

119 As discussed above, the Bank Policy Institute recommends that the Federal Reserve increase the executive officer "other purpose" lending limit to $2 million, rather than $400,000, subject to indexing going forward in the same manner as the other thresholds. Consistent with the alignment recommended here, we recommend that the FDIC make a corresponding increase to its dollar-based cap under 12 C.F.R. § 337.3(c)(2).

120 FDIC Proposal, at 50733–34.

the updates self-executing, such that each FDIC-supervised institution may calculate and apply the adjusted thresholds every five years without awaiting FDIC publication.

XIII. Effective Date of Proposals

a. The Bank Policy Institute recommends that the Federal Reserve and FDIC adopt a common effective date for their final rules at least one year after publication, permitting but not requiring early compliance.

The Federal Reserve Proposal contemplates major changes to a longstanding rule with well-established compliance programs. As a result of these changes, banks will need to redesign their existing compliance programs and procedures and may need to develop new compliance systems. The Bank Policy Institute therefore recommends that the Federal Reserve adopt an effective date for its final rule that occurs at least one year after publication, permitting but not requiring early compliance with individual provisions.[121] In particular, we recommend that the Federal Reserve allow banks to apply the increased thresholds and qualified fund complex framework immediately after finalization. Because the FDIC's revised rule would align with the Federal Reserve's revised rule, we recommend that the FDIC adopt the same effective date and permit the same flexibility for early compliance.

In addition, the interim relief for Fund Complexes provided under the Federal Reserve's Joint Statement letter, as extended, is currently scheduled to expire on January 1, 2027.[122] Because the final rule is unlikely to become effective before that date, particularly if the Federal Reserve adopts the effective date recommended above, the Federal Reserve should extend the Joint Statement relief so that it remains in effect until the effective date of the final rule.[123] A lapse in that relief would subject banks, Fund Complexes, and their portfolio companies to the significant disruption and compliance burdens described above, only for the relief to be restored once the final rule takes effect.

Part II: Additional Recommendations to Modernize Regulation O

I. Regulation O Compliance Grace Period

The Federal Reserve Proposal asks whether Regulation O should provide for a grace period for application of the presumption of control when a principal shareholder "temporarily trips the

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121 For example, the final rule should allow banks to begin applying the increased thresholds once their compliance systems have been appropriately updated, but should not require compliance with any new recordkeeping requirements until the required compliance date.

122 *See* Federal Reserve, Statement Regarding Status of Certain Investment Funds and their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations.

123 We presume that the FDIC, together with the OCC, will not rescind the Joint Statement letter before the Federal Reserve's rule becomes effective. FDIC, OCC, OCC and FDIC Statement Regarding the Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Insider Lending Restrictions and Related Reporting Requirements, at 1 ("This statement will continue to be effective unless amended, superseded, or rescinded in writing. The agencies anticipate that this statement will no longer be necessary upon the adoption of a final rule by the [Federal Reserve] that revises Regulation O to fully address the treatment of extensions of credit by a bank to fund complex-controlled portfolio companies that are insiders of the bank.").

presumption of control with respect to a portfolio company due to events outside its control or that do not become known immediately."[124] The Federal Reserve Proposal identifies 90 days as a possible grace period.[125]

a. The Bank Policy Institute supports a grace period when a principal shareholder triggers principal shareholder status or loses an applicable exception.

The Federal Reserve Proposal contemplates that a principal shareholder's portfolio companies could immediately become subject to Regulation O if the shareholder triggers the presumption of control or loses an applicable exception.[126] A grace period would allow principal shareholders and banks time to either remediate the issue or come into compliance with Regulation O's applicable requirements.

The requirements of Regulation O are complex, and implementing the necessary compliance measures takes time. A principal shareholder's ownership interest in a portfolio company may change unexpectedly and for reasons outside the shareholder's or the bank's control, such as fund inflows, and the bank may not have timely access to the information needed to determine whether the change triggers a Regulation O requirement. Similar compliance challenges may arise when a change in an investor's ownership interest in the bank causes it to become a principal shareholder. It may also take time for the shareholder to reduce its interest below the applicable threshold after crossing it unintentionally. Immediate application of Regulation O would create particular difficulties where the shareholder is seeking to reverse the change that brought the lending relationships into scope. Even where a change in ownership is expected or intended, a bank and principal shareholder may require additional time to ensure compliance. The Bank Policy Institute therefore recommends that the Federal Reserve adopt a grace period for compliance with Regulation O when a change in ownership or the loss of an applicable exception brings additional lending relationships within scope.

b. The grace period should be available regardless of the reason for triggering the presumption of control.

The Federal Reserve Proposal's discussion of the potential grace period appears to contemplate that it would apply only when the presumption is triggered temporarily by events outside the shareholder's control or that do not become known immediately. It is unclear how these conditions would be applied in this context, and conditioning relief on those concepts would require banks to evaluate a principal shareholder's intent and knowledge, which they generally cannot verify. In addition, the need for time to implement compliance measures also applies to a shareholder that has intentionally triggered the presumption of control or intends to retain the ownership interest that triggered it. We therefore recommend that the grace period not be conditioned on the temporary,

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124 Federal Reserve Proposal, at 49533 (Question 14).

125 Federal Reserve Proposal, at 49533 (Question 14).

126 For example, the Federal Reserve Proposal states that if a qualified fund complex loses its claim to the proposed exception from the presumption of control by attempting to influence the lending decision of a bank in its portfolio in favor of one of its other portfolio companies, "[a]ll of the [F]und [C]omplex's portfolio companies would immediately become related interests of the [F]und [C]omplex and thus insiders of each bank of which the [F]und [C]omplex is a principal shareholder." Federal Reserve Proposal, at 49532.

unintended, or unknown nature of the events that cause the principal shareholder to trigger the presumption of control. The grace period would not, however, excuse any attempt by the principal shareholder to influence the bank's lending decisions.

c. The length of the grace period should reflect whether the shareholder intends to cure the triggering event or implement compliance and should run from the date the principal shareholder notifies the bank.

If the Federal Reserve views the grace period as time to put in place compliance programs, a period longer than 90 days would be appropriate. The Federal Reserve should consider adopting a grace period of at least 14 months, consistent with the transition period we recommend above for including transition loans in the individual and aggregate lending limits, for implementing the policies and programs associated with Regulation O compliance. Although banks have Regulation O policies and procedures, bringing a principal shareholder and its related interests within the applicable requirements could require significant upfront work, including onboarding, developing new processes between the principal shareholder and the bank, obtaining extensive information about the principal shareholder's portfolio companies, and identifying all affected products and accounts.[127] Moreover, some banks' existing Regulation O policies and procedures may be primarily targeted at compliance with respect to executive officers and directors, rather than Fund Complex investors that are also clients of the bank's institutional business. Onboarding a new Fund Complex or other institutional investor may require additional systems and programs to manage risks specific to the bank's business relationships with institutional clients. If the Federal Reserve views the grace period solely as time for the principal shareholder to reduce its holdings or make other changes to avoid application of the presumption of control, a six-month grace period may be appropriate. That period would permit an orderly reduction in holdings and reduce the potential for market disruption.

The Federal Reserve could adopt both periods to accommodate these different circumstances. For example, a principal shareholder could be required to notify the Federal Reserve and the bank within 30 days after becoming aware that it has triggered the presumption of control or lost an applicable exception. The notice would indicate whether the shareholder intends to cure the triggering event within six months after notifying the bank or instead implement compliance with the applicable requirements. If the principal shareholder plans to implement compliance, the bank and the principal shareholder would have 14 months from the date of notice to the bank to come into compliance with Regulation O's applicable requirements, including through the adoption and implementation of policies and programs tailored to that principal shareholder.

In either case, the grace period should run from the date the principal shareholder notifies the bank of the triggering event.

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127 The time necessary to complete these procedures will depend in part on the characteristics of the principal shareholder; a smaller principal shareholder (*e.g.*, a family office) may be simpler to onboard than a large Fund Complex.

II. Secondary Market Purchases of Extensions of Credit to Insiders

a. The Federal Reserve should treat arm's-length secondary market acquisitions of extensions of credit similarly to transition loans.

Under the Federal Reserve Proposal, secondary market purchases of extensions of credit would be treated as Regulation O extensions of credit by the purchaser.[128] Banks routinely acquire and trade assets on secondary markets and through corporate activities, including acquiring large portfolios of mortgages, loans, credit card receivables, and other assets. Arm's-length secondary market transactions are negotiated with third parties who are not insiders, are conducted on market terms, and do not provide transaction proceeds to the relevant insiders. Requiring these acquisitions to comply immediately with Regulation O provides limited protection against self-dealing because the acquiring bank does not establish or change the insider's credit terms. The operational burden associated with this treatment is substantial and disproportionate to any potential corresponding supervisory benefit.

The Bank Policy Institute recommends that the Federal Reserve treat these secondary market purchases of extensions of credit in a manner similar to that proposed for transition loans. Under the Federal Reserve Proposal, a transition loan "need not conform to Regulation O until such extension[] [is] renewed, revised, or extended, at which time the extension[] of credit would be treated as a new extension of credit."[129] Similarly, if a bank purchases a loan or other extension of credit to an insider in an arm's-length secondary market transaction, the acquired extension of credit should not be required to conform to Regulation O unless and until the bank agrees to a renewal, increase in commitment, extension of maturity, or other material change to the loan. This approach targets the point at which preferential treatment could occur while avoiding unnecessary compliance burdens associated with acquisitions that do not implicate Regulation O's anti-self-dealing purpose.[130]

b. The Federal Reserve should value acquired extensions of credit based on the outstanding principal amount and any additional committed amount.

The Federal Reserve Proposal would value an extension of credit to an insider acquired from a third party as the "price paid by the bank for the extension of credit plus any additional amount that the bank could be required to provide to, or on behalf of, the insider under the terms of the agreement governing the extension of credit."[131] Although the purchase price may be readily identifiable when a bank purchases a single note, that approach would be difficult to administer for portfolios of mortgages, loans, or other assets acquired for an aggregate price that may not be allocated among the individual extensions of credit. The Bank Policy Institute therefore recommends that an acquired extension of credit be valued for purposes of Regulation O at the outstanding principal amount owed by the insider

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128 Federal Reserve Proposal, at 49536. The proposed treatment would be similar to the current rule, except that the Federal Reserve Proposal would explicitly incorporate certain derivatives as extensions of credit, to reflect statutory changes implemented by the Dodd-Frank Act. *See* Federal Reserve Proposal, at 49533, 49562; 12 C.F.R. § 215.3(a)(4).

129 Federal Reserve Proposal, at 49546.

130 We also recommend that our suggested modifications to the proposed treatment of transition loans apply to these secondary market transactions, including the recommended transition period for counting acquired extensions of credit toward the individual and aggregate lending limits.

131 Federal Reserve Proposal, at 49536.

plus any additional amount that the bank is legally obligated to provide to, or on behalf of, the insider under the governing agreement. Accordingly, a fully funded term loan or note would be valued at its outstanding principal amount, while a revolving line of credit or credit card account would be valued at its outstanding principal amount plus any undrawn amount that the bank is legally obligated to fund. This approach focuses on the insider's indebtedness and the bank's contractual commitment to provide credit and would permit banks to rely on information maintained in their existing loan and account systems. This valuation method should apply whenever an acquired extension of credit must be counted toward Regulation O's individual or aggregate lending limits, consistent with the transition period recommended above and in our discussion of transition loans.

III. Market Terms Standard for Asset Purchases and Sales

a. The Bank Policy Institute supports the adoption of definitions of "purchase of asset" and "market terms."

Section 615 of the Dodd-Frank Act prohibits banks from purchasing assets from or selling assets to insiders unless the transaction is on market terms. If the Federal Reserve incorporates this statutory prohibition into Regulation O, the Bank Policy Institute supports including in the final rule clear definitions of key terms, including "purchase of asset" and "market terms," to facilitate compliance and reduce interpretive uncertainty.[132]

b. The Federal Reserve should confirm that the "comparable transactions" referenced in the definition of "market terms" are transactions with similarly situated non-insiders.

The Federal Reserve proposes to define "market terms" as "substantially the same, or at least as favorable to the insured depository institution, as those prevailing at the time for comparable transactions with or involving persons that are not insiders of the insured depository institution."[133] We support the proposed definition, which appropriately measures market terms by reference to comparable transactions with non-insiders. We understand "comparable transactions" to refer to the terms offered, or that would be offered, to similarly situated non-insiders, and we recommend that the Federal Reserve confirm this understanding in the final rule. A comparison to non-insiders without regard to their characteristics would be unworkable because transaction terms vary significantly based on creditworthiness, transaction size, the size and breadth of the overall relationship, and relationship history.

c. The Federal Reserve should not prohibit asset purchases or sales with insiders on terms more favorable to the bank than market terms.

The Federal Reserve Proposal asks whether it should be impermissible for a bank to sell an asset to or purchase an asset from an insider on terms more favorable to the bank than could be expected for

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132 Federal Reserve Proposal, at 49540. The Bank Policy Institute notes that the title of Regulation O should also be updated to reflect that it would now cover purchases of assets from and sales of assets to insiders, and not solely loans to insiders.

133 Federal Reserve Proposal, at 49566.

a similar transaction with a non-insider.[134] We oppose such a prohibition because it would impose burdensome documentation requirements without protecting banks from insider abuse.

"Market terms" are often difficult to determine because there may not be an established market or clear comparables and therefore the determination has a significant degree of subjectivity. In similar situations under Regulation W/Section 23B of the Federal Reserve Act, banks often "lean" in favor of the bank on pricing and other terms to avoid unfavorable treatment. The proposed prohibition would eliminate this flexibility and require banks to identify terms that favor neither the insider nor the bank. Compliance with such a requirement would be complex, if not impossible, in many circumstances.

d. The Federal Reserve should provide that implementing and adhering to policies requiring market terms satisfies Regulation O's documentation requirements for asset purchases and sales.

Banks should not be required to document comparables for every transaction because a market terms policy consistently applied to all applicable transactions will mitigate the risk of the bank purchasing assets at excessive prices or selling assets at inadequate prices. Moreover, for many asset purchases and sales, there may be no established market or clear comparable transactions, so a requirement to document comparables could not be satisfied in practice. Instead, the Federal Reserve should provide that a bank may satisfy the documentation requirements if it implements and adheres to a policy requiring covered asset purchases and sales to be made on terms no less favorable to the bank than those offered, or believed in good faith would be offered, to similarly situated non-insiders. Such a policy would include periodic review of transactions to assess compliance.

At a minimum, the Federal Reserve should adopt a *de minimis* carveout, such as $500,000 per transaction (subject to an aggregate limit), for asset transactions with related interests of insiders, such as portfolio companies of qualified fund complexes, that are subject to the market terms requirement under Section 615. Such a threshold would reduce banks' recordkeeping burden while minimizing risks from insider transactions.

IV. Changes to the Definition of "Extension of Credit"

a. Credit Card Exception

i. The Federal Reserve should modernize the credit card exception definition.

Under the Federal Reserve Proposal, the credit card exception would apply (up to the threshold amount) to any general arrangement in which a bank (1) acquires charge or time accounts; or (2) makes payments to or on behalf of participants in a bank credit card plan, check credit plan, or similar open-ended credit plan, provided (a) the indebtedness does not involve prior individual clearance or approval by the bank other than for purposes of determining authority to participate in the arrangement and compliance with any other dollar limit under the arrangement, and (b) the indebtedness is incurred on terms no more favorable than those offered to the general public.[135] Although it is widely understood that this exception applies to credit cards, the Federal Reserve should modernize the definition to

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134 Federal Reserve Proposal, at 49540 (Question 47).

135 Federal Reserve Proposal, at 49562.

recognize that approvals in connection with credit cards extend beyond "determining authority to participate in the arrangement and compliance with any other dollar limit under the arrangement."[136] For example, the definition should accommodate transaction-level authorizations for fraud prevention and other routine risk controls.

ii. The term "general public" in the credit card exception should be replaced with "similarly situated customers."[137]

The proposed and current credit card exceptions require indebtedness to be incurred on terms no more favorable than those offered to the "general public."[138] Because credit card terms are not uniform across the general public, but instead vary with objective factors such as creditworthiness, income, account history, and the card product or program, it is unclear which terms offered to the general public serve as the benchmark. Replacing "general public" with "similarly situated customers"—meaning non-insider customers with comparable credit profiles applying for the same card product or program—would preserve the anti-preferential-treatment purpose of Regulation O while confirming that credit card terms may vary among customers based on relevant factors other than insider status.

iii. The Federal Reserve should confirm that the credit card exception is available separately for an insider and each of the insider's related interests.

The Federal Reserve Proposal states that for purposes of applying the thresholds for the exceptions from the definition of extension of credit, including the credit card exception, all extensions of credit to an insider must be aggregated.[139] However, an insider's related interests may obtain and manage credit cards separately from the insider's accounts. For example, a related interest may have its own business credit card account. The Federal Reserve should therefore confirm that a separate threshold applies to the insider and each related interest, with balances aggregated separately for each accountholder, for purposes of the credit card exception.

b. The Bank Policy Institute supports the Federal Reserve's proposed clarifications regarding modifications to extensions of credit.

The Federal Reserve Proposal would expand the list of transactions that are extensions of credit to include an increase in the amount of, extension of maturity of, or adjustment to the interest rate term or other material term of, an existing extension of credit to an insider.[140] The Bank Policy Institute supports this clarification, which is consistent with how many of our members apply the requirements of Regulation O. The Federal Reserve should also expressly confirm that modifications outside these categories do not, solely by reason of the modification, constitute new extensions of credit. This confirmation would reduce the burden of conservatively seeking board approval for immaterial or administrative changes.

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136 Federal Reserve Proposal, at 49562.

137 Federal Reserve Proposal, at 49562.

138 Federal Reserve Proposal, at 49562; 12 C.F.R. § 215.3(b)(5)(ii)(B).

139 Federal Reserve Proposal, at 49529–30.

140 Federal Reserve Proposal, at 49537.

c. The Federal Reserve should clarify that the exception for "expenses incurred on behalf of the bank" may include personal purchases made under a bank product testing program, subject to reasonable limits.

The Federal Reserve Proposal would maintain the exception from the definition of "extension of credit" for "an advance to an insider for the payment of authorized travel or other expenses incurred or to be incurred on behalf of the bank."[141] We recommend clarifying that "expenses incurred on behalf of the bank" may include purchases for an insider's personal use made under a bona fide, bank-sanctioned, limited product testing or evaluation program, subject to reasonable limits. These limits could include a per-insider dollar cap and a defined testing period under a documented program. Such clarification would recognize the bank's business purpose in testing products through actual use.

V. Alter Ego Determination

a. The Federal Reserve should adopt a uniform standard for determining alter ego status, based on Delaware law.

The Federal Reserve Proposal states that "[w]hether a related interest [of an executive officer] is considered an alter ego of an executive officer would be determined by the facts and circumstances of a particular case and generally with reference to general principles of corporate law setting forth when a company is the mere alter ego of another person."[142] The Federal Reserve also asks for feedback on whether general principles of corporate law are sufficient to determine when a related interest is an alter ego of an insider.[143]

A general reference to corporate law principles does not provide banks with a sufficiently clear standard because states articulate and apply alter ego standards differently. For example, Delaware limits veil piercing to "exceptional" cases involving both misuse of the corporate form (with indicia of misuse including inadequate capitalization or insolvency, lack of corporate formalities, and misappropriation of funds) and an overall element of injustice or unfairness.[144] The terms "alter ego theory" and "piercing the corporate veil" are used interchangeably in Delaware law.[145] California asks whether there is such a unity of interest and ownership between the corporation and its owner that they do not have separate personalities, and whether adherence to the corporate fiction would produce an "inequitable result,"[146] and New York requires a transactionally specific showing of "complete

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141 Federal Reserve Proposal, at 49562; 12 C.F.R. § 215.3(b)(1).

142 Federal Reserve Proposal, at 49548.

143 Federal Reserve Proposal, at 49548 (Question 86).

144 *See* Manichaean Cap., LLC v. Exela Tech., Inc., 251 A.3d 694, 706–07, 713 (Del. Ch. 2021); Doberstein v. G-P Indus., Inc., 2015 WL 6606484, at *4 (Del. Ch. Oct. 30, 2015).

145 *See* Winner Acceptance Corp. v. Return on Capital Corp., 2008 WL 5352063, at *5 n.32 (Del. Ch. Dec. 23, 2008); Harrison v. Soroof Int'l, Inc., 320 F. Supp. 3d 602, 609 n.4 (D. Del. 2018).

146 *See* Automotriz Del Golfo de California S.A. De C.V. v. Resnick, 47 Cal. 2d 792, 796 (Cal. 1957); Cam-Carson, LLC v. Carson Reclamation Authority, 82 Cal. App. 5th 535, 549 (Cal. Ct. App. 2022).

domination" used to "commit a fraud or wrong."[147] The Federal Reserve should specify a uniform standard rather than leave banks to determine which state-law principles apply.

The Bank Policy Institute recommends a uniform standard based on Delaware law to promote consistent application and reduce compliance costs. Delaware is the principal state of incorporation for a majority of U.S. public companies and other business entities, and so its alter ego jurisprudence is the most developed and the most familiar to banks, insiders, and their related interests. In particular, the Federal Reserve could adopt the following factors for analysis of whether a related interest is an alter ego of an insider: (1) whether the related interest is adequately capitalized for the relevant undertaking; (2) whether the related interest is solvent; (3) whether corporate formalities are observed by the related interest; (4) whether the insider has misappropriated funds of the related interest; and (5) whether, in general, the related interest functions simply as a façade for the insider. No single factor should be determinative.

VI. Safe Harbor for Directors and Executive Officers of Affiliates

a. The Bank Policy Institute supports maintaining and modernizing the safe harbor allowing directors and executive officers of affiliates to be exempted from certain Regulation O provisions.

Under the current rule, an extension of credit to a director or executive officer of an affiliate of the bank is not subject to the general prohibitions contained in Section 215.4, the prohibition on knowingly receiving an unauthorized extension of credit in Section 215.6, or the recordkeeping requirements in Section 215.8, if the insider borrower is excluded, by resolution of the board of directors or by the bylaws of the bank, from participation in major policymaking functions of the bank and the person does not actually participate in such functions and the other conditions of the safe harbor are satisfied.[148] The Federal Reserve Proposal would keep this safe harbor but implement it through a new "exempt official" term, which would cover directors and executive officers that are currently excluded from the definitions of director and executive officer for purposes of Sections 215.4, 215.6, and 215.8.[149]

We support retaining the express safe harbor permitting a bank's board to identify by resolution directors and executive officers that should be exempted. The safe harbor aligns with many banks' existing corporate governance practices and provides institutional certainty and flexibility, allowing banks to identify affirmatively the persons authorized to participate in major policymaking functions, rather than separately identifying every affiliate director or executive officer excluded from those functions. The Bank Policy Institute recommends that the Federal Reserve confirm that the proposed codification is intended to affirm that banks may continue to use their existing corporate governance practices to take advantage of the safe harbor and does not require changes in processes.[150]

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147 Morris v. New York Dep't of Tax'n & Fin., 82 N.Y.2d 135, 141–42 (N.Y. 1993)*; see also* Cortlandt Street Recovery Corp. v. Bonderman, 45 N.Y.3d 990, 991–92 (N.Y. 2025).

148 12 C.F.R. § 215.2(d)(2), (e)(2).

149 *See* Federal Reserve Proposal, at 49550.

150 For example, some banks currently adopt resolutions identifying the persons authorized to participate in the bank's major policymaking functions and update those resolutions as appropriate.

In addition, the Bank Policy Institute recommends that the Federal Reserve confirm that a resolution of the bank's board alone is sufficient for purposes of the safe harbor. The relevant determination concerns participation in the bank's own major policymaking functions, which the bank's board is well positioned to assess. Requiring an additional holding company board resolution would add a procedural step without improving that determination.

b. The Federal Reserve should clarify that exempt officials are excluded consistently from Regulation O requirements arising solely from their affiliate positions.

As under the current rule, the Federal Reserve Proposal would exclude exempt officials from certain, but not all, of the requirements of Regulation O.[151] The conditions for exempt-official status already limit the individual's involvement in the bank's policymaking and the affiliate's relationship to the bank. Continuing to impose requirements solely because of that individual's affiliate position would perpetuate existing compliance burdens without a corresponding supervisory benefit. We therefore recommend that the Federal Reserve exclude exempt officials from requirements triggered solely by their positions as directors or executive officers of affiliates, while preserving requirements arising from any independently covered capacity.

VII. Definition of "Executive Officer"

a. The Bank Policy Institute supports removing "vice president" from the titles presumed to confer executive officer status.[152]

We agree with the Federal Reserve's assessment that the title of vice president has become widely used to cover a range of officials with limited or no policymaking responsibilities,[153] and therefore support removing the presumption associated with that title. Treating these officials as presumptive executive officers requires banks to collect, maintain, and review information about their personal borrowing, their family members, and their related interests, and to disclose that information within the bank for monitoring and approval purposes. That process intrudes on the privacy of large numbers of employees and their families, increases the risk that sensitive personal financial information is accessed or disclosed beyond those with a need to know, and may discourage qualified individuals from accepting positions or obtaining ordinary banking services from their employer, all without a corresponding reduction in the risk of insider abuse.

VIII. Disclosure Requirements for Extensions of Credit

a. The Federal Reserve should eliminate the public disclosure requirement for extensions of credit to insiders.

The Federal Reserve Proposal would restate, with certain modifications, the public disclosure requirement currently contained in Section 215.9 in a new Section 215.31. Under the proposed

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Other affiliate directors and executive officers are excluded from those functions, subject to satisfaction of the remaining safe-harbor conditions.

151 Federal Reserve Proposal, at 49550.

152 *See* Federal Reserve Proposal, at 49541 (Question 52).

153 *See* Federal Reserve Proposal, at 49541.

Section 215.31, upon receiving a written request from the public, a member bank would be required to disclose the names of its executive officers and principal shareholders to whom, or to whose related interests, the bank had qualifying extensions of credit outstanding as of the end of the most recent quarter.[154] Although the Federal Reserve Proposal would increase the applicable dollar thresholds and simplify certain definitions,[155] it would retain the underlying public disclosure requirement.

The Bank Policy Institute recommends that the Federal Reserve eliminate this requirement. Section 7(k) of the Federal Deposit Insurance Act provides that the federal banking agencies are "authorized"—but not required—to issue rules and regulations to require public disclosure concerning extensions of credit to executive officers and principal shareholders.[156] The Federal Reserve therefore has discretion to determine whether the public disclosure requirement continues to serve a meaningful public purpose.

The public disclosure requirement is unnecessary given the prescriptiveness of Regulation O and improvements in supervision and regulation in the past several decades. Regulation O already comprehensively regulates insider lending, including through restrictions on terms and creditworthiness, lending limits, board approval requirements, recordkeeping obligations, and close supervision and enforcement by the federal banking agencies. Moreover, our experience is that most banks have not received any requests from the public under the existing provision in recent years. As a result, no meaningful public purpose is served by the public disclosure requirement. In addition, disclosure poses meaningful downsides, particularly with respect to privacy. Accordingly, and consistent with the Federal Reserve Proposal's objectives of modernizing Regulation O, the Bank Policy Institute recommends that the Federal Reserve eliminate proposed Section 215.31.

b. The Federal Reserve should clarify the scope of the disclosure requirement for extensions of credit secured by shares of a bank holding company.

The Federal Reserve Proposal would consolidate separate requirements under Regulation O and Regulation Y regarding disclosures to the board about extensions of credit to directors or executive officers secured by shares of the bank or its bank holding company.[157] The preamble to the Federal Reserve Proposal makes clear that this requirement is intended to apply only to shares of the bank holding company (or bank) that are not publicly traded.[158] However, the text of the proposed Section 215.32(a) could be read to require disclosure when an extension of credit to a director or executive officer of a member bank (that does not have publicly traded shares) is secured by shares of the bank holding company, regardless of whether the bank holding company's shares are publicly traded.[159] The Bank Policy Institute recommends that the Federal Reserve clarify in the regulatory text that the disclosure requirement applies only when the extension of credit is secured by shares of a bank or bank holding company that are not publicly traded.

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154 *See* Federal Reserve Proposal, at 49567; *see also* 12 C.F.R. § 215.9(b).

155 *See* Federal Reserve Proposal, at 49545–46.

156 *See* 12 U.S.C. § 1817(k).

157 *See* Federal Reserve Proposal, at 49551.

158 Federal Reserve Proposal, at 49551.

159 *See* Federal Reserve Proposal, at 49567.

IX. Regulatory Burden

a. The Federal Reserve should reduce the paperwork burden imposed by Regulation O.

Regulation O imposes significant paperwork burdens on banks by requiring them to identify and track insider relationships and extensions of credit to insiders. The Federal Reserve Proposal would not meaningfully reduce these burdens. Instead, the proposed recordkeeping requirements for correspondent bank insider relationships would substantially increase them without advancing Regulation O's goal of preventing preferential lending. As discussed above, the Bank Policy Institute recommends that the Federal Reserve not adopt the proposed correspondent bank insider recordkeeping requirements. The Federal Reserve should also review Regulation O's existing recordkeeping requirements to identify opportunities to simplify compliance and reduce unnecessary paperwork while preserving effective oversight of insider lending.

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We appreciate your attention to the issues and recommendations discussed in this letter. If you have any questions, please contact Gregg Rozansky at gregg.rozansky@bpi.com.

Respectfully submitted,

/s/ Gregg Rozansky

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