

# **FEDERAL RESERVE SYSTEM**

## **12 CFR Parts 215 and 225**

**[Regulations O and Y; Docket No. R-1896]**

**RIN 7100-AH27**

### **Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Bank Holding Companies**

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Notice of proposed rulemaking with request for public comment.

**SUMMARY:** The Board is inviting public comment on proposed amendments to Regulation O, which governs loans by member banks to their insiders and insiders of their affiliates. The proposed amendments would update and modernize the regulation, increase transparency by clarifying requirements and incorporating existing interpretations, and promote efficiency by reducing regulatory burden. The proposed amendments also would incorporate existing statutory requirements that are not currently reflected in the regulation. Moreover, the proposed amendments would update several outdated dollar-based thresholds in Regulation O and index these thresholds going forward. In addition, the proposed amendments would address the application of Regulation O to member banks that lend to companies that are presumed to be controlled by large asset management companies through passive investment funds. Finally, the proposed amendments would revise and reorganize the regulation to streamline the text and make it more accessible.

**DATES:** Comments must be submitted on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

**ADDRESSES:** You may submit comments, identified by Docket No. R-1896 and RIN 7100-AH27, by any of the following methods:

- *Agency Website:* <https://www.federalreserve.gov/apps/proposals/>. Follow the instructions for submitting comments, including attachments. ***Preferred Method.***
- *Mail:* Benjamin W. McDonough, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue NW, Washington, DC 20551.
- *Hand Delivery/Courier:* Same as mailing address.
- *Other Means:* [publiccomments@frb.gov](mailto:publiccomments@frb.gov). You must include the docket number in the subject line of the message.

Comments received are subject to public disclosure. In general, comments received will be made available on the Board's website at <https://www.federalreserve.gov/apps/proposals/> without change and will not be modified to remove personal or business information including confidential, contact, or other identifying information. Comments should not include any information such as confidential information that would not be appropriate for public disclosure. Public comments may also be viewed electronically or in person in Room M-4365A, 2001 C St. NW, Washington, DC 20551, between 9 a.m. and 5 p.m. during Federal business weekdays.

**FOR FURTHER INFORMATION CONTACT:** Jay Schwarz, Deputy Associate General Counsel, (202) 452-2970, Daniel Hickman, Senior Counsel, (202) 973-7432, Jasmin Keskinen, Counsel, (202) 853-7872, Legal Division; or Anna Lee Hewko, Associate Director, (202) 250-1577, Missaka Nuwan Warusawitharana, Manager, (202) 452-3461, Helen Xu, Manager, (202) 452-2555, Lesley Chao, Lead Financial Institution Policy Analyst, (202) 974-7063, Li Gu, Senior Economist, (202) 912-4655, Division of Supervision and Regulation; Board of Governors

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**12 CFR Part 215**

**I. Background**

Section 22(h) of the Federal Reserve Act restricts the amount and terms of extensions of credit from a member bank to its executive officers, directors, and principal shareholders and to any company or any political or campaign committee controlled by these individuals or entities (collectively, insiders).<sup>1</sup> Section 22(g) of the Federal Reserve Act imposes additional limitations on extensions of credit made by member banks to their executive officers.<sup>2</sup> An “extension of credit” includes, among other things, the making or renewing of any loan, granting a line of credit, or entering into any similar transaction.<sup>3</sup>

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<sup>1</sup> 12 U.S.C. 375b.

<sup>2</sup> 12 U.S.C. 375a.

<sup>3</sup> 12 U.S.C. 375b(9)(D)(i)(I); 12 CFR 215.3.

The Board's Regulation O<sup>4</sup> implements sections 22(g) and 22(h)<sup>5</sup> and requires, among other things, that:

- Extensions of credit to an insider be on substantially the same terms that the member bank would offer to a person not affiliated with the bank, not present more than normal risk to the bank, and be made based on underwriting standards that are not less stringent than those used for a person not affiliated with the bank;<sup>6</sup>
- A member bank's board of directors approve certain large extensions of credit to insiders;<sup>7</sup>
- The amount of all extensions of credit from a member bank to any one insider and the amount of extensions of credit to all insiders remain below a percentage of the bank's unimpaired capital and unimpaired surplus;<sup>8</sup> and

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<sup>4</sup> 12 CFR part 215.

<sup>5</sup> The Board may prescribe such rules and regulations, including definitions of terms, as it determines to be necessary to effectuate the purposes and prevent evasions of sections 22(g) and 22(h). *See* 12 U.S.C. 375a(8) and 375b(10).

<sup>6</sup> 12 U.S.C. 375b(2)(A); 12 CFR 215.4(a). Section 22(h) and Regulation O also prohibit banks from paying overdrafts to executive officers and directors unless certain exceptions apply. 12 U.S.C. 375b(6); 12 CFR 215.4(e). The overdraft prohibition does not apply to principal shareholders, unless the principal shareholder is also an executive officer or director. The prohibition also does not apply to the related interests of an executive officer or director. The exceptions to the prohibition include an exception for inadvertent overdrafts, as defined in Regulation O. *See* 12 CFR 215.4(e).

<sup>7</sup> 12 U.S.C. 375b(3); 12 CFR 215.4(b).

<sup>8</sup> *See* 12 U.S.C. 375b(4)-(5); 12 CFR 215.4(c)-(d). The individual lending limit is based on the lending limits applicable to national banks in 12 U.S.C. 84 and is therefore 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured. 12 U.S.C. 375b(4); 12 CFR 215.2(i). In calculating this limit, all of the bank's loans to the insider and the insiders' related interests are aggregated. In general, the aggregate lending limit is 100 percent of the bank's unimpaired capital and unimpaired surplus. 12 U.S.C. 375b(5)(A); 12 CFR 215.4(d).

- Member banks maintain records to document compliance with all of these restrictions and make certain disclosures concerning extensions of credit subject to the rule.<sup>9</sup>

The statute and Regulation O also prohibit an insider from knowingly receiving an extension of credit that does not comply with the requirements of Regulation O.<sup>10</sup>

Sections 22(g) and 22(h), and Regulation O, apply to all banks that are members of the Federal Reserve System.<sup>11</sup> Other federal law subjects federally insured state non-member banks and insured savings associations to sections 22(g) and 22(h) in the same manner and to the same extent as if they were member banks.<sup>12</sup> Accordingly, these insured depository institutions generally are subject to Regulation O, as enforced by their appropriate Federal banking agency. For ease of reference in this **SUPPLEMENTARY INFORMATION**, the term bank is used to refer to all insured depository institutions subject to the rule.

## **II. Overview of Proposed Rule**

Sections 22(g) and 22(h), and Regulation O, have been longstanding features of the banking regulatory framework.<sup>13</sup> These statutory provisions and the regulation are designed to protect banks against potential harm from the conflicts of interest of, and self-dealing by, insiders who are in a position to put their personal or business self-interest ahead of the interests of the

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<sup>9</sup> 12 CFR 215.8-.10.

<sup>10</sup> 12 U.S.C. 375b(7); 12 CFR 215.6.

<sup>11</sup> 12 U.S.C. 375b(1) (“No member bank may...”); *id.* 375a (same); *see also* 12 CFR 215.4-.5.

<sup>12</sup> 12 U.S.C. 1828(j) (insured non-member banks); 12 U.S.C. 1468(b) (insured savings associations); 12 CFR 337.3 (insured state non-member banks and state savings associations); 12 CFR 31.2 (insured national banks and federal savings associations). *See also* 12 CFR 215.12 (insured savings associations).

<sup>13</sup> Congress adopted section 22(g) as part of the Banking Act of 1933. 48 Stat. 162, 182 (June 16, 1933); 21 FRB No. 12, 854 (Dec. 1935). Congress adopted section 22(h) as part of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA). P.L. 95-630, 92 Stat. 3641; 44 FR 12959, 12962 (Mar. 9, 1979).

banks.<sup>14</sup> Over the years, these statutory provisions and the regulation have been significantly revised and interpreted. This has increased the complexity of complying with the regulation. In addition, the passage of time and structural changes in the market have resulted in the need to update regulatory thresholds and modernize the framework consistent with the purpose of protecting banks against potential harm from self-dealing by insiders.

The Board previously stated that it would periodically review Regulation O and adopt any modifications to the regulation that are shown by experience to be necessary or appropriate to carry out the intent of Congress in this area or to prevent evasions of the statute.<sup>15</sup> The Board conducted a comprehensive review, including feedback received through Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) public notices and public outreach meetings.<sup>16</sup> This proposal (the proposed rule) includes several revisions that are responsive to that feedback, including proposals to update, modernize, increase the transparency of, and reduce unnecessary burden of the rule. The proposed rule would incorporate statutory revisions addressing insider transactions, provide greater clarity with respect to the application of certain requirements, incorporate certain longstanding interpretations,<sup>17</sup> and harmonize Regulation O with other regulations. In addition, the proposed rule would increase outdated dollar-based thresholds to account for economic growth and inflation and other market developments, as well as index these thresholds to economic growth going forward. The proposed rule also would improve the

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<sup>14</sup> See Insider Lending Restrictions, J. Virgil Mattingly, 3 Ann. Rev. Banking L. 21, 26-28 (1984) (noting that section 22(h) was based on concerns about insufficient protections against self-dealing by bank insiders and providing discussion of the impetus behind the legislation and citations to relevant Congressional record).

<sup>15</sup> 44 FR 12959, 12963 (Mar. 9, 1979).

<sup>16</sup> Public Law 104–208, Div. A, Title II, section 2222, 110 Stat. 3009–414, (1996) (codified at 12 U.S.C. 3311). See also Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 89 FR 62679 (Aug. 1, 2024).

<sup>17</sup> Existing interpretations not incorporated into the regulation would continue to apply, unless they are inconsistent with the proposed rule.

ability of banks to make extensions of credit to certain publicly traded companies (portfolio companies) in which companies that sponsor, advise, and manage investment funds (fund complexes) have accumulated significant holdings.<sup>18</sup> Finally, the proposed rule includes several technical amendments to Regulation O, including a reorganization to make it more user-friendly.

The Board has consulted with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (together with the Board, the Federal banking agencies) on the proposed rule.

In view of the extensive proposed changes and reorganization, the Board is restating Regulation O in its entirety as amended, rather than proposing revised regulation text only for the portions of Regulation O that would change.<sup>19</sup> The details of each proposed amendment are described below. The Board invites comments on all aspects of the proposed rule.

### **III. Proposed Revisions to Modernize Regulation O**

#### **A. Updating Dollar-Based Thresholds in Regulation O**

The Board last adjusted certain dollar-based thresholds in Regulation O in 1994, while apparently choosing not to adjust others.<sup>20</sup> The proposed rule would increase the dollar-based thresholds in Regulation O to adjust for economic growth and inflation since 1994 and provide a methodology for indexing these thresholds going forward.<sup>21</sup> In addition, the proposed rule

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<sup>18</sup> For purposes of the proposed rule, investment fund means an investment company registered under the Investment Company Act of 1940, such as mutual funds and exchange traded funds, as well as collective investment trusts, separately managed institutional accounts and other pooled investment vehicles.

<sup>19</sup> The proposed rule will result in a fairly significant renumbering and reordering of Regulation O sections and citations. The Regulation O citations used throughout this **SUPPLEMENTARY INFORMATION** are to the existing text of Regulation O.

<sup>20</sup> 59 FR 8831, 8835-36 (Feb. 24, 1994) (updating credit card threshold but declining to update an overdraft threshold and the “other purpose” exception for lending to executive officers).

<sup>21</sup> In response to the EGRPRA comment solicitation, commenters requested the Board update the outdated dollar-based thresholds in Regulation O.

would clarify that certain extensions of credit should be aggregated when determining whether a given threshold is met and would simplify the applicable thresholds.

*1. One-time adjustment to dollar-based thresholds*

The proposed rule would increase the dollar-based limits in Regulation O. Specifically, the proposed rule would increase the limit:

- For the amount of certain credit card debt that is exempt from the definition of “extension of credit,” from \$15,000 to \$60,000.<sup>22</sup>
- For the amount of indebtedness arising from certain interest-bearing overdraft credit plans that are exempt from the definition of “extension of credit,” from \$5,000 to \$20,000.<sup>23</sup>
- For the inadvertent overdraft exception from the prohibition against paying an overdraft to an executive officer or director, from \$1,000 to \$4,000.<sup>24</sup>

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<sup>22</sup> To qualify for the exemption, the indebtedness must arise from an arrangement whereby the member bank (i) acquires charge or time credit accounts, or (ii) makes payments to or on behalf of participants in a bank credit card plan, check credit plan, or similar open-end credit plan, provided that (A) the indebtedness does not involve prior individual clearance or approval by the bank other than for the purposes of determining authority to participate in the arrangement and compliance with any dollar limit under the arrangement; and (B) the indebtedness is incurred under terms that are not more favorable than those offered to the general public. 12 CFR 215.3(b)(5). The Board last revised this limit in 1994. 59 FR 8831, 8835 (Feb. 24, 1994).

<sup>23</sup> To qualify for the exemption, the indebtedness must arise by reason of a written, preauthorized, interest-bearing overdraft extension of credit plan that specifies a method of repayment or a written, preauthorized transfer of funds from another account of the account holder at the bank. 12 CFR 215.3(b)(6). The Board last revised this limit in 1979. 44 FR 12959, 12960, 12965-66 (Mar. 9, 1979). The Board chose not to revise this limit in 1994 when it revised the threshold for credit card debt. 59 FR 8831, 8835 (Feb. 24, 1994).

<sup>24</sup> Regulation O generally prohibits a member bank from paying an overdraft on the account of an executive officer or director. 12 CFR 215.4(e)(1). However, the prohibition does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of \$1,000 or less, provided that (i) the account is not overdrawn for more than 5 business days; and (ii) the member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances. 12 CFR 215.4(e)(2). The Board last revised this limit in 1979. 44 FR 12959, 12960, 12965-66 (Mar. 9, 1979).

- For the “other purpose” exception from the special prohibitions applicable to extensions of credit to an executive officer, from \$100,000 to \$400,000.<sup>25</sup>
- For the size of an extension of credit to an insider that requires prior approval by a bank’s board of directors, from \$500,000 to \$2 million.<sup>26</sup>

These dollar-based thresholds in Regulation O have become obsolete, particularly in light of inflation and economic growth since the Board last revised them. The proposed increases reflect inflation and economic growth since 1994. As such, these updates would restore the thresholds to their originally intended level of stringency and would reduce unnecessary regulatory burden. Raising these thresholds is particularly important for community banks because the outdated limits may pose particular hardship in smaller communities and rural markets. In these communities, bank directors typically are active business persons whose businesses have credit requirements. Choosing to join a bank board can impose meaningful frictions in their access to credit, while simultaneously depriving the bank of creditworthy local customers. In addition, in these communities, a bank’s insiders have fewer alternative credit

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<sup>25</sup> Regulation O generally prohibits a member bank from extending credit to any of its executive officers. 12 CFR 215.5(a). The Board last revised this limit in 1983. 48 FR 42804 (Sept. 20, 1983). The Board chose not to revise this limit in 1994 when it revised the threshold for credit card debt. 59 FR 8831, 8836 (Feb. 24, 1994). This limit is set by the Board, FDIC, and OCC separately for their supervised institutions. 12 U.S.C. 375a(4). One exception to this prohibition is for extensions of credit that do not qualify for another exception, if the aggregate amount of extensions of credit to the executive officer does not exceed the higher of 2.5 percent of the bank’s unimpaired capital and unimpaired surplus or \$25,000, but in no event more than \$100,000. 12 CFR 215.5(c)(4). Extensions of credit not subject to this prohibition nevertheless are subject to the other requirements in Regulation O.

<sup>26</sup> Regulation O generally requires the board of directors of a member bank to approve an extension of credit to an insider that, together with all other extensions of credit to that insider, exceeds (i) the higher of \$25,000 or 5 percent of the member bank’s unimpaired capital and unimpaired surplus; or (ii) \$500,000. Such an extension of credit must be approved by a majority of the entire board of directors, and the interested party must abstain from participating directly or indirectly in the voting. 12 CFR 215.4(b)(2). The Board last revised this limit in 1983. 48 FR 42804 (Sept. 20, 1983). This limit is set by the Board, FDIC, and OCC separately for their supervised institutions. 12 U.S.C. 375b(3). The proposed rule would also increase the identical threshold used for related public disclosure requirements in section 12 CFR 215.9(b) of Regulation O, from \$500,000 to \$2 million, pursuant to the authorization to issue reporting and disclosure related rules and regulations. 12 U.S.C. 1817(k). This limit is set by the Board, FDIC, and OCC separately for their supervised institutions. *Id.*

sources, making it more likely that they will need to obtain credit from a direct local competitor of the bank.

To determine the new thresholds, Board staff adjusted the existing thresholds based on changes in seasonally adjusted U.S. nominal gross domestic product (nominal GDP), as calculated quarterly by the U.S. Bureau of Economic Analysis.<sup>27</sup> The Board adjusted each threshold using nominal GDP from the fourth quarter of 1994 to the fourth quarter of 2025. The fourth quarter of 1994 is used as the start date because 1994 is the most recent year in which the Board considered adjusting any of the thresholds.<sup>28</sup> The Board chose not to adjust several of the thresholds in 1994. This uniform start date is used for updating all the thresholds in order to maintain the relative relationship increase across the thresholds. To simplify compliance with the thresholds, as adjusted for nominal GDP, the proposed thresholds are rounded down to simple whole numbers that are multiples of the existing thresholds.

| <b>Threshold</b>                                                            | <b>Value in 1994</b> | <b>Proposed value</b> |
|-----------------------------------------------------------------------------|----------------------|-----------------------|
| Credit card exception                                                       | \$15,000             | \$60,000              |
| Overdrafts with credit plan exception                                       | \$5,000              | \$20,000              |
| Inadvertent overdrafts exception                                            | \$1,000              | \$4,000               |
| Extensions of credit to executive officers not subject to another exception | \$100,000            | \$400,000             |
| Prior approval by board of directors                                        | \$500,000            | \$2,000,000           |

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<sup>27</sup> U.S. Bureau of Economic Analysis, account code: A191RC, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDP>, May 1, 2026.

<sup>28</sup> See 59 FR 8831, 8835 (Feb. 24, 1994) (updating credit card threshold but declining to update other thresholds).

|                               |           |             |
|-------------------------------|-----------|-------------|
| Public disclosure requirement | \$500,000 | \$2,000,000 |
|-------------------------------|-----------|-------------|

*Question 1: What are the advantages and disadvantages of using a nominal GDP deflator calculation to adjust the dollar-based thresholds? What are the advantages and disadvantages of using an alternative methodology or source of data, such as using a deflator based on the Consumer Price Index published by the U.S. Bureau of Labor Statistics (CPI)? If available, provide data and proposed alternative methodology.*

*Question 2: What are the advantages and disadvantages of alternative approaches, such as not using absolute dollar thresholds and instead relying solely on thresholds set by a percentage of the bank's unimpaired capital and unimpaired surplus? What would be an appropriate percent to use for each threshold and why?*

*Question 3: To what extent should the Board consider easing certain requirements or increasing the thresholds even further for certain well capitalized and well managed community banks? If so, which requirements or thresholds should be revised and why?*

*Question 4: Would a date other than 1994 be appropriate as the baseline for indexing the thresholds? For example, the Board last revised the thresholds for loans to executive officers not otherwise specifically authorized under section 22(g) and to insiders requiring prior approval by the board of directors under section 22(h) in 1983. If so, what date would be more appropriate and why?*

## *2. Periodic indexing of dollar-based thresholds by nominal GDP*

As discussed above, without periodic adjustments, dollar-based thresholds become obsolete and undermine the purpose of Regulation O by restricting more extensions of credit than Congress intended in light of inflation and real economic growth. To limit the need for

future adjustments through rulemaking, the proposal would adopt a mechanism to automatically adjust the dollar-based thresholds periodically going forward.

Specifically, under the proposal, the Board would adjust the dollar-based thresholds of Regulation O every five years to reflect real economic growth and inflation. Notice of the new thresholds would be published in the Federal Register. The five-year time period was chosen to balance the compliance burden of firms implementing new thresholds against the potential for misalignment with the thresholds' objective over time. The periodic adjustment would be based on five years of cumulative growth of nominal GDP. Indexing under this approach would help ensure that changes in the dollar-based thresholds are reflective of inflation and the size of the U.S. economy. The proposed mechanism would not adjust the thresholds if the five-year cumulative growth of nominal GDP is negative. This approach would reduce the potential for procyclicality during a prolonged period of economic contraction.

To ensure an accurate and predictable measure of gross domestic product, the Board generally would use the most current estimate of nominal GDP for a given calendar year published by the Bureau of Economic Analysis on or before September 30 of the year of the publication of the scalar.<sup>29</sup> At the end of every consecutive five-year period, the Board would calculate the value for the GDP growth adjustment scalar as a ratio of the nominal GDP estimate for the calendar year preceding the year in which the scalar is published, divided by the nominal GDP for the calendar year preceding the effective date of any final rule for which estimates are available. For example, if the Board were to adopt a final rule with an effective date of 2027 for the updated dollar-based thresholds described above, the Board would calculate and publish the

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<sup>29</sup> See Bureau of Economic Analysis, A191RC, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDP>. The Board may elect to use a comparable value in instances such as where a nominal U.S. GDP growth estimate from the Bureau of Economic Analysis is unavailable.

GDP growth adjustment scalar in 2032 by dividing the nominal GDP at end of calendar year 2031 by the nominal GDP at end of the calendar year 2026.<sup>30</sup> The Board would calculate and publish a GDP growth adjustment scalar, along with updated dollar-based thresholds, every five years. Additionally, thresholds adjusted under the proposed indexing methodology would be rounded based on the size of the threshold (e.g., millions, thousands), generally, to the nearest two significant digits.<sup>31</sup>

The Board would expect the initial scalar to be 1 and to publish that in connection with the final rule.

*Question 5: What are the advantages and disadvantages of indexing the dollar-based thresholds based on nominal GDP? What alternative approaches, for example indexing the dollar-based thresholds based on CPI, should the Board consider, and why?*

*Question 6: What are the advantages and disadvantages of the proposed approach to indexing the dollar-based thresholds so that they do not change to reflect a period of negative average nominal GDP growth? Under what circumstances, if any, should the update to a dollar-based threshold reflect negative average nominal GDP growth, and why?*

*Question 7: What, if any, operational challenges are associated with the proposed approach? What adjustments could the Board make to the proposed approach to address such challenges?*

*Question 8: What is the appropriate frequency for updating the dollar amounts (for example updated every 5 years)?*

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<sup>30</sup> The proposal would include a definition of the GDP growth adjustment, which sets forth the way in which the adjustment would be calculated.

<sup>31</sup> For example, a threshold that otherwise would be calculated as \$5.964 million would be rounded to \$6.0 million, or the nearest \$0.1 million.

*Question 9: What alternative rounding methodology, if any, should the Board adopt for the proposed ongoing adjustments to the dollar-based thresholds? For example, what would be the advantages or disadvantages of rounding different-sized thresholds in different ways (such as rounding thresholds in the millions to the nearest two significant digits and rounding thresholds in the thousands to the nearest significant digit)?*

*3. Clarification to apply certain limits on an aggregate basis*

Regulation O contains limited exceptions from the definition of “extension of credit” for certain charge or time credit accounts, credit card plans, check credit plans, or similar open-ended plans, and overdrafts up to a specified amount. Consistent with a longstanding interpretation, the proposed rule would clarify that the dollar-based limit for each exception applies to the aggregate of all such extensions of credit to the same insider.<sup>32</sup> For example, the proposed rule would make explicit that, when determining whether extensions of credit arising by reason of an interest-bearing overdraft credit plan are excepted from the definition of “extension of credit,” a bank must aggregate all outstanding balances owed by an insider and compare that aggregate number to the dollar-based limit. The proposed rule would make the same change to the inadvertent overdraft exemption from the prohibition on paying overdrafts in section 215.4(e)(2) of Regulation O.

*4. Streamlining limits on loans to executive officers and prior approval by bank boards of directors for certain large loans*

The exception from section 215.5 for an extension of credit to an executive officer for purposes other than a home mortgage or a child’s education is currently subject to three different

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<sup>32</sup> 12 CFR 215.3(b)(5)-(6). When it adopted these thresholds, the Board stated that they were meant to limit the aggregate amount of each category of extension of credit in the threshold. *See* 44 FR 12959, 12960, 12965-66 (Mar. 9, 1979).

limits.<sup>33</sup> To streamline the procedure for calculating the applicable limit, the proposed rule would condense the overlapping thresholds. The revised provision would allow for extensions of credit to executive officers for purposes other than a home mortgage or a child's education up to the lesser of 2.5 percent of the bank's unimpaired capital and unimpaired surplus or \$400,000.<sup>34</sup>

Similarly, the requirement that a bank's board of directors provide prior approval for an extension of credit to an insider is currently subject to three different thresholds.<sup>35</sup> The proposed rule would consolidate and streamline the thresholds and require prior approval if an extension of credit, when aggregated with all extensions of credit to an insider, exceeds the lesser of 5 percent of the bank's unimpaired capital and unimpaired surplus, or \$2,000,000.<sup>36</sup> These revisions to streamline the applicable thresholds will make the requirements of Regulation O easier to understand and administer.

## **B. Rebuttable Presumptions of Control**

Section 22(h) and Regulation O restrict the amount and terms of extensions of credit from a bank to companies controlled by an executive officer, director, or principal shareholder of the bank (related interests).<sup>37</sup> The term "control" is defined in section 22(h) as directly or indirectly, or acting through or in concert with one or more persons: (i) owning, controlling, or having the

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<sup>33</sup> Section 215.5(c)(4) of Regulation O states that exception "...does not exceed at any one time the higher of 2.5 percent of the bank's unimpaired capital and unimpaired surplus or \$25,000, but in no event more than \$100,000."

<sup>34</sup> The limit would be \$400,000 rather than \$100,000 because the proposed rule would raise the \$100,000 threshold to \$400,000, as discussed in section III.A.1 of this **SUPPLEMENTARY INFORMATION**.

<sup>35</sup> Section 215.4(b) of Regulation O states that prior approval is required if the aggregate extensions of credit to an insider "exceed the higher of \$25,000 or 5 percent of the member bank's unimpaired capital and unimpaired surplus [and] in no event may a member bank extend credit to any insider [that] exceeds \$500,000 [without prior approval.]"

<sup>36</sup> The limit would be \$2,000,000 rather than \$500,000 because the proposed rule would raise the \$500,000 threshold to \$2,000,000, as discussed in section III.A.1 of this **SUPPLEMENTARY INFORMATION**. Conforming edits are being proposed to the related public disclosure requirements in section 12 CFR 215.9(b) of Regulation O.

<sup>37</sup> 12 CFR 215.2(n). Related interest also covers any political or campaign committee that is controlled by that person or the funds or services of which will benefit that person.

power to vote 25 percent or more of any class of voting securities of the company or bank; (ii) controlling in any manner the election of a majority of the directors of the company or bank; or (iii) having the power to exercise a controlling influence over the management or policies of the company or bank.<sup>38</sup> Section 22(h) also defines a principal shareholder of a bank as “any person that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank.”<sup>39</sup> In addition, Regulation O presumes that a person is a related interest of a principal shareholder if the principal shareholder directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company and no other person owns, controls, or has the power to vote a greater percentage of that class of voting securities (presumption of control).<sup>40</sup>

*1. Exemption from presumption of control for portfolio companies of fund complexes that meet certain criteria*

Because of the increasing popularity of passive investing through index funds, fund complexes have acquired, or have approached acquiring, more than 10 percent of a class of voting securities of a wide range of public companies, including bank and non-bank companies. Upon acquiring more than 10 percent of a class of voting securities of a banking organization, a fund complex becomes a “principal shareholder” of the bank (principal shareholder fund complex).<sup>41</sup> This is not a presumption; it is a statutory definition. In addition, under Regulation

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<sup>38</sup> 12 U.S.C. 375b(9)(B).

<sup>39</sup> 12 U.S.C. 375b(9)(F).

<sup>40</sup> 12 CFR 215.2(c)(2)(ii).

<sup>41</sup> 12 U.S.C. 375b(9)(F); 12 CFR 215.2(m). In the case of a fund complex, the shares of a bank held by different investment funds in the same group generally are treated as shares controlled by the fund complex. See Letter from Scott G. Alvarez, Board General Counsel, to Robert L. Tortoriello, Esq. (Sept. 29, 2006).

O, any portfolio company in which a principal shareholder owns more than 10 percent of a class of voting securities would be presumed to be a “related interest” of the principal shareholder if the principal shareholder is the largest shareholder of the company because it would trigger the presumption of control.<sup>42</sup> In that event, the portfolio companies presumed to be controlled by the principal shareholder would be considered related interests of the principal shareholder of the bank under Regulation O. Accordingly, the bank’s lending to such portfolio companies of the principal shareholder would be subject to the lending limits and other restrictions and standards of Regulation O.

As detailed below, it is highly unlikely that Congress foresaw or intended for section 22(h) to apply to extensions of credit to portfolio companies of passive fund complexes or the heavy compliance burden that this would create based on the presumption of control in Regulation O, which is not in the statute.<sup>43</sup> 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 because 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. This stands in contrast to most related interests captured by Regulation O, which normally are closely held companies over which a principal shareholder of a bank exerts significant influence. If portfolio companies held by these fund complexes are deemed to be a bank’s insiders, the bank would be

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<sup>42</sup> 12 CFR 215.2(c)(2)(ii).

<sup>43</sup> In response to the EGRPRA comment solicitation, commenters highlighted this issue and recommended the Board carve out certain portfolio companies of passive investment funds from the rebuttable presumption of control in Regulation O.

required to develop extensive monitoring and recordkeeping systems to ensure that any extensions of credit to these portfolio companies comply with Regulation O, including adherence to applicable approvals and lending limits.

Index funds make investment decisions to buy and sell shares of companies on behalf of investors to closely mirror the risk and return characteristics of underlying third-party indices. These index-based funds, unlike actively managed funds, are less likely to seek to influence the lending decisions of banks for which they are principal shareholders to make preferential extensions of credit to their other portfolio companies.<sup>44</sup> For this reason, the proposed rule would provide the exception only to fund complexes that overall exhibit passive investment qualities—that is, those fund complexes that hold investments primarily through investment funds with an investment objective of replicating the risk and return characteristics of a third-party index (passive fund complex).

In addition, the proposed rule would reduce unnecessary compliance burden. Passive fund complexes hold a wide array of portfolio companies at any given point in time and their ownership interests can fluctuate daily based on market dynamics. Banks often rely heavily on insiders to self-identify their related interests, particularly when a principal shareholder has a vast network of related interests.<sup>45</sup> Banks and fund complexes may be forced to rely on publicly available information to determine levels of third-party ownership in publicly traded

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<sup>44</sup> 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.

<sup>45</sup> For example, Regulation O permits a member bank to meet some of its recordkeeping requirements by issuing an annual survey to insiders to identify extensions of credit to the insider, including its related interests; or to rely on borrowers to identify themselves as insiders of the bank when receiving an extension of credit from the bank. *See* 12 CFR 215.8(c)(1)-(2).

companies.<sup>46</sup> Since this information may not be timely or complete, it can be particularly problematic for a bank to determine who is a related interest of a passive fund complex when applying the presumptions of control to portfolio companies, particularly the presumption of control based on whether the passive fund complex owner is the largest shareholder. As such, many banking organizations could be operating with an incomplete or outdated list of insiders. When a passive fund complex that is a principal shareholder of a bank has numerous related interests, establishing a framework that captures all of the related interests could take considerable time and effort. The proposed revision would mitigate the regulatory burden arising from this asymmetry of information by reducing the number of potential portfolio companies captured as related interests of principal shareholder fund complexes.

In December 2019, the federal banking agencies issued a joint statement acknowledging this issue and providing temporary relief to allow banks to continue to lend to portfolio companies presumed to be controlled by certain fund complexes while the Board considered whether to amend Regulation O.<sup>47</sup> Since then the Federal banking agencies have extended that temporary relief to allow additional time for regulatory changes addressing the underlying issue.<sup>48</sup>

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<sup>46</sup> Fund complexes are subject to applicable federal securities laws which require, among other things, the public disclosure of beneficial ownership stakes under various conditions. These disclosure obligations may change based on several factors, including whether the fund complex is acquiring the securities with the purpose or effect of “changing or influencing the control of the issuer.” Fund complexes should consult the rules and guidance of the Securities and Exchange Commission (SEC) to determine their disclosure obligations given the facts and circumstances around whether an investor or group would be viewed as acquiring or holding the securities with the purpose or effect of changing or influencing the control of an issuer under the SEC’s rules.

<sup>47</sup> See 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 (Dec. 27, 2019). See also OCC Bulletin 2019-65 (Dec. 27, 2019); FDIC FIL 85-2019 (Dec. 27, 2019).

<sup>48</sup> See 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). See also OCC Bulletin 2025-47 (Dec. 18, 2025); FDIC FIL-61-2025 (Dec. 18, 2025).

The proposed rule would not apply the presumption of control in Regulation O to the portfolio companies of fund complexes if the fund complex meets certain requirements designed to ensure that the relationship between the fund complex and the bank is sufficiently passive (qualifying fund complex). The proposed rule would look to the status of the relationship between the fund complex and the bank to determine whether the portfolio companies of the fund complex should be presumed to be related interests of a principal shareholder fund complex for purposes of Regulation O. The Board has authority to define the scope of the presumption of control in Regulation O and is proposing to exempt the portfolio companies of qualifying fund complexes from the presumption of control. While the ability to qualify for the status of a qualifying fund complex is based on the relationship between the bank and the fund complex, the Board is only altering the presumption of control with respect to the relationship between the fund complex and its portfolio companies. This focus on the relationship between the fund complex and the bank is consistent with the purpose of Section 22(h), which is concerned with potential influence on bank lending decisions. The Board is not able to alter the threshold for when a fund complex is considered an insider of a bank because the definition of principal shareholder is statutory. Nevertheless, focus on the fund complex's ability to control the bank as a basis for the relief would allow Regulation O to discourage the principal shareholder fund complex from improperly influencing the bank's lending for the benefit of the principal shareholder's other portfolio companies. In particular, under the proposed rule, the presumption of control would not apply to determine whether a portfolio company is a related interest of a fund complex that is a principal shareholder of a bank if:

- 1) The 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);

- 2) No individual investment fund in the fund complex owns or controls more than 10 percent of any class of voting securities of a regulated company;
- 3) Investment funds in the fund complex that are not index funds<sup>49</sup> do not in the aggregate own or control more than 10 percent of any class of voting securities of a regulated company; and
- 4) The fund complex does not meet any of the conditions that would give rise to a rebuttable presumption of control under the Board's Regulation Y control rule<sup>50</sup> with respect to a regulated company.

The effect of this proposed exception for qualifying fund complexes would be to permit lending relationships between banks and portfolio companies held by qualifying fund complexes to continue free from the limitations in Regulation O, because portfolio companies held by qualifying fund complexes would no longer be captured by the presumption of control. Pursuant to section 22(h) and the proposed rule, however, any portfolio company of a qualifying fund complex would continue to be a related interest of the fund complex if the complex directly, indirectly, or acting in concert owns or controls, or has the power to vote, 25 percent or more of any class of the portfolio company's voting securities; controls in any manner the election of a majority of the portfolio company's directors; or has the power to exercise a controlling influence over the management or policies of the portfolio company.<sup>51</sup>

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<sup>49</sup> For purposes of the proposed rule, an "index fund" is 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.

<sup>50</sup> See 12 CFR 225.32.

<sup>51</sup> 12 U.S.C. 375b(9).

If a qualifying fund complex attempts to influence the lending decisions of any bank in its portfolio in favor of its other portfolio companies, the Board could find that the portfolio company is a related interest of the fund complex because the fund complex no longer qualifies for the exemption from the presumption of control with respect to the portfolio company. All of the fund complex's portfolio companies would immediately become related interests of the fund complex and thus insiders of each bank of which the fund complex is a principal shareholder. In addition, any outstanding extensions of credit to the portfolio companies would count towards each bank's Regulation O lending limits and all future extensions of credit would be subject to all of the requirements in Regulation O. Each bank also would be required to maintain records of future extensions of credit to the portfolio companies, and the fund complex would be liable for knowingly permitting any of the portfolio companies to receive a future extension of credit from one of the banks.

This proposed exception is intended to align the proposed rule with the purpose of the insider lending restrictions and the nature of a qualifying fund complex's ownership of portfolio companies. The purpose of the insider lending restrictions is to protect banks against potential harm from self-dealing by insiders by providing safeguards aimed at mitigating the potential for conflicts of interest from individuals who may be in a position to influence a bank's lending decisions for personal advantage.<sup>52</sup> These concerns are not implicated when fund complexes offer investment funds that acquire ownership in a wide array of publicly traded companies (including banks) for investment purposes based primarily on tracking third-party broad-based

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<sup>52</sup> See e.g., House Hearing; Comm. on Banking; Sep/Oct 1977 hearings on H.R. 9086 (Part 3), at 1631, Testimony of Chairman St. Germain (noting that the provision is designed to remove the appearance of conflicts of interest and preferential treatment related to insider loans); Senate Hearing; Senate Banking Comm.; May 1977 (Part 1), Statement of George A. LeMaistre, Chairman, FDIC, at 40-41 (highlighting the issue of self-dealing by bank insiders and seeking more explicit statutory limitations to prevent banks from incurring undue risks by lending excessive amounts to insiders and related businesses).

market indices. While many fund complexes also offer actively managed funds, the popularity of index funds has been the primary source of the increasing ownership of publicly traded companies that has resulted in the application of Regulation O to these lending relationships.<sup>53</sup> This investment structure and market dynamic was not prevalent at the time that the statutory framework underpinning Regulation O was enacted or when the regulation was last amended. As such, the insider lending restrictions were not drafted with the purpose of governing lending relationships between banks and portfolio companies where a principal shareholder fund complex does not have an ability or intent to influence bank lending decisions for the benefit of portfolio companies.

The exception from the presumption of control for qualifying fund complexes would apply only for purposes of determining whether a qualifying fund complex controls another portfolio company. The exception would not apply for the purposes of determining whether a fund complex is a principal shareholder of a bank or whether a person controls a qualifying fund complex. Under the proposed rule, a person would continue to be presumed to control a qualifying fund complex if the person directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the qualified fund complex and no other person owns, controls, or has the power to vote a greater percentage of that class of voting securities.

*Question 10: What are the advantages and disadvantages of using the Board's control rule for evaluating controlling influence by fund complexes over regulated companies? What would be the advantages and disadvantages of considering other specific factors, such as:*

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<sup>53</sup> See section VI of this **SUPPLEMENTARY INFORMATION**.

*A fund complex may not, directly or indirectly, or acting in concert with one or more others:*

- 1) Have more than one director interlock with the regulated company (that is, one person serving as director for both the fund complex and regulated institution) or appoint more than one director of the regulated company as a representative of the fund complex;*
- 2) Have any officer or employee interlock with the regulated company;*
- 3) Propose a director or slate of directors in opposition to any nominee proposed by the management or board of directors of the regulated company;*
- 4) Attempt to influence the dividend policies; loan, credit, or investment decisions or policies; pricing of services; personnel decisions; operations activities (for example location of any offices or branches or hours of operation, etc.); or any similar activities or decisions of the regulated company or any of its subsidiaries;*
- 5) Enter into any agreement with the regulated company that substantially limits the discretion of the regulated company's management over major policies or decisions;*
- 6) Solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of the regulated company or any of its subsidiaries; or*
- 7) Dispose or threaten to dispose (explicitly or implicitly) of equity interests of the regulated company or any of its subsidiaries as a condition or inducement of specific action or non-action by the regulated company or any of its subsidiaries.*

*Question 11: What alternative ways to address the application of Regulation O to portfolio companies of passive fund complexes should the Board consider? For example, (1) raising the presumption of control percentage threshold from 10 percent to a higher amount (for example 15, 20 or 25 percent), (2) eliminating the presumption of control (subject to certain*

*passivity criteria such as no board representation or management agreements), or (3) adopting the control framework from Regulation Y? If available, provide data to support proposed alternative options.*

*Question 12: Would it be necessary and appropriate to extend the exception for a qualifying fund complex to the rebuttable presumption of control in section 215.2(c)(2)(i) of Regulation O? For example, is it possible for a qualifying fund complex to be an executive officer or director of a company or regulated company?*

*Question 13: Who is the appropriate party to maintain records to verify that a fund complex is a qualified fund complex? Is the principal shareholder that is a qualified fund complex the appropriate party to be responsible for asserting and supporting that it is a qualified fund complex? Should the rule require these principal shareholders to provide the supporting information to a bank in the principal shareholder's portfolio and/or the Federal banking agencies?*

*Question 14: What would be the advantages or disadvantages of providing a grace period for application of the presumption of control when a principal shareholder temporarily trips the presumption of control with respect to a portfolio company due to events outside its control or that do not become known immediately? If a grace period were applied what would be an appropriate amount of time (for example 90 days)?*

*Question 15: Would it be necessary or appropriate to continue to require market terms for lending between banks and portfolio companies that are no longer subject to the presumption of control? For example, should the proposed rule prohibit banks from knowingly making an extension of credit to a portfolio company that would be covered by the existing presumption of control, unless the terms of such extension of credit are on substantially the same terms as those*

*prevailing for comparable transactions with unaffiliated third parties and do not involve more than normal risk of repayment or present other unfavorable features?*

*2. Appropriate Federal banking agency determination regarding a rebuttal of presumptions of control*

The proposed rule would continue to permit insiders to rebut the presumptions of control.<sup>54</sup> While compliance with Regulation O is enforced by the individual Federal banking agencies, the underlying regulation is promulgated by the Board. This has caused some confusion and insiders have asked which Federal banking agency is the appropriate agency to make a determination regarding a rebuttal of a presumption. For purposes of determining a rebuttal of control, the appropriate Federal banking agency, as defined in 12 U.S.C. 1813(q), is the relevant Federal agency.<sup>55</sup> However, in light of the Board's statutory responsibility to issue regulations implementing sections 22(g) and (h), the other Federal banking agencies often consult with the Board when considering evidence presented in a rebuttal of a presumption of control. To facilitate coordination of the review of arguments presented to rebut presumptions and enhance consistency in interpretation of the presumptions of control, the proposed rule would note that the appropriate Federal banking agency should consult with the Board when making a determination regarding a rebuttal of a presumption of control.

This clarification is not intended to impact how the Federal banking agencies process rebuttals of a presumption of control, including any delegations of authority that the agencies may have made with respect to this provision of Regulation O. The change would note only that

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<sup>54</sup> Regulation O permits a person to rebut a presumption by submitting to the appropriate Federal banking agency (as defined in 12 U.S.C. 1813(q)) written materials that, in the agency's judgment, demonstrate an absence of control. 12 CFR 215.2(c)(4).

<sup>55</sup> As discussed in section V.H. of this **SUPPLEMENTARY INFORMATION**, the proposed rule also would create a definition of "appropriate Federal banking agency" in the definition section.

the party's appropriate Federal banking agency should consult with the Board. This change also would not undo any determinations regarding any rebuttals of presumptions of control in Regulation O issued prior to the finalization of the proposed rule.

*Question 16: What are the advantages and disadvantages related to the clarification that the Board should be consulted regarding a rebuttal of a presumption of control?*

### **C. Dodd-Frank Act and Updating Definition of “Extension of Credit”**

Section 614 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the definition of “extension of credit” in section 22(h) to include “having credit exposure to the person arising from a derivative transaction . . . , repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the [ ] bank and the person.”<sup>56</sup> However, the Dodd-Frank Act did not define the term “credit exposure” or otherwise prescribe a methodology for the valuation of a credit exposure arising from these types of transactions. The proposed rule would set forth valuation methodologies for credit exposures arising from derivatives transactions and from securities borrowing or lending transactions, repurchase agreements, and reverse repurchase agreements (collectively, securities financing transactions). The Board invites comment on the proposed methodology for the valuation of credit exposures caused by derivatives transactions and securities financing transactions, and on possible alternatives discussed in greater detail below.

In Board staff's experience, banks and their insiders rarely engage in derivatives transactions or securities financing transactions. Nevertheless, for ease of reference, the proposed rule would set forth the valuation methodologies. The proposed rule also would

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<sup>56</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 614, 124 Stat. 1376 (2010) (codified at 12 U.S.C. 375b(9)(D)(i)(II)).

eliminate paragraph (a)(1) of section 215.3 of Regulation O, which specifies that an extension of credit includes “a purchase under repurchase agreement of securities, other assets, or obligations.”<sup>57</sup> This paragraph no longer would be necessary because the proposal would set forth a new methodology for banks to value extensions of credit attributable to repurchase agreements.

The Dodd-Frank Act also amended section 23A of the Federal Reserve Act<sup>58</sup> so that credit exposures to an affiliate from derivatives transactions and securities financing transactions are similarly treated as extensions of credit for purposes of that section.<sup>59</sup> Section 22(h) and section 23A both apply to all insured depository institutions, regardless of size. Given the similarities in the amendments made by the Dodd-Frank Act to sections 22(h) and 23A, the Board is considering whether any valuation methodologies in the proposed rule for Regulation O should also be used to value those same credit exposures for purposes of section 23A and the Board’s Regulation W.<sup>60</sup> The adoption of a methodology to value credit exposures for purposes of section 23A and Regulation W would occur in a separate rulemaking.

*Question 17: What are the advantages and disadvantages of using the same methodology to value credit exposures from derivative transactions and securities financing transactions for purposes of Regulation O and Regulation W? What would be the reasons for these regulations to use different methods?*

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<sup>57</sup> 12 CFR 215.3(a)(1).

<sup>58</sup> 12 U.S.C. 371c.

<sup>59</sup> Section 608 of the Dodd-Frank Act (codified at 12 U.S.C. 371c(b)(7)(G)). Because covered transactions under section 23A also are subject to section 23B of the Federal Reserve Act, credit exposures from derivatives and securities financing transactions also are subject to the requirements of section 23B. 12 U.S.C. 371c-1.

<sup>60</sup> 12 CFR part 223.

*Question 18: To what extent do banks enter into derivative and securities financing transactions with their insiders or insiders of their affiliates (including the related interests of such insiders)?*

*1. Negative credit exposures*

The proposed rule would value only credit exposures of a bank to its insider, and would not include credit exposures of an insider to the bank. Specifically, the proposed rule would not permit a credit exposure from an insider to the bank to count towards either the individual or aggregate lending limits of the bank. This would be consistent with the focus of the insider lending restrictions on credit risk to a bank from an insider, regardless of any credit risk the insider might have to the bank. For example, section 22(h) and Regulation O do not permit a bank to reduce the aggregate amount of extensions of credit to a single insider by accounting for extensions of credit made by the insider to the bank. This also would be consistent with the definition of “extension of credit” in section 22(h) and Regulation O, which includes an insider owing money or its equivalent to a bank; not the reverse.<sup>61</sup>

*2. Credit exposure from derivative transactions and derivative netting sets*

The proposed rule would allow banks to value the credit exposure arising from a derivative transaction using any method it is authorized to use under the Federal banking agencies’ risk-based capital rule. Similarly, any credit exposure associated with a derivative netting set could be valued using any method a bank is permitted to use under the Federal banking agencies’ risk-based capital rule. The proposed valuation methodology would leverage the significant consideration given to the valuation of derivative transactions generally for purposes of regulatory capital requirements by the Federal banking agencies, including with the

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<sup>61</sup> 12 U.S.C. 375b(9)(D)(i)(I); 12 CFR 215.3(a).

benefit of public comment. This proposed methodology also would allow banks to rely on their existing systems and processes for calculating regulatory capital requirements to ensure compliance with Regulation O, minimizing cost to the banks.

The proposed rule also 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, and any obligations of, or fully guaranteed as to principal and interest by, the United States or its agencies, received by the bank from the insider as collateral for the derivative or derivative netting set. Limiting the types of collateral that can offset a credit exposure for derivatives to cash and U.S. obligations provides the greatest protection for a bank from credit risk it may face from a derivative with its insiders. This limitation also would be consistent with the preference in section 22(h) for cash and U.S. government obligations. Specifically, extensions of credit secured by this collateral are not subject to the individual lending limit.<sup>62</sup>

Consistent with section 22(h), the proposed rule would define derivative transaction to have the same meaning given in 12 U.S.C. 84(b).<sup>63</sup>

*Question 19: What are the advantages and disadvantages of using methodologies in the Federal banking agencies' risk-based capital rules to measure credit exposures from derivative transactions and derivative netting sets? Would another methodology be more useful or*

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<sup>62</sup> 12 U.S.C. 375b(4); 12 CFR 215.4(c). The individual lending limit permits extensions of credit in amounts that are excepted from the lending limit in the National Bank Act. The National Bank Act lending limit excepts the entire amount of loans secured by certain cash and U.S. government obligations from the limit. 12 U.S.C. 84(c)(4)-(6).

<sup>63</sup> See 12 U.S.C. 375b(9)(D)(i)(II).

*accurate? For example, should the proposed rule value credit exposures at current exposure, which reflects a bank's present obligations under a derivative transaction?*

*Question 20: What would be the advantages and disadvantages to expanding the scope of collateral that can offset a credit exposure from a derivative transaction to include more than cash and U.S. government obligations?*

*Question 21: Are there other types of collateral that have sufficiently reliable value and liquidity that they should be permitted to offset a derivative exposure between a bank and an insider? For example, should a bank be able to offset an exposure for the assets that constitute "eligible collateral" as defined in the Board's Single Counterparty Credit Limit rule, 12 CFR 252, subparts H and Q, or "financial collateral" as defined in the Federal banking agencies' risk-based capital rules? Should convertible bonds that convert into publicly traded securities be included?*

*Question 22: Should cash that can be used to reduce a credit exposure be required to be held in a segregated earmarked deposit account at the bank? Would a bank's interest in cash that is used as collateral for a derivative transaction be sufficiently protected without these requirements or under alternate arrangements?*

*Question 23: What would be the benefit of limiting cash collateral that can be used to offset a credit exposure arising from a derivative transaction or securities financing transaction to certain currencies? For example, would it be beneficial to limit eligible cash collateral to U.S. dollars or a currency that matches the denomination of the asset being secured?*

### *3. Valuation of credit derivative transactions and similar derivative transactions*

Under the Board's Regulation W, certain credit derivatives in which a member bank provides credit protection to the nonaffiliate with respect to an obligation of an affiliate of the

member bank are guarantees by the member bank on behalf of that affiliate.<sup>64</sup> Similarly, the proposed rule would treat certain credit derivatives as guarantees on behalf of an insider. Because of this treatment, the proposed rule would value these credit derivatives differently than other derivatives. Specifically, the proposed rule would value credit exposures arising from these derivatives at the greater of (i) the notional principal amount or (ii) the maximum potential loss to the member bank on the transaction.

The proposed rule also would include in the scope of derivatives that are treated as guarantees any equity derivative or total return swap (whether funded or unfunded) that is functionally similar to a guarantee. Equity derivative agreements under which a bank, in exchange for a fee, agrees to compensate a third-party for any depreciation in the value of the underlying equity securities issued by an insider of the bank effectively serve as a price guarantee for those underlying securities. Similarly, total return swaps can be structured to provide a similar guarantee on a funded or unfunded basis. Where the securities issued by a bank's insider(s) represent only a portion of the reference assets, the valuation would be limited to the amount of the guarantee provided by the bank with respect to the obligations of its insider(s).

The Board observes that credit derivatives in which a bank provides credit protection to an affiliate and similar equity derivatives or total return swaps (whether funded or unfunded) subject the bank to similar risk of loss as if the bank had purchased the reference asset itself. As a result, the proposed methodology would treat this synthetic asset purchase similarly to Regulation O's valuation of an asset purchase by a member bank from an affiliate by valuing the

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<sup>64</sup> 12 CFR 223.33(c).

transaction at the greater of (i) the total notional exposure or (ii) the maximum potential loss to the member bank on the transaction.

*Question 24: The Board invites comment on the proposed treatment of, and valuation for, equity derivatives and total return swaps. What alternative treatment for or additional clarifications should the Board consider?*

#### *4. Credit exposure from securities financing transactions*

To value credit exposures from securities financing transactions, the proposed rule would seek to measure the risk of loss that a bank may face by entering into such a transaction with an insider. In general, this risk can be separated into two subcomponents. First, the risk that an insider is unable to give back to the bank what is owed, either in the form of cash or securities (credit risk). Second, where securities are involved, the risk that the value of securities fluctuates to the detriment of the bank (market risk).

To achieve this purpose, the proposed rule would allow a bank to use any methodology that it is authorized to use under the Federal banking agencies' risk-based capital rules to measure credit exposures arising from securities financing transactions. By relying on the Federal banking agencies' risk-based capital rules, this method inherently achieves the purpose of measuring a bank's credit and market risks given the sensitivity of the capital rules to these risks. This alignment also would minimize compliance burdens as banks already are familiar with the Federal banking agencies' risk-based capital rules. Further, the proposed valuation of credit exposure from securities financing transactions would be consistent with the treatment of derivatives.

This proposed approach for valuing credit exposures from a securities financing transaction may not be relevant for smaller banks that have elected to use the community bank

leverage ratio framework to comply with their risk-based capital requirements. Accordingly, the proposed rule also would provide a simplified option to determine credit exposures arising from securities financing transactions. All banks would be permitted to use this simplified method, including those that have not elected to use the community bank leverage ratio framework. This simplified amount would equal the sum of cash and the fair market value of securities transferred by the bank to the insider, minus the sum of cash and the fair market value of U.S. government obligations transferred from the insider to the bank in connection with that transaction. This method has the benefit of being simpler than the amounts calculated by using the Federal banking agencies' risk-based capital rules and also provides a reasonable measure of the risk faced by a bank when entering into a securities financing transaction with an insider (that is, the dollar value of what the bank is owed less the dollar value of reliable collateral provided by the insider). This method also acknowledges the preference that Congress expressed for credit exposures collateralized by cash and U.S. government obligations.<sup>65</sup> Consistent with this intent, the proposed rule also would require that any cash collateral used by banks to offset its exposure to an insider be in a segregated deposit account with the bank over which the bank has a perfected security interest.

*Question 25: Should the definition of “securities financing transaction” be revised or expanded to include any other transactions (e.g., margin loans)?*

*Question 26: What would be the advantages and disadvantages of requiring all banks to use the same method to determine credit exposure from a securities financing transaction? For*

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<sup>65</sup> Extensions of credit secured by certain cash and U.S. government obligations are not subject to the individual lending limit in section 22(h) or Regulation O. 12 U.S.C. 375b(4); 12 CFR 215.4(c). The individual lending limit permits extensions of credit in amounts that are excepted from the lending limit in the National Bank Act. The National Bank Act lending limit excepts the entire amount of loans secured by certain cash and U.S. government obligations from the limit. 12 U.S.C. 84(c)(4)-(6).

*example, should all banks be required to determine the amount of a credit exposure from a securities financing transaction using the simplified method set forth in the proposed rule for banks that use the community bank leverage ratio framework, or should all banks be required to use the methods they are authorized to use under their applicable capital requirements?*

*Question 27: What would be the advantages and disadvantages of expanding or narrowing the scope of eligible collateral? For example, would it be better for eligible collateral to include all of the assets that are “financial collateral” as defined in the Federal banking agencies’ risk-based capital rules? Should convertible bonds that convert into publicly traded securities be included?*

*Question 28: Are there any circumstances where securities issued by an insider or, more likely, an insider’s related interest, should be permitted to qualify as eligible collateral?*

*Question 29: Should cash that can be used to reduce a credit exposure be required to be held in a segregated earmarked deposit account at the bank? Would a bank’s interest in cash that is used as collateral for a derivative transaction be sufficiently protected without these requirements or under alternate arrangements?*

*Question 30: Should the proposed rule specify that securities issued by an insider (or, more likely, an insider’s related interest) cannot be used to offset a credit exposure from a securities financing transaction? For example, should the proposed rule require a bank to assign a value of zero to any such securities when using the Federal banking agencies’ risk-based capital rules to value the credit exposure?*

#### **D. Valuation Principles for Extensions of Credit**

As discussed above, the proposed rule would include a method for determining the credit exposure of a derivative or securities financing transaction. To provide similar clarity on how

banks should value other extensions of credit under Regulation O, the proposed rule would set forth valuation principles for various types of extensions of credit and purchases and sales of assets. In order to minimize compliance burdens with this change, the proposed rule would rely on the valuation principles currently in Regulation W, with which banks already are familiar.

*1. Extensions of credit originated by a bank*

For extensions of credit, the proposed rule would set forth valuation methodologies for extensions of credit originated by a bank, purchased by a bank, and made through a bank's acquisition of a debt security of an insider. For extensions of credit originated by a bank, the proposed rule generally would value the transaction as the amount of funds provided by a bank to, or on behalf of, an insider plus any additional amounts that the bank could be required to provide to, or on behalf of, the insider. Specifically, the proposed rule would value such a transaction at the greater of (i) the principal amount of the extension of credit; (ii) the amount owed by the insider to the bank under the extension of credit; or (iii) the sum of the amount provided by the bank to, or on behalf of, an insider plus any additional amount that the bank could be required to provide to, or on behalf of, the insider. Regulation W sets forth examples for using these methodologies.<sup>66</sup> Banks may look to these examples to help understand the valuation methodologies in the proposed rule.

The first prong ("the principal amount of the extension of credit") likely would determine the valuation of a transaction in which a bank purchases a zero-coupon note issued by an insider. Such an extension of credit should be valued at the amount the insider ultimately is obligated to pay to the bank, rather than the amount of funds initially advanced by the bank. For example, a

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<sup>66</sup> 12 CFR 223.21(a)(4)(i)-(iv).

bank that purchases from an insider for \$50 a 10-year zero-coupon note issued by the insider with a face value of \$100 would be required to value the extension of credit at \$100.

The second prong (“the amount owed by the insider”) likely would determine the valuation of a transaction in which an insider fails to pay a bank when a fee is due to the bank. This second prong is not intended to include amounts not yet due to the bank, including accrued interest not yet due. This would ensure that the value of an extension of credit equals the full amount of the exposure from the bank to the insider.

The third prong (“the sum of the amount provided by the bank to, or on behalf of, an insider plus any additional amount that the bank could be required to provide to, or on behalf of, the insider”) likely will determine the value of most extensions of credit made by a bank to an insider. Under this prong, for example, a \$100 term loan is a \$100 extension of credit, a \$300 revolving credit facility is a \$300 extension of credit (regardless of the amount of the facility drawn down by the insider), and a guarantee backstopping a \$500 debt issuance by an insider is a \$500 extension of credit.

*Question 31: How should guarantees provided by a bank to an insider when the bank acts as agent for the insider to engage in a trade with a clearinghouse be valued for purposes of Regulation O? When the trade is a derivative transaction and the bank guarantees performance of the insider on the derivative contract, what would be the advantages and disadvantages of valuing the guarantee as an extension of credit or as a derivative, in each case pursuant to the methods set forth in the proposed rule?*

## *2. Extensions of credit acquired by a bank*

Banks may extend credit to insiders by acquiring an extension of credit to an insider that was made by a third-party. In these cases, the proposed rule would value the transaction 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. For example, if a bank pays a third-party \$90 for a \$100 term loan that the third-party made to an insider of the bank (for example, because the loan was at a fixed rate and had declined in value due to a rise in the general level of interest rates), the extension of credit amount is \$90 rather than \$100. This lower amount reflects the fact that the bank's maximum loss on the transaction is \$90, rather than the original principal amount of the loan. By way of additional illustration, if a bank pays a third-party \$70 for a \$100 line of credit to an insider of which the insider had drawn \$70, the amount of the extension of credit would be \$100, which is the purchase price paid plus the remaining amount of the line of credit that the bank could be required to lend under the purchased credit line.

*3. Extensions of credit through the purchase of or investment in a debt security*

As discussed in section III.D.2 of this **SUPPLEMENTARY INFORMATION**, the proposed rule would include in the definition of "extension of credit" a bank's acquisition by purchase, discount, exchange, or otherwise of a note or other obligation, including commercial paper or other debt securities of an insider, upon which an insider is liable as maker, drawer, endorser, guarantor, or surety. For the purchase of or investment in the debt securities of an insider, the proposed rule would value this extension of credit as the greater of the bank's purchase price or the carrying value of the debt securities. Accordingly, a bank that paid no consideration in exchange for the debt securities of an insider would nevertheless be required to value the extension of credit at no less than the bank's carrying value of the securities. The carrying value of the security would be the amount at which the securities are carried on the GAAP financial statements of the bank. In addition, if the bank's carrying value of the securities

increased or decreased after the bank's initial investment, the amount of the extension of credit would increase or decrease to reflect the bank's changing financial exposure to the insider. In no case could the amount of the extension of credit fall below the amount paid by the bank for the securities. Regulation W includes examples of this valuation principle, which banks may look to in order to understand the valuation principle in the proposed rule.<sup>67</sup>

Valuing the purchase of or investment in debt securities of an insider at the carrying value of the securities would be consistent with GAAP, which requires a bank to reflect its investment in securities issued by an insider at the carrying value throughout the life of the investment, even if the bank paid no consideration for the securities. As noted above, this approach also would be consistent with Regulation W, so banks would be able to rely on existing compliance systems to value extensions of credit for purposes of Regulation O. Lastly, this approach would be consistent with the purposes of section 22(h)—that is, limiting the financial exposure of banks to their insiders.

As noted, the proposed rule would set a floor for the value of an extension of credit resulting from the investment in or purchase of debt securities of an insider at the consideration paid by the bank for the securities. Although this approach would not be consistent with GAAP, it would ensure that the amount of the extension of credit never falls below the amount of funds actually transferred by the bank to the insider. The floor also would limit the ability of a bank to provide additional funding to an insider in circumstances where the insider approaches insolvency.

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<sup>67</sup> 12 CFR 223.23(a)(2)(i).

## **E. Other Revisions to the Definition of “Extension of Credit”**

Section 22(h) and Regulation O define “extension of credit” to mean the making or renewal of any loan, a granting of a line of credit, or entering into any similar transaction.<sup>68</sup> Regulation O also provides a non-exhaustive list of transactions that are extensions of credit, including “[a]ny other similar transaction as a result of which a person becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.”<sup>69</sup> Over the years, the Board and Board staff have identified transactions that fall within the scope of this provision. The proposed rule would expand the non-exhaustive list of transactions that are extensions of credit to include these additional identified transactions, as described in this section.

A number of the proposed additions to the definition of extension of credit would use similar or identical language found in Regulation W. The Board would seek to interpret similar language between the proposed rule and Regulation W consistently where possible.

*Question 32: What would be the advantages and disadvantages of using interpretations of language in Regulation W to interpret similar language in the proposed rule?*

### *1. Leases that are the functional equivalent of an extension of credit*

The proposed rule would include as an extension of credit a lease that is the functional equivalent of an extension of credit. These leases involve money or its equivalent being owed to a bank, and, by definition, are substantially similar to a loan. This treatment would be a

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<sup>68</sup> 12 U.S.C. 375b(9)(D); 12 CFR 215.3(a).

<sup>69</sup> 12 CFR 215.3(a).

codification of an existing interpretation<sup>70</sup> and would be consistent with the definition of “extension of credit” in Regulation W.<sup>71</sup>

A lease that is the functional equivalent of an extension of credit also would include a full-payout net lease permissible for a national bank under 12 U.S.C. 24(Seventh) and 12 CFR part 23.<sup>72</sup> In most cases, a full-payout net lease results in the payment of rent and tax benefits to the lessor bank that return to the lessor bank the full initial value of the rented property plus some additional amount. This additional amount normally is comparable to an interest rate that would be charged on a traditional loan for the same property and with a maturity equal to the life of the non-operating lease.<sup>73</sup> This treatment also would be consistent with the Board’s interpretation of “leases that are the functional equivalent of an extension of credit” for purposes of Regulation W.<sup>74</sup>

The Board would continue to assess, on a case-by-case basis, whether other leases also constitute extensions of credit. In other contexts, Board staff has noted that the following factors may contribute to a determination that a lease is an extension of credit: (1) the agreement contains a Uniform Commercial Code financing statement of the type normally filed in connection with a secured credit transaction, (2) many attributes of ownership of the equipment, such as responsibility for servicing, insuring, licensing and assumption of risk of loss, pass to the lessee, (3) the lessee has the right to purchase the equipment at the end of the lease period, and

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<sup>70</sup> See Staff Opinion, April 8, 1976, FRRS 3-1080.

<sup>71</sup> See 12 CFR 223.3(o)(3).

<sup>72</sup> The same treatment would apply for a full-payout net lease permissible for a federal savings association under 12 CFR 160.41.

<sup>73</sup> See Staff Opinion, April 8, 1976, FRRS 3-1080 (holding that full-payout nonoperating leases are extensions of credit).

<sup>74</sup> Transactions Between Member Banks and Their Affiliates, 67 FR 76560, 76570 (Dec. 12, 2002).

(4) the useful life of the equipment is of such a short duration that the lessor must look to the terms of the agreement, rather than to the equipment's resale value, as the primary source of recovery for the investment.<sup>75</sup> These and other relevant factors could contribute to an analysis of whether a lease is an "extension of credit" for purposes of the proposed rule.

*Question 33: What are the advantages and disadvantages of the proposed factors that may be used to determine whether a lease is an extension of credit? What other factors may be relevant in considering whether a lease is an "extension of credit"? For example, should the Board consider the accounting treatment of the lease under GAAP?*

## *2. Investments in debt securities*

The proposed rule would include as an extension of credit an investment in debt securities of an insider. When a bank invests in the debt securities issued by an insider that is not a natural person, the investment gives rise to an obligation by the insider to pay funds to the bank in satisfaction of the debt security. The bank therefore has credit exposure to the insider. The bank also has credit exposure to the insider because performance on the security would be reflected on the bank's balance sheet. Therefore, investments in debt securities of an insider are viewed as extensions of credit. This addition also would be consistent with Regulation W, which specifies that a purchase of or investment in debt securities issued by an affiliate constitutes an extension of credit.<sup>76</sup>

*Question 34: What are the advantages and disadvantages of including an investment in debt securities issued by an insider as an extension of credit?*

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<sup>75</sup> See FRRS 3-1190.1 (noting that an equipment lease agreement is essentially a financing arrangement for purposes of section 23A if, based on a combination of factors, it is the equivalent of a loan or extension of credit).

<sup>76</sup> 12 CFR 223.3(o)(4) (defining "extension of credit" to include "[a]n acquisition by purchase, discount, exchange, or otherwise of a note or other obligation, including commercial paper or other debt securities, of an affiliate").

*Question 35: Should an investment in securities other than debt securities issued by an insider constitute an extension of credit? Should the scope of securities be expanded or reduced?*

### *3. Modifications to existing extensions of credit*

The proposed rule 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. This language comes from the definition of “extension of credit” in Regulation W, which also treats modifications as an extension of credit.<sup>77</sup> This revision would clarify when modifications made to an existing extension of credit would constitute a new extension of credit that must comply with the requirements of Regulation O. The proposed revision is intended to address significant modifications to an existing extension of credit that economically amount to a new extension of credit. A bank’s credit risk could be materially altered if a bank and insider modify an extension of credit in one of these ways. Failure to treat these events as a new extension of credit also would create a significant opportunity for evasion of the insider lending restrictions. If such events did not constitute an extension of credit, an insider and bank seeking to grant the insider favorable treatment could approve an extension of credit that is compliant with the proposed rule, only to later revise the extension of credit in a manner inconsistent with the proposed rule. This revision would codify the Board’s existing interpretation of treatment for these modifications as a new extension of credit. By using the same language that currently exists in Regulation W, the proposed rule also would create efficiencies for banks by using the same standard in both regulations.

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<sup>77</sup> See 12 CFR 223.3(o)(5).

The list of transactions that are extensions of credit in Regulation O already includes “[a]n increase of an existing indebtedness.”<sup>78</sup> Regulation O excepts increases of an existing indebtedness for certain accrued interest and incidental expenses from the definition of “extension of credit.”<sup>79</sup> Because the proposed rule would modify the definition of extension of credit to include an increase in the amount, extension of maturity, or adjustment to the interest rate term or other material term, of an extension of credit, the existing inclusion of “[a]n increase of an existing indebtedness” in the list of transactions that are extensions of credit would not be necessary. Accordingly, the proposed rule would eliminate this language from the list. However, the proposed rule would preserve the exception for certain accrued interest and incidental expenses by adding a new separate exception from the definition of extension of credit.

*Question 36: What are the advantages and disadvantages to specifying that an extension of credit includes an increase in the amount, extension of maturity, or adjustment to the interest rate term or other material term, of an extension of credit?*

#### *4. Exception for inadvertent overdrafts*

In 1968, the Board excepted certain inadvertent overdrafts that are promptly repaid from the definition of “extension of credit.”<sup>80</sup> The Board expanded this exception in 1979 to apply to the prohibition against overdrafts in section 22(h), noting that “[t]he Board intends that this provision be used solely in the unusual case of an inadvertent overdraft.”<sup>81</sup> Regulation O still

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<sup>78</sup> 12 CFR 215.3(a)(5) (An extension of credit includes “[a]n increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for: (i) [a]ccrued interest; or (ii) [t]axes, insurance, or other expenses incidental to the existing indebtedness”).

<sup>79</sup> *Id.*

<sup>80</sup> 33 FR 2837 (Feb. 10, 1968).

<sup>81</sup> 44 FR 12959, 12964 (Mar. 9, 1979).

contains this exception, provided that all inadvertent overdrafts to an insider do not amount in the aggregate to more than \$1,000.<sup>82</sup> There is a separate broader exception with respect to indebtedness of \$5,000 or less arising by reason of an interest-bearing overdraft credit plan.<sup>83</sup> Over the years, there has been confusion over the relationship between these two similar and overlapping exceptions.

To avoid confusion, the proposed rule would eliminate the exception for inadvertent overdrafts from the definition of “extension of credit” while retaining the broader exception for interest-bearing overdraft credit plans. This change would recognize that, since the exception was adopted in 1968, banking practices with respect to overdrafts have changed. Banks are more likely to have overdraft protection plans, and account holders often enter into arrangements with their banks that would prevent the bank from paying an overdraft that would not be automatically repaid. This change also would be consistent with Regulation W, which does not provide an exception for inadvertent overdrafts made by a bank’s affiliates.

However, the proposed rule would not eliminate the separate exception for inadvertent overdrafts with respect to the prohibition against overdrafts to executive officers and directors.<sup>84</sup> This would permit banks to pay inadvertent overdrafts to executive officers and directors provided that they meet the requirements that apply to all extensions of credit and the terms of the exception (specifically, below the specified amount, not more than 5 business days, and third-party fees). Eliminating the inadvertent overdraft exception for executive officers and directors would be overly punitive because a bank would immediately be in violation of

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<sup>82</sup> 12 CFR 215.3(b)(2).

<sup>83</sup> 12 CFR 215.3(b)(6).

<sup>84</sup> 12 CFR 215.4(e)(2).

Regulation O for these overdrafts which, by definition, are small and unintentional. As noted above, the proposed rule would increase the inadvertent overdraft threshold to \$4,000.

*Question 37: What are the advantages and disadvantages of eliminating the exception for inadvertent overdrafts as part of the definition of “extension of credit” (section 215.3(b)(2) of Regulation O)?*

*Question 38: In the alternative, what would be the advantages and disadvantages of retaining but narrowing the exception to cover qualified custodial overdrafts (for example ordinary course of business in connection with payment transactions, settlement services, or futures, derivatives, and securities clearing)? If revised, what criteria would constitute appropriate limitations? For example, should these criteria include consideration of a repayment timeline (for example 5 business days), concerns about repayment, policies and procedures, or something else?*

*Question 39: What other clarifications, if any, should the Board consider for the treatment of inadvertent overdrafts?*

#### *5. Guarantees and similar transactions by a bank on behalf of an insider*

Section 215.3(a)(3) of Regulation O specifies that a standby letter of credit (or other similar arrangement regardless of name or description) or an ineligible acceptance are extensions of credit. The proposed rule would expand this provision to include additional similar transactions using the language from the definition of “covered transaction” in Regulation W. Specifically, the proposed rule would include the issuance of a guarantee, acceptance, or letter of

credit, including an endorsement on behalf of an insider, and a confirmation of a letter of credit issued by an insider as extensions of credit.<sup>85</sup>

Like standby letters of credit or ineligible acceptances, these additional transactions expose a bank to the credit risk of an insider. These transactions also are the types of credit transactions for which an insider could be incentivized to exert undue influence over the decision to issue a guarantee, acceptance, or letter of credit because of the benefit provided by the transaction to the insider. In addition, harmonizing the scope of terminology with Regulation W would have the added benefit of decreasing compliance costs for banks because they already are familiar with and likely have developed policies for compliance with Regulation W.

Consistent with Regulation W, the proposed rule would clarify that a credit derivative between a bank and a third-party in which the bank provides credit protection to the third-party with respect to an obligation of an insider of the bank is a guarantee by a bank on behalf of an insider for purpose of Regulation O. The proposed rule would specify that credit derivatives would include: (i) an agreement under which the bank, in exchange for a fee, agrees to compensate the third-party for any default of the underlying obligation of the insider; (ii) an agreement under which the bank, in exchange for payments based on the total return of the underlying obligation of the insider, agrees to pay the third-party a spread over funding costs plus any depreciation in the value of the underlying obligation of the insider; (iii) an equity derivative under which the bank, in exchange for a fee, agrees to compensate a third-party for any depreciation in the value of an equity security of the insider; and (iv) a total return swap, whether funded or unfunded, under which the bank, in exchange for a fee, agrees to compensate

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<sup>85</sup> See 12 CFR 223.3(h)(5); *see also* 12 U.S.C. 371c(b)(7)(E). As noted in section III.C of this **SUPPLEMENTARY INFORMATION**, the definition also would include derivative transactions, cross-insider netting arrangements, and securities financing transactions.

a third-party for any loss or depreciation in the value of a security or debt obligation issued by an insider.

*Question 40: What are the advantages and disadvantages of expanding the list of extensions of credit so that it includes the issuance of a guarantee, acceptance, or letter of credit, including an endorsement, on behalf of an insider, and a confirmation of a letter of credit issued by an insider, as extensions of credit?*

*Question 41: Should the Board consider adding any other items to the non-exhaustive list of examples of extensions of credit? If so, which items should be added?*

*6. Application of the tangible economic benefit rule to spouses and trusts and estates*

Section 215.3(f) of Regulation O includes the tangible economic benefit rule, which treats extensions of credit made to a borrower as having been made to another person, to the extent that the proceeds are transferred to the person or are used for the tangible economic benefit of the person.<sup>86</sup> The proposed rule would codify the Board's longstanding practice of applying this rule so that extensions of credit to the spouse of an insider or to an estate or trust in which an insider has a substantial beneficial interest are treated as having been made to the insider.

i. Spouses of insiders

The proposed rule would codify previous interpretations by treating extensions of credit to the spouse of an insider, or to the related interest of a spouse of the insider, as having been made to the insider, unless the extension of credit meets the conditions described below.

Extensions of credit to the spouse of an insider or the related interest of a spouse of an insider typically indirectly inure to the insider's benefit given the sharing of financial resources that is

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<sup>86</sup> 12 CFR 215.3(f).

common between spouses. This default treatment is aimed at preventing a significant source of potential evasion by ascribing extensions of credit to an insider when the extension of credit is made to the insider's spouse or the spouse's related interest. This treatment also would reduce the undue influence and conflict of interest concerns that the insider lending restrictions are meant to mitigate.

The proposed rule would not treat an extension of credit to an insider's spouse as having been made to the insider, however, if (i) the spouse is independently creditworthy, and (ii) repayment of the extension of credit is not predicated on the insider's income. An extension of credit to the related interest of an insider's spouse would not be treated as an extension of credit to the insider if, in addition to the two conditions in the preceding sentence, (i) the insider does not have a financial or ownership interest in the company, and (ii) the insider does not participate in management of the company. These conditions would help to mitigate the risk that a bank would be exposed to the credit risk of an insider arising indirectly through the insider's spouse. This exception also would ensure that Regulation O does not impede the ability of a spouse of an insider to obtain credit for the spouse's own business ventures independently of the insider. An extension of credit that meets these conditions could still be treated as an extension of credit to the insider if, for example, the proceeds of the extension of credit are transferred to or used for the tangible economic benefit of the insider-spouse, or if the business is a related interest of the insider.

If both spouses in a relationship are insiders of the same bank, an extension of credit by the bank to one insider would be treated as having been made separately to both insiders if the exception above does not apply to the extension of credit. Accordingly, the extension of credit would need to satisfy the requirements in Regulation O with respect to both insiders.

*Question 42: What are the advantages and disadvantages of treating an extension of credit made to the spouse of an insider, or a related interest of a spouse of an insider, as an extension of credit to the insider?*

*Question 43: What are the advantages and disadvantages of the proposed factors? Are there any other conditions under which an extension of credit to the spouse of an insider, or a related interest of a spouse of an insider, should not be treated as having been made to the insider? For example, could a spouse provide some type of evidence showing that the proceeds of a loan would not be used for the tangible economic benefit of the insider?*

ii. Beneficiaries of trusts and estates

The proposed rule would codify the Board's previous interpretation of the tangible economic benefit rule that renders some extensions of credit to a trust or estate to be deemed as having been made to a beneficiary of the trust or estate.<sup>87</sup> A beneficiary of a trust or an estate has an interest in the property of the trust or estate. When the trust or estate receives an extension of credit, the proceeds inure to the benefit of the beneficiary because they often are used to preserve or enhance the value of other assets held by the trust or estate. Specifically, the proposed rule would treat an extension of credit to a trust or estate in which an insider has a 25 percent or more present or contingent beneficial interest as being made to the insider because it is a sufficiently large interest in a trust or estate that it could give rise to a motivation for the

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<sup>87</sup> See, e.g., FRRS 3-1062.1 (citing a letter from Neal L. Petersen, General Counsel of the Board, to John P. Amershadian (May 23, 1980), available at <https://www.federalreserve.gov/supervisionreg/legalinterpretations/letter-from-petersen-to-amershadian-may-23-1980.pdf>). In addition, as noted in section IV.B of this **SUPPLEMENTARY INFORMATION**, a trust can be a related interest of an insider if the insider controls the trust and the proposed rule will indicate that trustees are presumed to control a trust, and settlors, appointers, or beneficiaries can be presumed to control a trust under certain circumstances.

beneficiary to attempt to exert undue influence on the decision of a bank to lend to the trust or estate.

In addition, use of the 25 percent threshold is consistent with other thresholds in banking statutes and regulations. For example, both section 22(h) and the BHC Act define control to include ownership of 25 percent or more of a class of voting securities.<sup>88</sup> Among other things, this statutory requirement implies that, when a company owns 25 percent or more of a class of voting securities of a bank, it is sufficiently interested in the performance of the bank that it should be subject to certain requirements with respect to the bank. Accordingly, a 25 percent or more present or contingent beneficial interest in an estate or trust could be viewed similarly as giving rise to a sufficient interest in the estate or trust for extensions of credit to be attributed to beneficiaries that are insiders.

In the alternative, the Board could set the threshold lower at 10 percent. A beneficial interest of 10 percent might give rise to sufficient motivation for the beneficiary to attempt to exert undue influence on the lending decisions of the bank. Section 22(h) and Regulation O already deem the 10 percent threshold sufficient to render a person an insider and, thus, subject to the prohibitions of the insider lending restrictions. The 10 percent threshold also is consistent with other statutory thresholds that the Board has deemed sufficient to trigger heightened scrutiny. For example, prior notice is required in certain circumstances where an individual acquires 10 percent or more of a bank or bank holding company,<sup>89</sup> and Regulation O sets forth presumptions of control when an individual owns more than 10 percent of a bank.<sup>90</sup>

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<sup>88</sup> 12 U.S.C. 375b(9)(B); 12 U.S.C. 1841(a)(2)(A).

<sup>89</sup> See 12 CFR 225.41(c)(2).

<sup>90</sup> See 12 CFR 215.2(c)(2). As discussed in sections III.B and IV.B of this **SUPPLEMENTARY INFORMATION**, the proposed rule would amend these presumptions.

*Question 44: What are the advantages and disadvantages to this proposed clarification regarding when an extension of credit to a trust or an estate should be treated as having been made to a beneficiary of the trust or estate?*

*Question 45: Is the proposed 25 percent threshold appropriate or should the proposed beneficial interest threshold be set at a different level? For example, should the threshold be set at 10 percent, 33.3 percent, or some other value between 10 percent and 100 percent?*

#### **F. Dodd-Frank Act and the Purchase or Sale of an Asset Between an Insider and a Bank**

The proposed rule would include the requirements of section 615 of the Dodd-Frank Act, which added paragraph (z) to 12 U.S.C. 1828. Section 615 prohibits a depository institution from purchasing or selling an asset from or to an insider unless (i) the transaction is on “market terms;” and (ii) if the transaction represents more than 10 percent of the capital stock and surplus of the institution, the transaction has been approved in advance by a majority of the members of the board of directors of the institution “who do not have an interest in the transaction.”<sup>91</sup>

As required by 12 U.S.C. 1828(z), the Board has consulted with the OCC and FDIC regarding this portion of the proposed rule.

##### *1. “Market terms”*

The proposed rule would interpret market terms, as it is used in 12 U.S.C. 1828(z), to mean the terms described in section 23B of the Federal Reserve Act.<sup>92</sup> Section 23B requires that the terms of a transaction between a bank and its affiliates be “the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies.”<sup>93</sup> In the event there are no such comparable

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<sup>91</sup> 12 U.S.C. 1828(z).

<sup>92</sup> 12 U.S.C. 371c-1.

<sup>93</sup> 12 U.S.C. 371c-1(1)(A).

transactions, section 23B requires that the proposed affiliate transaction be on terms that the bank would offer to nonaffiliates in good faith.<sup>94</sup>

The proposed rule would use the same standard as in section 23B but substitute insiders and non-insiders for affiliates and nonaffiliates, as appropriate. This standard is intended to ensure that the sale or purchase of an asset between a bank and an insider would not be disadvantageous to the bank relative to similar transactions between the banks and non-insiders. This standard also would create consistency between the market terms requirements in two of the Board's regulations governing transactions between banks and related parties, namely Regulation O and Regulation W. Using the same standard in Regulation O that already is in Regulation W should decrease compliance costs for banks because they already are familiar with and likely have developed policies for compliance with section 23B that could be modified for purposes of Regulation O more easily than developing policies for a new standard. Because the language used in the two regulations would be similar, the Board would seek to interpret the language consistently when possible.

*Question 46: What are the advantages and disadvantages of interpreting "market terms" to mean the standard set forth in section 23B?*

*Question 47: What would be the advantages and disadvantages of requiring that a purchase or sale of assets strictly be on fair market terms? Should it be impermissible for a bank to sell or purchase an asset from an insider on terms that are more favorable to the bank than could be expected for a similar transaction with a noninsider?*

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<sup>94</sup> 12 U.S.C. 371c-1(1)(B).

*Question 48: What would be the advantages and disadvantages of defining “market terms” to be consistent with the “prevailing comparable transactions” terms requirement in section 22(h) and section 215.4(a)(1) of Regulation O?*<sup>95</sup>

*Question 49: What alternative standard could the Board consider adopting to define “market terms?”*

*Question 50: What would be the advantages and disadvantages of using interpretations of the market terms standard in section 23B to interpret the similar standard in the proposed rule?*

## *2. Indirect participation by an interested party*

The proposed rule also would make clear that approval of a purchase or sale of an asset between an insider and a bank by a majority of directors cannot include an interested party’s participation in the discussion or any attempt to influence the voting of the board of directors regarding the transaction. This requirement is the same as that imposed currently by Regulation O to implement the prior approval requirement in section 22(h).<sup>96</sup>

Absent this requirement, the purpose of the statute—to prevent an insider from participating in approval by the board of directors of a transaction that presents a conflict of interest for the insider—would not be discharged. This is because an interested party could exert undue influence on the approval of a transaction by a bank’s board of directors other than by participating in the voting. For example, directors that are not interested parties could be less

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<sup>95</sup> See 12 U.S.C. 375b(1)(a)(i); 12 CFR 215.4(a)(1). The “prevailing comparable transactions” terms requirement in Regulation O requires any extension of credit by a bank to an insider to be (i) “made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this part and who are not employed by the bank”; and (ii) “not involve more than the normal risk of repayment or present other unfavorable features.” 12 CFR 215.4(a)(1)(i) and (ii).

<sup>96</sup> 12 CFR 215.4(b)(4).

likely to speak openly in a meeting to discuss a proposed transaction that is attended by the interested party. An interested party also could encourage other directors to approve a proposed transaction or monopolize a conversation about the transaction, which could limit the amount of time that directors who are not interested in the transaction are able to discuss any concerns related to the transaction.

The Board proposes adopting the same standard to clarify participation in the voting for purposes of 12 U.S.C. 1828(z) as in section 22(h) to maintain consistency in the regulation, for simplicity, and also to avoid creating a new standard for banks to interpret.

While the proposed rule would seek to align the prior approval requirements in section 22(h) and 12 U.S.C. 1828(z) when possible, there is one notable statutory difference between them. Section 22(h) requires approval by a majority of a bank's "*entire* board of directors" whereas 12 U.S.C. 1828(z) requires approval by a majority of "the members of the board of directors . . . *who do not have an interest in the transaction.*"<sup>97</sup> For purposes of determining what number of directors constitutes a majority, section 22(h) does not exclude directors with an interest in the transaction. For example, if two directors out of seven have an interest in a transaction, section 22(h) would require four directors to vote in favor of the transaction (that is, a majority of the entire board of directors); whereas, 12 U.S.C. 1828(z) would require three (that is, a majority of the five uninterested directors).

### 3. "*Purchase of asset*" definition

For purposes of this section, the proposed rule would define the term "purchase of asset" generally in line with the term "purchase of an asset" in Regulation W.<sup>98</sup> Regulation W states

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<sup>97</sup> Compare 12 U.S.C. 375b(3)(B) with 12 U.S.C. 1828(z)(1)(B) (emphasis added).

<sup>98</sup> 12 CFR 223.3(dd).

that “[p]urchase of an asset by a member bank from an affiliate means the acquisition by a member bank of an asset from an affiliate in exchange for cash or any other consideration, including an assumption of liabilities. The merger of an affiliate into a member bank is a purchase of assets by the member bank from an affiliate if the member bank assumes any liabilities of the affiliate or pays any other form of consideration in the transaction.” For purposes of Regulation O, the proposal would use the term “insured depository institution” in place of “member bank” and the term “insider” in the place of “affiliate.” General alignment with the Regulation W definition in this manner would ensure consistent treatment of these concepts in the Regulation W and Regulation O contexts.

#### **G. Modernizing Definition of “Executive Officer”**

Regulation O defines “executive officer,” in part, by providing a list of titles that, if held by a person, would presumptively render them an “executive officer.”<sup>99</sup> The proposed rule would revise this list to remove “every vice president,” “the cashier,” and “the secretary.” Accordingly, persons with these titles would no longer be presumed to be executive officers for purposes of Regulation O.<sup>100</sup> The proposed rule also would add to the list of titles the chief executive officer, chief financial officer, chief lending officer, and chief investment officer.

These changes would modernize this list, which has remained essentially unchanged since 1935.<sup>101</sup> Banking practices, including the responsibilities of persons with certain titles,

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<sup>99</sup> 12 CFR 215.2(e)(1) (“The chairman of the of the board, the president, every vice president, the cashier, the secretary, and the treasurer of a company or bank are considered executive officers. . .”).

<sup>100</sup> These persons could nevertheless be “executive officers” in practice because Regulation O defines the term to include any “person who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions of the company or bank, whether or not: the officer has an official title; the title designates the officer an assistant; or the officer is serving without salary or other compensation.” 12 CFR 215.2(e)(1).

<sup>101</sup> The list of official titles that would be considered executive officers was first included in the definition of executive officer in 1935. The titles were switched to presumptions in 1938 and the definition was slightly updated in 1968 by among other things removing the title of trust officer. *See* 21 FRB No. 12, 854 (Dec. 1935); 25 FRB p. 636 (1939); 33 FR 2837 (Feb. 10, 1968).

have changed since that time. For example, the title of vice president has become widely used, particularly at large banking organizations, to cover a range of officials with limited policymaking responsibilities.<sup>102</sup> Similarly, the scope and use of the titles of the secretary and the cashier have changed significantly over time, and no longer reliably connote an individual who participates in major policymaking functions of a bank. For example, the role of a board secretary typically involves ministerial functions such as maintaining minutes from meetings and certifying passed resolutions. These functions do not constitute participation in major policymaking decisions of a bank. The titles that would be added to the proposed rule identify persons who typically participate in the policymaking decisions of a company.

These revisions should reduce regulatory burden by decreasing the number of individuals covered by the title presumption. Currently, a bank may overcome this presumption if the bank board adopts a resolution meeting certain requirements set forth in Regulation O.<sup>103</sup> The proposed rule would negate the need to complete this exercise for persons no longer included in the list. Although the proposed rule would add titles that are presumed to be executive officers, persons with these titles likely already are treated as executive officers under the existing standard and requirement.

The proposed rule otherwise would not change the definition, including the functional analysis portion of the definition specifying that anyone who in practice participates in major policymaking functions of the bank is an executive officer. Accordingly, a person could be an “executive officer” regardless of title if the nature of the person’s duties and role concern major

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<sup>102</sup> The Board previously highlighted this trend by acknowledging that resolutions to exclude officers from participation in major policymaking functions might be particularly appropriate for the many vice presidents of large banks. 33 FR 2837 (Feb. 10, 1968).

<sup>103</sup> 12 CFR 215.2(e)(1).

policymaking functions. A person also could be an “executive officer” regardless of whether a bank has adopted a resolution excluding the person from major policymaking functions if the person *in fact* participates in major policymaking functions of the bank or other company.

*Question 51: Is elimination of the title of the cashier and the secretary appropriate? Are there any other titles that are outdated which should be removed or revised?*

*Question 52: Is elimination of the title of vice president appropriate? Should senior vice president or other similar title be added?*

*Question 53: Should any other titles be included? For example, should additional or all C-suite officers be presumed to be “executive officers?”*

*Question 54: What would be the advantages or disadvantages of aligning the scope of titles that are presumed to be executive officers with definitions of “executive officer” in other Board regulations, including, for example, the definition in the Board’s capital rule<sup>104</sup> or the definition included in the proposed rule on incentive-based compensation arrangements?<sup>105</sup> How might it differ from this proposal?*

*Question 55: What would be the advantages or disadvantages of aligning the scope of titles that are presumed to be executive officers with definition of “senior executive officer” in section 914 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)? How might it differ from this proposal? In particular, how should the Board consider Congress’s use of term “senior executive officer” in FIRREA versus “executive officer” in sections 22(g) and 22(h), as well as the statutory definition of “executive officer” in section 22(h)?<sup>106</sup>*

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<sup>104</sup> 12 CFR 217.2.

<sup>105</sup> 81 FR 37670, 37808 (June 10, 2016) (proposed to be codified at 12 CFR 236.2(gg)).

<sup>106</sup> 12 U.S.C. 375b(9)(C).

*Question 56: Do any other terms need to be clarified (for example “authority to participate,” “other than in the capacity of a director”). If so, how?*

#### **H. Lending Limit and Collateralization Requirements for Undrawn Lines of Credit**

The proposed rule would modify the collateralization requirements applicable to the undrawn portion of a line of credit. Lines of credit are extensions of credit subject to Regulation O and, thus, the entire amount (that is both the drawn and undrawn portions) of a line of credit counts towards the individual lending limit in section 215.4(c) of Regulation O.<sup>107</sup> When a bank grants a line of credit to an insider in an amount that, together with all extensions of credit to the insider, amounts to more than 15 percent of the bank’s unimpaired capital and unimpaired surplus, Regulation O requires the bank to (i) count the entire amount of the line of credit when determining the amount of collateral that the insider must provide; and (ii) obtain collateral for the entire amount of all extensions of credit to the insider in excess of 15 percent, including undrawn portions of the line of credit.

For example, suppose a bank grants a line of credit (and no other extensions of credit) to an insider equal to 20 percent of the bank’s unimpaired capital and unimpaired surplus. Regulation O would require the bank to collect qualifying collateral from the insider equal to 5 percent of the face amount of the line of credit, immediately upon granting the line of credit.<sup>108</sup> This is true regardless of whether the insider draws on the line of credit.

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<sup>107</sup> 12 CFR 215.4(c). The entire amount of a line of credit also counts against the aggregate lending limit. *Id.* 215.4(d).

<sup>108</sup> The lending limit for an insider equals 15 percent of a bank’s unimpaired capital and unimpaired surplus, in the case of uncollateralized extensions of credit. The limit can be as high as 25 percent of the bank’s unimpaired capital and unimpaired surplus, but only if the insider provides collateral for any amount of an extension of credit above 15 percent. 12 CFR 215.2(i). Accordingly, in the example cited here, the insider must collateralize  $20 - 15 = 5$  percent.

The proposed rule would provide a new exception to this requirement. Specifically, the proposed rule would not require a bank to collect collateral from an insider for the unused portion of a line of credit, if the bank does not have any legal obligation to advance funds under the line of credit until the insider has posted the required collateral. Under this condition, securing the unused portion of a line of credit would be unnecessary for the protection of the bank because the insider would be unable to require the bank to advance additional funds without posting the additional collateral required by section 22(h). This treatment also would be consistent with similar treatment provided for the unused portion of certain extensions of credit made by a bank to an affiliate in Regulation W.<sup>109</sup> The unused portion of a line of credit would continue to count towards the 15 percent limit for unsecured extensions of credit and the 25 percent limit for all extensions of credit in the proposed rule. A bank could not advance funds under a line of credit until it collects any collateral required by the proposed rule.

For example, suppose the aggregate amount of extensions of credit granted by a bank to an insider amounts to 15 percent of the bank's unimpaired capital and unimpaired surplus, and that none of these extensions of credit are a line of credit. Suppose further that the bank then grants a line of credit to the same insider equal to 10 percent of the bank's unimpaired capital and unimpaired surplus. So long as the line of credit remains undrawn and the bank does not have any legal obligation to advance additional funds under the line of credit until the insider has posted the required collateral, the proposed rule would not require the bank to collect collateral from the insider until the insider draws on the line of credit. However, the insider would be required to provide qualifying collateral for any drawn amount. Furthermore, the bank would be unable to make an additional extension of credit to the insider because the amount of extensions

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<sup>109</sup> See 12 CFR 223.14(f)(2).

of credit to the insider, including the face amount of the line of credit, meet the limit set forth in section 22(h), or 25 percent of the bank's unimpaired capital and unimpaired surplus.

This exception would represent a change from the current requirement in Regulation O that the entire amount of a line of credit, whether drawn or undrawn, be collateralized. This is because the existing requirement may be unduly burdensome and unnecessary to protect the bank as it requires collateralization of a credit that has not been extended. The proposed exception would provide equivalent protection to a bank because a bank would not provide proceeds of a line of credit until the bank has collateral. Accordingly, the bank would not risk advancing funds to an insider on an uncollateralized basis. The proposed new approach to collateralization of lines of credit is appropriate because it would reduce burden and preserve the protection that Regulation O currently affords a bank.

*Question 57: What are the advantages and disadvantages of this proposed treatment for collateralization of the unused portion of lines of credit?*

## **J. Harmonizing Certain Definitions in Regulation O with Definitions in the Board's Regulation Y**

The proposed rule would define two new terms that Regulation O uses but does not define. Specifically, the proposed rule would define the terms "acting in concert" and "class of voting securities." Regulation O uses both terms in the definitions of "control" and "principal shareholder."<sup>110</sup> The proposed rule would define these terms by using definitions of these terms from Regulation Y.<sup>111</sup> This change would provide a clearer standard for when two parties should

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<sup>110</sup> See 12 CFR 215.2(c) and (m)(1).

<sup>111</sup> This approach is consistent with the legislative history of the underlying terms. Congress added the terms acting in concert and class of voting securities to both section 22(h) and the Change in Bank Control Act at the same time as part of the adoption of the FIRA in 1978. See P.L. 95-630, 92 Stat. 3641.

aggregate their voting securities for purposes of determining control and principal shareholder status.

The proposed rule would define “acting in concert” to be the same as the definition in section 225.41(b)(2) of Regulation Y, which is used for the portion of Regulation Y implementing the Change in Bank Control Act.<sup>112</sup> The term also would incorporate the rebuttable presumptions of concerted action in section 225.41(d) of Regulation Y.<sup>113</sup> One of the presumptions concerns “immediate family”, which is defined differently between Regulation O and Regulation Y.<sup>114</sup> The proposed rule would rely on the existing definition of “immediate family” set forth in Regulation O. Accordingly, when determining for purposes of Regulation O the scope of family members that are presumed to be acting in concert pursuant to section 225.41(d)(2) of Regulation Y, a person should look to the definition of “immediate family” in section 215.2 of Regulation O.

The proposed rule also would define “class of voting securities” by cross referencing to the definition of the same term in section 225.2 of Regulation Y.<sup>115</sup>

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<sup>112</sup> 12 CFR 225.41(b)(2) (“Acting in concert includes knowing participation in a joint activity or parallel action towards a common goal of acquiring control of a state member bank or bank holding company whether or not pursuant to an express agreement.”).

<sup>113</sup> 12 CFR 225.41(d). As noted, the proposed rule, however, would not revise the definition of “immediate family.” 12 CFR 215.2(g).

<sup>114</sup> Compare 12 CFR 215.2(g) with 12 CFR 225.41(b)(3).

<sup>115</sup> 12 CFR 225.2(q)(1)-(3). The text of these paragraphs is as follows:

“(1) Voting securities means shares of common or preferred stock, general or limited partnership shares or interests, or similar interests if the shares or interest, by statute, charter, or in any manner, entitle the holder:

(i) To vote for or to select directors, trustees, or partners (or persons exercising similar functions of the issuing company); or

(ii) To vote on or to direct the conduct of the operations or other significant policies of the issuing company.

(2) Nonvoting shares. Preferred shares, limited partnership shares or interests, or similar interests are not voting securities if:

Historically, Board staff often has consulted the definition of “acting in concert” and the rebuttable presumptions for acting in concert in Regulation Y to determine when two parties could be considered to be acting through or in concert with one another for purposes of Regulation O.<sup>116</sup> Similarly, Board staff has used the definitions for “voting securities,” “nonvoting securities,” and “class of voting securities” in Regulation Y to evaluate the term “class of voting securities” in Regulation O. The proposed rule would reflect this approach, which would increase transparency by clarifying what “acting in concert” and “class of voting securities” mean for purposes of Regulation O. Using definitions already in Regulation Y also would simplify compliance with the proposed rule, given existing familiarity with the definitions in Regulation Y.

*Question 58: What are the advantages and disadvantages of using of the definition and presumptions for acting in concert in Regulation Y? Does adopting these definitions and presumptions present any challenges? If so, how should they be addressed?*

*Question 59: Should the definition of immediate family in Regulation O be harmonized with the Regulation Y definition?<sup>117</sup>*

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(i) Any voting rights associated with the shares or interest are limited solely to the type customarily provided by statute with regard to matters that would significantly and adversely affect the rights or preference of the security or other interest, such as the issuance of additional amounts or classes of senior securities, the modification of the terms of the security or interest, the dissolution of the issuing company, or the payment of dividends by the issuing company when preferred dividends are in arrears;

(ii) The shares or interest represent an essentially passive investment or financing device and do not otherwise provide the holder with control over the issuing company; and

(iii) The shares or interest do not entitle the holder, by statute, charter, or in any manner, to select or to vote for the selection of directors, trustees, or partners (or persons exercising similar functions) of the issuing company.

(3) Class of voting shares. Shares of stock issued by a single issuer are deemed to be the same class of voting shares, regardless of differences in dividend rights or liquidation preference, if the shares are voted together as a single class on all matters for which the shares have voting rights other than matters described in paragraph (o)(2)(i) of this section that affect solely the rights or preferences of the shares.”

<sup>116</sup> See 12 CFR 225.41(d).

<sup>117</sup> See 12 CFR 225.41(b)(3).

*Question 60: What are the advantages and disadvantages of using the Regulation Y definitions for class of voting securities? Does adopting the Regulation Y definitions present any challenges? If so, how should they be addressed?*

*Question 61: Should the definition of nonvoting shares in Regulation Y be included in Regulation O?*

*Question 62: Are there any other terms in Regulation O that need greater clarification? If so, would it be helpful to harmonize such terms with similar terms in Regulation Y?*

#### **K. Residence Exception to Limits for Extensions of Credit to Executive Officers of a Bank**

Section 22(g) and section 215.5 of Regulation O generally prohibit a bank from making an extension of credit to an executive officer, with four exceptions.<sup>118</sup> One exception is for extensions of credit secured by a first lien on a single “residence” that is “owned” by the executive officer (home mortgage exception).<sup>119</sup> The proposed rule would revise the home mortgage exception to better ensure that the exception is used for a “residence” as required by the statute. The proposed revisions would not substantively alter the Board’s current interpretation of the home mortgage exception, but rather incorporate in a transparent manner how the home mortgage exception has been interpreted and implemented.<sup>120</sup> The proposed rule also would make a technical revision to make more explicit that the exception is available only for one residence of the executive officer.

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<sup>118</sup> See 12 U.S.C. 375a; 12 CFR 215.5(a).

<sup>119</sup> See 12 U.S.C. 375a(2); 12 CFR 215.5(c)(2).

<sup>120</sup> See, e.g., 57 FR 22417, 22423 (May 28, 1992) (dropping term primary from residence exception). A second home, for example used for vacation, can count as a residence for purposes of section 215.5(c)(2) of Regulation O so long as the executive officer annually resides at the home for some period of time during the year.

*1. Whether a property is a “residence”*

The proposed rule would add two conditions for the home mortgage exception that would further ensure the exception is used only for a residence.<sup>121</sup> First, an executive officer would be required to live in the property for at least three months each year. The legislative history for section 22(g) indicates that Congress intended the home mortgage exception to be used for an executive officer’s “home.”<sup>122</sup> An officer must reside at a property for some period of time for it to qualify as a home. Read most permissively, a residence that is a home could mean a property that is distinguishable from a property used as a temporary shelter, like a hotel or other accommodation. A minimum period of one month each year could establish that an executive officer uses the property differently than a temporary shelter. Read more conservatively, a “residence” that is a home could mean the property where a person lives for a majority of the year, or at least six months.

The proposed rule would require that an executive officer live in a property for three months each year to use the home mortgage exception. This number falls in the middle of the range of reasonable values discussed above. The proposed rule would not use a lower value within this range in recognition of the apparent interest of Congress that the exception be used for a home, rather than a property that may be only an occasional place where an executive officer stays. The proposed rule would not use the highest value in the range to prevent the home mortgage exception from being unduly restrictive. This value also would be consistent

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<sup>121</sup> See 12 CFR 215.5(c)(2)(i)-(ii).

<sup>122</sup> See e.g., S. Rep. No. 165 at 1 (Apr. 12, 1967) (discussing an exception to the lending restrictions for executive officers for “a first mortgage loan on a *home*”) (emphasis added).

with Board staff's interpretations of the home mortgage exception that it is available for a second home, but not a vacation property.<sup>123</sup>

An executive officer would not be required to live at the property for the three-month period consecutively. For example, an executive officer could satisfy the requirement by spending two months at the property and another month at a later time, provided all three months occur within the same 12-month period.<sup>124</sup>

Second, the proposed rule would require that the property not be a property for investment purposes, including renting or leasing out all, or a portion, of the property for income. This condition would prevent an insider from using the home mortgage exception for purposes not contemplated by section 22(g), which limits the exception to mortgage loans on properties used by an insider as a residence only.<sup>125</sup>

*Question 63: What period of time living in a property is sufficient to indicate that the property is a "residence" of a person? What period between one and six months should be required to qualify for the home mortgage exception?*

*Question 64: What would be the advantages or disadvantages of interpreting "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?*

*Question 65: What would be the advantages or disadvantages of interpreting residence to mean a place where an executive officer can be found for more than a de minimis amount of time*

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<sup>123</sup> Letter from Elisabeth L. Carmichael to Robert L. Jaynes (Oct. 11, 1967) ("The staff of the Board considers this authority to be limited to a loan to provide housing for an executive officer, and would not include a loan secured by a lien on a vacation home"); Letter from J. Virgil Mattingly to Charles R. Haley (Mar. 30, 1995).

<sup>124</sup> The first 12-month period would begin when a bank extends credit pursuant to the home mortgage exception.

<sup>125</sup> 12 U.S.C. 375a(2)(A).

*each year, but a small fraction of the year? For example, could a residence include a place that a person lives for only one month each year?*

*Question 66: What would be the advantages and disadvantages to requiring an executive officer to live in a residence for three months of every calendar year, rather than three months during a rolling 12-month period?*

*Question 67: Are there other ways to determine whether a property is a residence, for example, reliance on tax rules? If so, what are the advantages and disadvantages of such an approach?*

## *2. Mortgage exception for executive officers available only for one dwelling*

Section 22(g) and section 215.5 of Regulation O state that the home mortgage exception is available for a residence. Board staff has received a significant number of inquiries from banks and their executive officers about whether the bank may make extensions of credit pursuant to the home mortgage exception to the same executive officer for two different properties. Standing alone, section 22(g)(2)(A) is ambiguous because it refers to “a dwelling,” which could mean any dwelling. But section 22(g)(2)(B) resolves this ambiguity by limiting the exception to a single mortgage loan to an executive officer.<sup>126</sup> To resolve any residual ambiguity, the proposed rule would replace “a residence” in the home mortgage exception with “a single residence.”<sup>127</sup> The Board notes that the single residence restriction applies only to a

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<sup>126</sup> 12 U.S.C. 375a(2) (“A member bank may make a loan to any executive officer of the bank if . . . it is secured by a first lien on a dwelling . . . used by him as his residence [and] “no other loan by the bank to the officer under authority of this paragraph is outstanding.”) (emphasis added). This reading is also supported by legislative history suggesting that the provision was not meant to cover loans for multiple properties. H.R. Rep 90-262, 90<sup>th</sup> Cong., 1<sup>st</sup> Sess. 1967 (noting that a bank officer could not borrow, for example, \$18,000 from his bank for a year-round residence and another \$12,000 for a vacation residence.”).

<sup>127</sup> While section 22(g) and Regulation O limit, and the proposed rule would limit, the home mortgage exception to a single property, a person that serves as an executive officer at two different banks may receive one extension of

mortgage loan made to an executive officer. The single residence restriction does not apply to a mortgage loan made to a director or principal shareholder, or to a related interest of a director, principal shareholder, or executive officer.

## **L. Regulation O Requirements for Extensions of Credit to Insiders of Correspondent and Respondent Banks**

### *1. The requirements in 12 U.S.C. 1972*

The proposed rule would incorporate existing requirements for restrictions on extensions of credit from banks to the insiders<sup>128</sup> of correspondent banks and from correspondent banks to insiders of their respondent banks set forth in section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (BHC Act Amendments).<sup>129</sup> The correspondent lending restrictions generally require that extensions of credit by a bank to the insider of its respondent bank or correspondent bank (i) be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons; and (ii) not involve more than the normal risk of repayment or present other unfavorable features.<sup>130</sup> The

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credit from each bank pursuant to the home mortgage exception. The extensions of credit must otherwise comply with Regulation O and the conditions of the home mortgage exception. Generally, if two banks share an executive officer and contemplate merging, neither bank should make an extension of credit on the basis of the home mortgage exception if one of the banks already has made an extension of credit in reliance on the exception.

<sup>128</sup> The proposed rule would define “insiders” for purposes of the correspondent lending restrictions using the same definition of “director”, “executive officer”, and “related interest” as apply for the rest of Regulation O. However, the “principal shareholder” definition would not be included because the statute does not use the term “principal shareholder” and instead applies the restrictions to “any person who directly or indirectly or acting through or in concert with one or more persons owns, controls, or has the power to vote more than 10 per centum of any class of voting securities of” a bank. 12 U.S.C. 1972(2)(A)-(D).

<sup>129</sup> 12 U.S.C. 1972(2). These restrictions apply to banks that maintain a correspondent account for another bank and for banks that open and maintain a correspondent account at another bank. Section 106(b)(2) of the BHC Act Amendments applies by its terms to insured banks, mutual savings banks, savings banks, and savings associations. These restrictions have been interpreted to also apply to extensions of credit by subsidiaries of these entities. *See* Letter from J. Virgil Mattingly to James M. Mataya (Sept. 26, 1997).

<sup>130</sup> A bank may select any reasonably prudent method to ensure compliance with these restrictions. For example, a bank may establish policies and procedures to request additional information about a borrower’s relationships with correspondent banks when the bank determines that a prospective extension of credit to the borrower will be on preferential terms. 72 FR 30470, 30472 (June 1, 2007).

restrictions also prohibit a bank from opening a correspondent account at a second bank if either bank has any outstanding extensions of credit to insiders of the other that do not meet these same qualitative requirements. Congress adopted these restrictions in response to banks providing favorable loans to their insiders by allowing their correspondent bank to make the loan and taking the respondent bank's correspondent account as collateral.<sup>131</sup>

The proposed rule is intended to codify the correspondent lending requirements, including their scope of application, as set forth in the statute. Incorporating these restrictions in the proposed rule should benefit banks by consolidating requirements related to insider lending into one regulation.

For purposes of the requirements for extensions of credit involving correspondent banks, the proposed rule also would define “bank” and “correspondent account.” Consistent with section 106(b) of the BHC Act Amendments, the proposed rule would define “bank” to have the meaning given in the BHC Act and also to include a mutual savings bank, savings bank, and savings association, as each are defined in 12 U.S.C. 1813.<sup>132</sup> The term “bank” also would include a subsidiary of any of these entities, consistent with the definition of “member bank” applicable to other parts of Regulation O and with Board staff's past interpretations of the definition of “bank” in section 106.<sup>133</sup> The proposed rule would define “correspondent account” to mean an account maintained by a bank with another bank for the deposit or placement of funds. Consistent with the intent of Congress to prevent banks from using their correspondent accounts to circumvent the insider lending restrictions, this broad definition would capture most,

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<sup>131</sup> See e.g., H. Rep. No. 95-1383 at 13 (July 20, 1978).

<sup>132</sup> 12 U.S.C. 1972(2)(G)(i).

<sup>133</sup> See e.g., Letter from J. Virgil Mattingly to James M. Mataya (Sept. 26, 1997).

if not all, accounts at a correspondent bank that banks could use to enhance an extension of credit made by the correspondent bank.

The proposed rule also would eliminate paragraph (b)(4) of section 215.1 of Regulation O. This paragraph, which states that banks are subject to the requirements of 12 U.S.C. 1972(2) would no longer be necessary in light of the proposed incorporation of the correspondent lending restrictions into Regulation O.

## *2. Recordkeeping requirements for correspondent lending restrictions*

Because the correspondent lending restrictions would be codified in Regulation O, the Board is proposing to specify the applicable records maintenance expectations, as it does for other requirements in the regulation.<sup>134</sup> However, these relationships are fundamentally different than those addressed elsewhere in Regulation O, as there is an additional layer of separation between the lending bank and the insider because the relevant borrowers are insiders of an unaffiliated third-party. Taking this into consideration, the proposed rule would set forth two specific methods for banks to adequately maintain records for the correspondent lending restrictions. First, a bank could send an annual survey to its correspondent and respondent banks asking for a list of the relevant insiders of such banks (the “survey method”). Second, a bank could require, as part of all extensions of credit that it makes, that the borrower indicate whether the borrower is an insider of the bank’s respondent or correspondent bank (the “borrower inquiry method”). These methods are similar to the methods set forth in Regulation O for a bank to maintain records to ensure compliance with Regulation O with regard to loans to insiders of the bank’s affiliates.<sup>135</sup> As discussed in section IV.G of this **SUPPLEMENTARY**

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<sup>134</sup> See 12 CFR 215.8(a).

<sup>135</sup> See 12 CFR 215.8(c)(1) and (2).

**INFORMATION**, a bank that uses either the survey method or borrower inquiry method will have discharged its responsibility with respect to the recordkeeping requirements for the correspondent lending restrictions.

### *3. Bankers' Banks*

The correspondent lending restrictions apply by statute to bankers' banks (banks established by other financial institutions to provide services to the financial institutions that own them). Bankers' banks often maintain correspondent accounts for their bank-customers and make loans to the holding companies of their respondent banks. These holding companies would be treated as insiders of the respondent banks,<sup>136</sup> so loans by a bankers' bank to the holding company of a respondent bank are subject to the correspondent lending restrictions. Because bankers' banks generally serve only other financial institutions, a significant portion of their lending activity can be subject to the correspondent lending restrictions. This has led to questions about how a bankers' bank would comply with the requirement that loans subject to the restriction be on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons.

To comply with this requirement, a bankers' bank would have to demonstrate that the terms of a loan are substantially comparable to terms of loans it already has made to borrowers who are not subject to the correspondent lending requirement. It would not require identical terms and would not require all transactions to have the same terms. For bankers' banks, loans to insured depository institutions likely could be compared to loans to holding companies to

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<sup>136</sup> Holding companies generally are treated as insiders for purposes of the correspondent lending restrictions. As discussed in section IV.D of this **SUPPLEMENTARY INFORMATION**, holding companies are not treated as insiders for purposes of the rest of Regulation O.

determine compliance with this standard.<sup>137</sup> If a loan by a bankers' bank to the holding company of a respondent bank is on substantially the same terms, including interest rate and collateral, as a loan by the bankers' bank to similarly situated insured depository institutions and meets the other conditions of the correspondent lending restrictions, the loan generally would be compliant with these restrictions.

As reflected in the following questions, the Board is seeking input on the value of incorporating the restrictions of 12 U.S.C. 1972(2) into Regulation O. In particular, the Board is interested in feedback on the impact of the associated recordkeeping requirements on community banks.

*Question 68: What are the advantages and disadvantages to incorporating the requirements of 12 U.S.C. 1972(2) into Regulation O?*

*Question 69: What are the advantages and disadvantages of the proposed definitions of "bank" and "correspondent account?" Should the definition of "correspondent account" be limited to accounts used for certain purposes, like payment or other transaction services with a third-party? Should the definition align with the definition used for anti-money laundering and anti-terrorist financing purposes?*

*Question 70: How do "bankers' banks" currently manage the correspondent bank requirements in 12 U.S.C. 1972? What are the potential risks and benefits of not applying these requirements to a loan by a correspondent bank to a company that owns the respondent bank, including any parent bank holding company?*

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<sup>137</sup> A loan to an insured depository institution likely would not be subject to the correspondent lending restrictions because the institution likely is not an insider of a bank. The bank also would not be a "related interest" of an insider of the bank because a related interest must be a "company" and the correspondent lending restrictions exclude an insured depository institution from the definition of "company." See 12 U.S.C. 1972(2)(G)(ii) and (iii).

*Question 71: What other methods could a bank use to identify the insiders of its correspondent and respondent banks?*

*Question 72: What would be the advantages and disadvantages of exempting certain institutions from the recordkeeping requirements for the correspondent lending restrictions? At what point might the benefits of uniform recordkeeping requirements be outweighed by the burden of having to comply with those specific requirements?*

## **M. Simplification of Certain Disclosure and Reporting Requirements**

Regulation O requires a bank, in response to a written request from the public, to provide the names of each executive officer and principal shareholder that had extensions of credit outstanding from the bank, including extensions of credit made to the related interests of the executive officer or principal shareholder, if the total amount of such extensions of credit were a certain size as of the end of the latest previous quarter.<sup>138</sup> This requirement includes separate definitions for “principal shareholder” and “related interest.” The proposed rule would eliminate these separate definitions so that the requirement would instead rely on the definitions used in the rule’s main definition section.

### *1. Principal shareholder*

Compared to the definition of “principal shareholder” applicable to most of Regulation O, the definition in the disclosure requirement notably does not exclude a company of which the bank is a subsidiary.<sup>139</sup> This appears to be because the Board adopted the disclosure requirement when the statutory source of authority for the requirement did not use the term “principal shareholder” from section 22(h) or otherwise provide an exclusion for a bank’s holding

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<sup>138</sup> 12 CFR 215.9. As noted above, the proposed rule would raise the threshold from \$500,000 to \$2,000,000.

<sup>139</sup> Compare 12 CFR 215.2(m) with 12 CFR 215.9(a)(1).

company.<sup>140</sup> Congress later amended this authority to include the term “principal shareholder” and to permit the Federal banking agencies to define terms for reporting and public disclosure of information by a bank concerning extensions of credit to executive officers and principal shareholders of a bank.<sup>141</sup>

The definition of “principal shareholder” in the disclosure requirement also provides an explicit exception for foreign banks. When it adopted this exception, the Board stated that it did not believe that “normal and routine interbank transactions were the type of transactions for which the reporting requirements were designed or which they can adequately accommodate.”<sup>142</sup> At that time, the definition of “principal shareholder” in the disclosure requirement also was used for other more burdensome reporting requirements that no longer are required.<sup>143</sup>

The proposed rule would eliminate the special definition of “principal shareholder” in the disclosure requirement. This change would permit banks to exclude their holding companies from a disclosure mandated by the disclosure requirement. The benefit of simplifying the regulation by eliminating the special definition outweighs the benefit to the public of receiving confirmation that an extension of credit exists between a bank and its holding company because the disclosure requirement may only be used rarely. Furthermore, extensions of credit between a bank and its holding company are sufficiently common that disclosing the existence of these extensions likely does not reveal new information in most circumstances.

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<sup>140</sup> See FIRA, Pub. L. No. 95-630, § 901, 92 Stat. 3641, 3693-94 (1978).

<sup>141</sup> See Garn-St. Germain Depository Institutions Act of 1982, Pub. L. 97-320, §429, 96 Stat 1469, 1527 (1982).

<sup>142</sup> Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks, 44 FR 67973, 67976 (Nov. 28, 1979).

<sup>143</sup> See 12 CFR 215.10(b) (1980).

The change also would eliminate the exception from disclosure requirement for foreign banks. The Board adopted the exception in the definition when the disclosure and reporting requirements were substantially more complicated and burdensome. Now that the requirements are limited to simple disclosure of the existence of extensions of credit by a bank to a foreign bank that is a principal shareholder, it no longer would be unduly burdensome to scope foreign banks into the requirement. In addition, a foreign bank that is the disclosing bank's holding company would not be subject to the requirement, as described above.

## *2. Related interest*

The Board excluded foreign banks from the special definition of "related interest" in the disclosure requirement for the same reason that foreign banks were excluded from the definition of "principal shareholder" in the requirement. That is, the Board was concerned that including transactions between a bank and any affiliated foreign bank in the disclosure requirements would be unduly burdensome.<sup>144</sup> Including foreign banks in the definition of "related interest" would no longer create undue hardship on banks because the only requirement that remains is the relatively simple disclosure requirement, not the complex reporting requirements that were required by Regulation O in 1980.

*Question 73: What are the advantages and disadvantages of these proposed simplifications?*

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<sup>144</sup> Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks, 44 FR 67973, 67977 (Nov. 28, 1979).

## **IV. Proposed Codifications of the Board’s Application of Regulation O**

### **A. Application of Regulation O to Extensions of Credit Made to a Noninsider that Later Becomes an Insider**

The proposed rule would specify when the prohibitions in the proposed rule apply to extensions of credit made to a person that becomes an insider after the bank made the extension of credit (transition loans). Section 215.3(d) of Regulation O states that an extension of credit is considered to have been made “at the time the bank enters into a binding commitment to make the extension of credit.”<sup>145</sup> Board staff has received a significant number of questions related to this provision, particularly how it applies to transition loans. These revisions would codify existing interpretations of Regulation O.<sup>146</sup>

#### *1. Transition loan treatment*

The proposed rule would specify that (i) transition loans need not conform to Regulation O until such extensions are renewed, revised, or extended, at which time the extensions of credit would be treated as a new extension of credit, and that (ii) the amount of these transition loans must be included in the calculation of the individual and aggregate lending limits as soon as the borrower becomes an insider. For example, a person that is not an insider of a bank would not be required to modify or unwind loans from the bank if the person later becomes an insider and the loan does not meet a requirement in Regulation O. However, the bank would be required to count the amount of the loans towards all applicable quantitative limits in the rule, including, for example, the limit on extensions of credit to a single insider and the insider’s related interests. If

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<sup>145</sup> 12 CFR 215.3(d).

<sup>146</sup> See e.g., Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates, 62 FR 13294, 13296 fn. 11 (Mar. 20, 1997); FRRS 3-1036 (citing 1936 Fed. Res. Bull. 121).

this amount, together with all other extensions of credit to the person, exceeds any quantitative limit in the rule, the bank would not be required to unwind the loans, but the insider would not be able to receive an additional extension of credit subject to that limit.

This treatment strikes a balance between not imposing undue burden on persons who become insiders and ensuring that a bank has limited credit exposure to its insiders. On the one hand, requiring insiders and banks to modify transition loans could be overly burdensome because it would require an insider and a bank to renegotiate the terms of any outstanding extensions of credit made to the insider at the time that the person becomes an insider. This burden could discourage qualified persons who have preexisting lending relationships with a bank from becoming an insider of the bank. This problem could be particularly acute in small communities, where local banks often provide credit to a large portion of the local business community, including many persons that could be helpful as directors or executive officers. On the other hand, one purpose of the insider lending restrictions is to limit a bank's credit exposure to its insiders. The proposed rule would accommodate both of these concerns by generally not requiring an insider or a bank to modify transition loans, and also by prohibiting the bank from extending additional credit to the insider if the amount of transition loans to the insider exceeds the individual or aggregate lending limits.

To prevent evasion of the proposed rule, this treatment would not be available for transition loans made by a bank in contemplation of a borrower becoming an insider.<sup>147</sup> Such extensions of credit would undermine the purpose of sections 22(h) and (g) and the proposed rule, because a person whose extensions of credit will become or could become subject to

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<sup>147</sup> The Board has authority to write rules to prevent the evasion of sections 22(h) and 22(g). 12 U.S.C. 375a(8) and 375b(10).

Regulation O may be able to exert undue influence on bank staff. For example, a loan officer may be inclined to offer favorable terms to a person that will become the loan officer's boss, or a director or significant shareholder of the bank.

*Question 74: What are the advantages and disadvantages of the proposed application of requirements in the proposed rule to transition loans?*

*Question 75: What would be the advantages and disadvantages of providing a transition treatment for the requirements of Regulation O that apply only to certain types of insiders? For example, should loans made to an insider that is not an executive officer be immediately subject to the restrictions for executive officers as soon as the insider becomes an executive officer?*

*Question 76: What would be the advantages and disadvantages of requiring a bank to maintain records with respect to transition loans before they lose their transition loan status?*

## *2. Lines of credit*

The proposed rule also would specify that transition loans that are lines of credit to an insider would be subject to the treatment set forth above, but for only 14 months after the date the borrower becomes an insider. At that time, the line of credit would need to comply with all requirements of the proposed rule.

In practice, this requirement already exists for most lines of credit and the proposed rule simply would make this result more explicit. Section 215.4(b)(3) of Regulation O requires prior approval for advances made pursuant to a line of credit, unless the line of credit has been approved by a bank's board of directors in the 14 months preceding the advance. In other words, an insider readily may draw on a line of credit only if the bank's board of directors approves the line of credit every 14 months. In each case, such approval would constitute a new extension of

credit.<sup>148</sup> Accordingly, if a transition loan is a line of credit, the bank's board of directors generally must approve the line of credit within 14 months of the borrower becoming an insider, at which time the transition loan becomes a new extension of credit.

This treatment for lines of credit also addresses unique characteristics posed by lines of credit. Unlike other extensions of credit, lines of credit sometimes do not mature. Instead, many lines of credit persist until the lender or borrower terminates the line. This would create the possibility that a line of credit could remain a transition loan that would not need to conform to the requirements of the proposed rule in perpetuity. This result would be inconsistent with the purposes that the insider lending restrictions seek to address.

The proposed rule would apply this treatment to all transition loans that are lines of credit, not just the larger lines of credit which are subject to the prior approval requirement in section 215.4(b) of Regulation O. As noted above, without this requirement, an insider could have a line of credit that does not conform to the proposed rule in perpetuity. For example, such a line of credit would not be subject to the requirement that an extension of credit to an insider not be on favorable terms, present more than the normal risk of repayment, or have other unfavorable features. The proposed rule would use the 14-month benchmark to be consistent with the 14-month threshold for lines of credit subject to the prior approval requirement. This consistency should reduce the complexity of the rule and facilitate compliance. Fourteen months also should give a person who becomes an insider sufficient time to work with its bank to modify the line of credit, if necessary, to comply with the proposed rule.

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<sup>148</sup> See 12 CFR 215.3(a) (“[a]n extension of credit is a making or *renewal* . . .”) (emphasis added).

*Question 77: What are the advantages and disadvantages of requiring a transition loan that is a line of credit to comply with the requirements in the proposed rule no later than 14 months after a bank extends the line of credit?*

*Question 78: Should the proposed treatment for transition loans end no later than 14 months for extensions of credit other than lines of credit?*

*Question 79: What are the advantages or disadvantages of the 14 month reapproval for a line of credit (section 215.4(b)(3) of Regulation O)? Should it be replaced with an alternative process that is less burdensome, such as a notification requirement with certain criteria? If so, what criteria might be useful for obtaining the same consideration?*

## **B. Application of Regulation O to Trusts and Estates**

Over the years, the Board has issued interpretations in response to a significant number of inquiries concerning the application of Regulation O to trusts and estates. The proposed rule would codify some of these longstanding interpretations. This section IV.B of this **SUPPLEMENTARY INFORMATION** also restates existing interpretations regarding the current application of Regulation O that would continue to apply after adoption of the proposed rule.

### *1. When a trust is a related interest of an insider*

Section 22(h) and Regulation O explicitly define “company” to include business or other trusts. Accordingly, a trust can be a related interest of an insider, if the insider controls the trust. The proposed rule would set forth two rebuttable presumptions of control for when a person controls a trust.

First, the proposed rule would include a rebuttable presumption that a person controls a trust if the person is a trustee of the trust. This addition would be consistent with the Board’s

2020 revisions to Regulation Y concerning presumptions of control. As part of those revisions, the Board included a rebuttable presumption that one company controls another if the first company enters into any agreement making the first company a trustee of the second.<sup>149</sup> The Board reasoned that trust agreements often grant to trustees the ability to direct or exercise significant influence over the management or operations of a company.<sup>150</sup> This change also would be consistent with the definition of “control” in section 10 of the Home Owners’ Loan Act, which deems a person to control a trust if the person is a trustee of the trust.<sup>151</sup>

This revision to Regulation O would overturn an interpretation that Board staff issued in a 1980 letter stating that “[a]n extension of credit by a [bank] to an estate or trust for which a director of the [bank] is executor or trustee . . . is not considered made directly to the director . . . solely by reason of the director’s status as executor of the estate or trustee of the trust.”<sup>152</sup> Since Board staff issued this specific interpretation, the Board’s thinking about control of a trust has evolved, including with the changes to Regulation Y noted above. For the same reasons discussed in the rulemaking record for those revisions and for the reasons discussed above, the Board believes it is appropriate to presume that a person who is a trustee of a trust controls the trust.

Second, the proposed rule would create a new rebuttable presumption of control that a person that is a settlor, appointer, or beneficiary of a trust controls the trust if the person has the power to (i) remove or replace a trustee of the trust and (ii) limit a trustee’s power to make, sell, change, or exchange any investment or asset of the trust. The ability to remove or replace

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<sup>149</sup> 12 CFR 225.32(b).

<sup>150</sup> See Control and Divestiture Proceedings, 85 FR 12398 (Mar. 2, 2020).

<sup>151</sup> 12 U.S.C. 1467a(a)(2)(C).

<sup>152</sup> FRRS 3-1062.1 (citing the letter from Neal L. Petersen to John P. Amershadian (May 23, 1980)).

trustees enables a person to exert influence over the trustees because a trustee may not act freely out of fear that the person will remove the trustee. The power to limit a trustee's power to make, sell, change, or exchange any investment or asset of the trust also is a significant power because, while it does not enable a person to take an affirmative action with respect to the investments or assets of a trust, it enables the person to prevent the trustee from doing so. This amounts to a power to veto important decisions of the trustee. Taken together, these powers amount to sufficient control for purposes of the insider lending restrictions. A person with these powers that also is an insider of a bank has sufficient control of the trust to raise conflict of interest concerns about the insider attempting to influence the bank to extend credit to the trust.

These presumptions of control would not comprehensively define the scope of circumstances under which a settlor, appointer, or beneficiary would control a trust. Consistent with its past practice, the Board would continue to evaluate the specific facts and circumstances of a case to determine whether a person controls a trust.

*Question 80: What are the advantages and disadvantages of the proposed presumptions of control for when a person controls a trust?*

*Question 81: What would be the advantages and disadvantages of the proposed rule incorporating a portion of or the entire framework for presuming that a person controls a company set forth in the Board's control rule, section 225.32 of Regulation Y?*

*Question 82: Are there other circumstances where a person should be presumed to control a trust?*

## *2. Application of Regulation O to executors of estates*

The proposed rule would presume that a person controls any company or bank that is controlled by an estate for which the person serves as executor. The proposed rule also would

clarify that a person owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a bank or company when an estate for which the person serves as an executor owns, controls, or has the power to vote such shares. These presumptions would codify long-standing application of Regulation O.<sup>153</sup>

Companies controlled by an estate are indirectly controlled by the estate's executor because executors generally have the same authority over such companies as the estate itself. If an estate controls a company and an executor has authority over the estate and the estate's powers, the executor similarly has control over the companies controlled by the estate. For the same reasons, executors of an estate have sufficient control over shares controlled by the estate to also be considered to control the shares. As a result of this clarification, a person would be a principal shareholder of a bank if an estate for which the person serves as executor owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the bank.

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.<sup>154</sup> Accordingly, an estate normally would not meet the definition of "related interest," which includes only certain "companies" and "political or campaign committees."

*Question 83: What are the advantages and disadvantages of treating a company or shares of a company controlled by an estate as being controlled by an executor of the estate?*

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<sup>153</sup> FRRS 3-1062.1 (citing the letter from Neal L. Petersen to John P. Amershadian (May 23, 1980)). Pursuant to the definition of "extension of credit" under Regulation O and the proposed rule, if an insider guarantees a loan or the proceeds of a loan are transferred to the insider, then the loan would be an extension of credit to the insider.

<sup>154</sup> While an estate is not listed in the definition of "company" in Regulation O, 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.

*Question 84: Are there specific circumstances where an executor should not be treated as controlling a company or shares controlled by an estate because, for example, the agreements governing the estate limit the executor's or executors' authority?*

### **C. Application of Additional Restrictions on Loans to Executive Officers to Certain Related Interests of Executive Officers**

In general, the additional restrictions for extensions of credit made to executive officers set forth in section 22(g) and section 215.5 of Regulation O apply to extensions of credit made directly to executive officers and not their related interests. However, to prevent evasions of these requirements, the proposed rule would apply these restrictions to extensions of credit made to the related interest of an executive officer if the related interest is merely the alter ego of the executive officer and has no independent means to repay the extension of credit. Under these circumstances, there is a greater risk that an executive officer is using a related interest to evade the requirements of section 22(g).

Whether a related interest 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. This analysis could consider, among other things, (i) the executive officer's ownership interest and management responsibilities with respect to the related interest, (ii) whether the related interest was created to perpetrate a fraud, (iii) whether the related interest is organized and operated as a mere tool or business conduit for the executive officer, (iv) whether the related interest appears to have been formed to evade legal obligations of the executive officer, (v) the capitalization of the related interest, (vi) the failure of the related interest or its management to

observe corporate formalities, and (vii) the intermingling of funds of the executive officer and the related interest.

Similarly, whether a related interest has independent means to repay the extension of credit would be evaluated by the facts and circumstances of the case and would focus on whether the related interest has sources for funds other than the executive officer.

*Question 85: What are the advantages and disadvantages of treating extensions of credit to certain related interests of an insider as subject to the requirements of section 22(g) as proposed?*

*Question 86: Are general principles of corporate law sufficient to determine when a related interest is an alter ego of an insider? Should other factors be included to ensure that an insider does not use a related interest to evade the requirements of section 22(g)?*

*Question 87: What factors should be used to establish whether a related interest has a means of repayment independent from an insider?*

#### **D. Clarifying the Scope of the Definition of “Principal Shareholder”**

The proposed rule would revise the definition of “principal shareholder” to clarify that a person is not a principal shareholder of a bank *or any affiliates* of the bank if the bank is a subsidiary of such person. This change would mean that a company that controls the bank would not be treated as a principal shareholder of any of the company’s subsidiaries and, thus, extensions of credit by the bank to such subsidiaries would not be subject to the proposed rule.<sup>155</sup>

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<sup>155</sup> Regulation O specifies that a company of which a member bank is a subsidiary is not a principal shareholder, but only with respect to the member bank. 12 CFR 215.2(m)(2) (“A principal shareholder *of a member bank* does not include a company of which a member bank is a subsidiary.”) (emphasis added). Accordingly, the holding company of a bank could be treated as a principal shareholder of an affiliate of the bank, even if it is not treated as a principal shareholder of the bank itself, which would inadvertently subject extensions of credit to the holding company to Regulation O.

This change would result in a definition of “principal shareholder” in the proposed rule that better aligns with section 22(h).<sup>156</sup> This change also would be consistent with the Board’s previous statements that it had intended to exclude from the definition of “principal shareholders” companies of which a bank is a subsidiary, as well as the related interests of such companies.<sup>157</sup>

*Question 88: What are the advantages and disadvantages of revising the definition of “principal shareholder” as proposed?*

*Question 89: To what extent should transactions subject to Regulation W also be subject to Regulation O?*

## **E. Treatment of Subsidiaries of Banks**

The proposed rule would clarify that extensions of credit by a bank to its subsidiaries are not subject to the proposed rule, and that extensions of credit by the subsidiaries of banks would be treated as loans made by the bank itself. The proposed rule also would exempt extensions of credit made by a bank to insiders of an operating subsidiary of the bank from the proposed rule, and would treat extensions of credit to the insiders of a financial subsidiary the same as an extension of credit to an insider of an affiliate of the bank.

### *1. Extensions of credit made by and to subsidiaries of a bank*

The proposed rule would modify the definition of “subsidiary” so that it does not exclude subsidiaries of banks. Section 22(h) and Regulation O define “member bank” to include any subsidiary of a member bank.<sup>158</sup> Accordingly, an extension of credit made by a subsidiary of a

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<sup>156</sup> 12 U.S.C. 375b(9)(F)(ii) (“Principal shareholder . . . does not include a company of which a member bank is a subsidiary.”).

<sup>157</sup> “Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates,” 57 FR 60979 (Dec. 23, 1992).

<sup>158</sup> 12 U.S.C. 375b(9)(E); 12 CFR 215.2(j).

bank to an insider of the bank or its affiliates has been treated as subject to the requirements of Regulation O. However, there has been confusion about this treatment because the definition of “subsidiary” in Regulation O excludes subsidiaries of banks.<sup>159</sup> The proposed revision should resolve this ambiguity, and also would be consistent with the plain language of section 22(h).

The Board excluded the subsidiaries of a bank from the definition of “subsidiary” in 1979 to make clear that extensions of credit by a bank to its subsidiaries were not subject to Regulation O.<sup>160</sup> The Board reasoned that the regulation need not apply to transactions among these affiliates because Regulation W already provided restrictions for such transactions that are sufficient to protect the bank. To ensure that the proposed rule would continue to not inadvertently apply to extensions of credit by a bank to its subsidiaries, the proposed rule would revise the definition of “principal shareholder” to exclude member banks. This proposed change will prevent a bank from being treated as an insider.

## *2. Extensions of credit to insiders of a subsidiary of a bank*

Because the proposed rule would amend the term “subsidiary” to no longer exclude the subsidiaries of a bank, such subsidiaries would meet the definition of “affiliate” in Regulation O. Accordingly, the restrictions in the proposed rule that apply to extensions of credit to insiders of affiliates would apply to extensions of credit made to insiders of subsidiaries of the bank. This would be an unintentional change to the Board’s position of not applying Regulation O to extensions of credit made by a bank to the insider of an operating subsidiary. To maintain the Board’s existing approach, the proposed rule would exclude operating subsidiaries of a bank from the definition of “affiliate.” The proposed rule would define “operating subsidiary” to

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<sup>159</sup> 12 CFR 215.2(o).

<sup>160</sup> See “Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks,” 44 FR 12959, 12961-62 (Mar. 9, 1979).

mean a subsidiary that is not a “financial subsidiary” as that term is defined in section 223.3(p) of Regulation W.<sup>161</sup>

This treatment would be consistent with relief provided by the Board for operating subsidiaries in Regulation O, Regulation W,<sup>162</sup> and Regulation Y.<sup>163</sup> Compared to financial subsidiaries, operating subsidiaries are subordinate to their parent banks and often engage in only a subset of activities in which their parent banks may engage. An insider of such a subsidiary likely does not have sufficient influence over the lending decisions of the bank to warrant application of the proposed rule, absent other factors. By contrast, financial subsidiaries engage in activities in which banks themselves may not engage directly. These subsidiaries engage in separate business lines that are not a subset of the bank’s activities. Insiders of these subsidiaries are more similar to insiders of affiliates of a bank that are not operating subsidiaries. Therefore, the proposed rule would apply to extensions of credit to insiders of financial subsidiaries in the same manner and to the same extent as it would apply to extensions of credit to insiders of affiliates of the bank that are not operating subsidiaries of the bank. If the insider of an operating subsidiary is an insider of the bank or another affiliate of the bank, extensions of credit to the insider would continue to be subject to the proposed rule.

The proposed rule would rely on the definition of “financial subsidiary” in Regulation W to identify operating subsidiaries. This definition identifies the scope of subsidiaries that engage

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<sup>161</sup> Regulation W provides that the definition of “financial subsidiary” does not apply to subsidiaries of savings associations. 12 CFR 223.72(b) (item 8). To maintain consistency with Regulation W, the proposed rule would not treat subsidiaries of savings associations as financial subsidiaries (that is, the proposed rule would treat them as operating subsidiaries).

<sup>162</sup> In general, transactions between a member bank and its operating subsidiary are not subject to the requirements of Regulation W. See 12 CFR part 223.

<sup>163</sup> In general, a bank holding company is not required to provide notice pursuant to section 4 of the BHC Act for the activities of an operating subsidiary. See 12 CFR 225.22(e).

in the activities in which a bank itself may not engage. Relying on a definition in another one of the Board's rules would create consistency and allow banks to leverage their existing systems for classifying operating and financial subsidiaries for purposes of the proposed rule.

*Question 90: What are the advantages and disadvantages of revising the definitions of “member bank,” “subsidiary,” and “principal shareholder” as proposed? Are there consequences to these changes apart from the purposes discussed here?*

*Question 91: What would be the advantages and disadvantages of subjecting extensions of credit to insiders of certain subsidiaries of savings associations to Regulation O? For example, should extensions of credit to the insiders of subsidiaries of savings associations that engage in the activities of financial subsidiaries of national banks be subject to Regulation O?*

#### **F. Prior Approval Requirement and Abstention by All Interested Directors**

Section 22(h) and 12 U.S.C. 1828(z) require a vote by a bank's board of directors before the bank may engage in certain transactions with the bank's insider. Both sections also require any director with an interest in the transaction to abstain from participating in the vote.<sup>164</sup>

Consistent with Board staff's longstanding interpretation, the proposed rule would clarify that, for both prior approval requirements, all directors that are interested parties must abstain from participating directly or indirectly in the approval vote. In the past, some banks have asked whether the prior approval requirement in Regulation O requires only one director with an interest in a transaction to abstain. Clarifying that all directors who are interested in a transaction must abstain from a prior approval vote would recognize that more than one insider could have an interest in the same extension of credit, and that all such insiders would be required to abstain from the required approval process for such transactions. To allow any directors with an interest

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<sup>164</sup> 12 U.S.C. 375b(3)(B) and 1828(z)(1)(B).

in the transaction to participate in the vote would undermine the purpose of the requirement of excluding any persons with a conflict of interest from participating in a vote required by these sections.<sup>165</sup>

*Question 92: What are the advantages and disadvantages of clarifying the prior approval requirements?*

## **G. Safe Harbor for Affiliate and Correspondent Recordkeeping Requirements**

In general, banks are required to maintain records necessary to ensure compliance with the requirements in Regulation O.<sup>166</sup> However, the Board has acknowledged that banks may not have easy access to the information concerning extensions of credit to persons that are not insiders of the bank.<sup>167</sup> To help banks meet their recordkeeping requirements for extensions of credit to the insiders of affiliates, the Board adopted in 1994 two specific methods for banks to maintain necessary records.<sup>168</sup> The Board also stated that an “implicit safe harbor exists” for banks that use one of these two recordkeeping options.<sup>169</sup> The proposed rule would codify this safe harbor for the recordkeeping requirements related to insiders of a bank’s affiliates. The proposed rule also would extend this safe harbor to the new recordkeeping requirements for the correspondent lending restrictions discussed in section III.L of this **SUPPLEMENTARY**

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<sup>165</sup> As noted in section III.F.2 of this **SUPPLEMENTARY INFORMATION**, the proposed rule would seek to align the prior approval requirements in section 22(h) and 12 U.S.C. 1828(z) as much as possible, but one statutory difference between them is worth noting. Section 22(h) requires approval by a majority of a bank’s “entire board of directors” whereas 12 U.S.C. 1828(z) requires approval by a majority of “the members of the board of directors . . . who do not have an interest in the transaction.” For purposes of determining what number of directors constitutes a majority, section 22(h) does not exclude directors with an interest in the transaction. For example, if two directors out of seven have an interest in a transaction, section 22(h) would require four directors to vote in favor of the transaction (that is, a majority of the entire board of directors, or seven); whereas, 12 U.S.C. 1828(z) would require three (that is, a majority of uninterested directors, or five).

<sup>166</sup> 12 CFR 215.8(a).

<sup>167</sup> See e.g., Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates, 59 FR 8831, 8833 (Feb. 24, 1994).

<sup>168</sup> *Id.*

<sup>169</sup> *Id.* at 8834.

**INFORMATION** for banks that use one of the two recordkeeping requirements set forth in the proposed rule.

Compared to information related to insiders of a bank, information regarding insiders of other institutions, including the bank's affiliates and correspondent and respondent banks, is more difficult for a bank to obtain. A bank has greater access to information concerning its own insiders through shareholder and employment records because such information normally belongs to the bank. By contrast, a bank may not own information about the insiders of its affiliates or insiders of the bank's respondent or correspondent banks, and the burden of obtaining such information could, in some instances, outweigh the benefit of having the information. It also would be unreasonable in these circumstances to hold banks liable for recording information that is not entirely within their power to obtain.

*Question 93: What are the advantages and disadvantages of providing such a safe harbor?*

*Question 94: Are there other circumstances where a safe harbor might be appropriate? If so, explain and provide examples.*

## **V. Technical Revisions to Update and Streamline Regulation O**

The proposed rule would include a series of technical amendments that are designed to streamline the regulation and make it more understandable and user-friendly. Among other things, these revisions and reorganizations would adopt language that would be more understandable and eliminate unnecessary cross-references and footnotes. The proposed rule also would include new subsections to reorganize the regulation. These technical revisions are not intended to have substantive effect. In view of the extensive proposed changes and

reorganization, the Board would restate Regulation O in its entirety as amended, rather than proposing revised regulation text only for portions of Regulation O that would change.<sup>170</sup>

*Question 95: Are the proposed technical revisions and reorganizations helpful?*

*Question 96: Are there any other ways that Regulation O could be made more understandable and user-friendly?*

#### **A. Separating the Requirements in Section 215.4 of Regulation O**

The proposed rule would separate the five requirements in the general prohibitions section of Regulation O (12 CFR 215.4) into four new sections so that each requirement, with the exception of the individual and aggregate lending limits, would be stated in its own section. The proposed rule would state the individual and aggregate lending limits in one combined section.

The collection of these separate requirements in one section of Regulation O can be confusing. Some of these requirements are qualitative in nature, others are quantitative, and still others are procedural. Some of these requirements apply to all insiders, as in the case of the creditworthiness requirements, whereas others apply to only some insiders, as in the case of the overdraft prohibitions. The proposed revision would shorten section 215.4 of Regulation O and more intuitively categorize the requirements of the proposed rule.

#### **B. Insiders of Affiliates Exempt from Sections 215.4, 215.6, and 215.8 of**

#### **Regulation O**

The proposed rule would define a new term “exempt official” for directors and officers that already are excluded from the definitions of director and officer in Regulation O for the

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<sup>170</sup> The proposed rule would result in a fairly significant renumbering and reordering of Regulation O sections and citations. The Regulation O citations used throughout this **SUPPLEMENTARY INFORMATION** are to the existing text of Regulation O.

purposes of sections 215.4, 215.6, and 215.8.<sup>171</sup> The proposed rule would use this term in sections 215.11-13, .21, .23, and .30, and eliminate the exclusion in the definitions of director and executive officer. The scope of application of the proposed rule to directors and executive officers would not be different from the scope of application in Regulation O as a result of these changes.

Regulation O excludes directors and executive officers of the affiliates of banks from the scope of the requirements in section 215.4, 215.6, and 215.8 if: (i) the director or executive officer is excluded by a resolution of the bank's board of directors from participating in the policymaking functions of the bank, (ii) the director or executive officer in fact does not participate in the policymaking functions of the bank, (iii) the affiliate does not control the bank, (iv) the assets of the affiliate do not cross a certain threshold, and (v) the director or executive officer is not otherwise subject to sections 215.4, 215.6, and 215.8 of Regulation O. The proposed definition of "exempt official" would use the same criteria. The revision would shorten Regulation O. The term "exempt official" would be included in the new section dedicated to the definition of the term "insider," discussed in greater detail above.

### **C. Overdrafts**

The Board also proposes to simplify the requirements in the proposed rule related to overdrafts. Section 215.4(e) of Regulation O prohibits banks from paying overdrafts to certain insiders. Various portions of Regulation O cross reference to certain portions of this prohibition. For example, the definition of "extension of credit" in Regulation O includes two exceptions for certain types of overdrafts. These exceptions both refer to types of overdrafts "described in section 215.4." To eliminate this cross reference, the proposed rule would replace the language

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<sup>171</sup> 12 CFR 215.2(d)(2) and (e)(2).

directing a reader to look to section 215.4 with language describing the type of overdraft that is being referenced.

Some portions of Regulation O that refer to overdrafts use language that differs from the definition of “pay an overdraft on an account” in the regulation’s definition section. The proposed rule also would amend these references to better align with the definition. This proposed revision is not intended to alter the substance of any portion of the proposed rule that refers to an “overdraft.”

#### **D. Definition of “Unimpaired Capital and Unimpaired Surplus”**

The proposed rule would create a new definition for the term “capital stock and surplus” and remove the definition of the term from the definition of “lending limit.” This reorganization would not substantively change the meaning of the terms “lending limit” or “capital stock and surplus” as they are used in Regulation O. Instead, the proposed reorganization would separate the two terms within the text of the regulation to improve the readability of the regulation and to make it easier to revise one definition without affecting the other, should such a revision be necessary in the future.

#### **E. Disclosure Requirements for Extensions of Credit Secured by Shares of a Bank or Bank Holding Company**

Section 306(o) of the Federal Deposit Insurance Corporation Improvement Act of 1991 requires that an executive officer or director of a bank and its holding company report annually to the board of directors of his or her institution the outstanding amount of any extensions of credit secured by shares of the bank and its holding company, if the shares of the institution are

not publicly traded.<sup>172</sup> The Board previously codified portions of this requirement in section 215.10 of Regulation O for extensions of credit secured by stock of the bank, and in section 225.4(e) of Regulation Y for extensions of credit secured by stock of the bank holding company.<sup>173</sup> The proposed rule would consolidate these requirements in Regulation O. Consistent with section 306(o), the proposed rule also would make explicit that an executive officer or director of an insured depository institution must disclose the outstanding balance of an extension of credit if the extension of credit is secured by stock of the insured depository institution or such institution's holding company and that an executive officer or director of a holding company must disclose the outstanding balance of an extension of credit secured by stock of the holding company or the subsidiary lending bank. The Board also proposes to eliminate section 225.4(e) of Regulation Y, as that requirement would be incorporated into the proposed rule.

This revision would not substantively change the requirements of the proposed rule relative to Regulation O or Regulation Y, but would reorganize them for ease of reference and to more closely align this disclosure requirement in the proposed rule with section 306(o). Consistent with Regulation Y and Board staff's past interpretations for Regulation O, the proposed rule would specify that a company's shares are publicly traded if any class of equity securities of the company are registered securities under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l).<sup>174</sup>

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<sup>172</sup> Section 306(o) Pub.L. 102-242 (1991), codified in a note to 12 U.S.C. 375b. While the statute uses the term reporting, that term is typically used for information provided to regulators. The proposed rule would change the term to disclosure to align with the label typically used when information is provided to third-parties such as the bank's board of directors.

<sup>173</sup> 12 CFR 215.10; 12 CFR 225.4(e).

<sup>174</sup> 15 U.S.C. 78l. *See also* 12 CFR 225.41(c)(2)(i).

The proposed rule also would clarify that disclosure is required for extensions of credit to an executive officer or director of a bank, when the extension of credit is secured by bank holding company shares that are not publicly traded.<sup>175</sup>

*Question 97: Should Regulation O require that a director or executive officer of a bank or holding company disclose extensions of credit secured by shares of either the bank or holding company? Or, should Regulation O require that a director or executive officer of a bank disclose only extensions of credit secured by shares of the bank, and that a director or executive officer of a holding company disclose only extensions of credit secured by shares of the holding company?*

#### **F. Repeal of Existing Section 215.7 of Regulation O**

Section 215.7 of Regulation O set forth a transition period for compliance with the regulation for extensions of credit made prior to March 10, 1979, that either matured on or after that same date. The relief expired on March 10, 1980, and, therefore, no longer applies to any extensions of credit. Accordingly, the proposed rule would eliminate this section to streamline and shorten the regulation.

#### **G. Application of Regulation O to Insured Branches of Foreign Banking Organizations**

The proposed rule would revise the definition of “member bank” to include the insured branches of foreign banks. Regulation O already applies to the insured branches of foreign banks by statute, but the existing definition of “member bank” has caused confusion about this application because it states that “[t]he term does not include any foreign bank that maintains a

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<sup>175</sup> See Letter from J. Virgil Mattingly to C. Romain (Aug. 18, 1992).

branch in the United States, whether or not the branch is insured... .”<sup>176</sup> This language has been misread to specify the scope of application of Regulation O to foreign branches, rather than the foreign bank to which a branch belongs. To improve clarity, the proposed rule would be revised to reflect the relevant statutory language, which specifies that “[t]he term does not include any foreign bank solely because the foreign bank has an insured branch, but the term does include an insured branch.”

#### **H. Definition of “appropriate Federal banking agency”**

Regulation O refers to “appropriate Federal banking agency” in several instances but does not separately define the term in the definition section of the rule. The proposed rule would add the term to the definition section and define it to mean, “with respect to a member bank or company, [] the meaning given in 12 U.S.C. 1813.” This change to the regulation text is not intended to impact the meaning of the term in the proposed rule.

12 U.S.C. 1813 provides that the appropriate Federal banking agency means:

The OCC, in the case of:

- Any national banking association;
- Any Federal branch or agency of a foreign bank; and
- Any Federal savings association;

The FDIC, in the case of:

- Any State nonmember insured bank;
- Any foreign bank having an insured branch; and
- Any State savings association; and

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<sup>176</sup> 12 CFR 215.2(j); 12 U.S.C. 1828(j)(3)(B) (noting that the requirements of 12 USC 375a and 375b “shall not apply with respect to a foreign bank solely because the foreign bank has an insured branch, but shall apply with respect to the insured branch.”). *See also* FRRS 3-1085.5 (Apr. 21, 1993).

The Board, in the case of:

- Any State member bank;
- Any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act which is made applicable under the International Banking Act of 1978;
- Any foreign bank which does not operate an insured branch;
- Any agency or commercial lending company other than a Federal agency;
- Supervisory or regulatory proceedings arising from the authority given to the Board of Governors under section 7(c)(1) of the International Banking Act of 1978, including such proceedings under the Financial Institutions Supervisory Act of 1966;
- Any bank holding company and any subsidiary (other than a depository institution) of a bank holding company; and
- Any savings and loan holding company and any subsidiary (other than a depository institution) of a savings and loan holding company.<sup>177</sup>

## **I. Other Revisions to Improve Readability**

The proposed rule also would include various changes to simplify and modernize the language of Regulation O and to enhance its organization. For example, the proposed rule includes new subheadings and has replaced the term “interest-bearing extension of credit plan” in the section discussing the prohibition on overdrafts to certain insiders with “interest bearing overdraft protection plan.”

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<sup>177</sup> 12 U.S.C. 1813(q).

## VI. Economic Analysis

This section analyzes the potential economic impact of the proposed amendments to Regulation O. The economic analysis focuses on the effects of two key components of the proposal: (1) providing relief from the unintended application of insider lending restrictions to portfolio companies of qualifying fund complexes, and (2) adjusting dollar-based thresholds to account for inflation and economic growth, along with establishing an automatic indexing methodology. The analysis considers both the benefits and costs of these changes relative to the baseline. The proposal also provides clarifications and codifies existing interpretations of Regulation O, enhancing transparency and facilitating compliance by banks. The section does not further analyze these benefits.

The economic analysis is structured as follows. Section A provides an overview of the baseline, describing the current state of Regulation O and recent trends in fund complex ownership. Section B summarizes the proposed policy changes, with references to the detailed descriptions in Sections III.A and III.B of this **SUPPLEMENTARY INFORMATION**. Section C analyzes the economic impact of providing relief for qualifying fund complexes, and Section D analyzes the economic impact of adjusting and indexing dollar-based thresholds. Section E concludes.

### *Baseline*

The baseline considers the current state of Regulation O, which imposes constraints on bank lending to insiders, including principal shareholders and related interests of principal shareholders, in order to mitigate potential for self-dealing. Under Regulation O, if a fund complex holds aggregate ownership of more than 10 percent in a bank, the fund complex becomes a principal shareholder of the bank directly subject to the insider lending limits and

requirements. Additionally, any other company that a principal shareholder controls (holding at least 25 percent) or is presumed to control (holding more than 10 percent of and being the largest shareholder) becomes a “related interest” of the bank and is subject to these limits and requirements. In that event, the principal shareholder fund complex and its controlled portfolio companies would be considered insiders of the bank under Regulation O. Accordingly, the bank’s lending to the principal shareholder fund complex and its fund-complex controlled portfolio companies would be subject to the lending limits and other restrictions and standards of Regulation O.

The rise in assets under management by index funds has significantly increased the number of firms subject to Regulation O, creating unintended regulatory consequences. As of April 2026, indexed mutual funds and exchange traded funds hold 63.6 percent of the total combined domestic equity held by the nation's long-term active and index mutual funds and exchange traded funds, representing nearly two-thirds of long-term fund assets in domestic equity and demonstrating the importance of passive investment strategies.<sup>178</sup> Despite this substantial share, index funds do not pose the risk of self-dealing that Regulation O was designed to mitigate. Passive investment strategies, by their nature, do not involve the type of active control or influence that would create conflicts of interest or opportunities for preferential treatment, yet index funds holding a significant share of market equity are subject to the same restrictions as active investors who may exert significant influence over portfolio companies.

To assess the magnitude of this trend and its impact on the application of Regulation O, the analysis relies on institutional ownership holding data from the S&P Global Capital IQ

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<sup>178</sup> Statistical report by the Investment Company Institute.  
[https://www.ici.org/research/stats/combined\\_active\\_index\\_0426#:~:text=Total%20Net%20Assets%20Long%2DTerm,53.4](https://www.ici.org/research/stats/combined_active_index_0426#:~:text=Total%20Net%20Assets%20Long%2DTerm,53.4).

Ownership database.<sup>179</sup> The Board used this database to calculate the ownership of domestic banks and global non-bank portfolio companies for each fund group in aggregate.<sup>180, 181</sup>

As Table 1 shows, from the fourth quarter of 2004 to the fourth quarter of 2025, the number of banks of which fund groups hold more than 10% has increased sharply (by 247 percent). This growth is also observed for their holdings in non-banks (by 44 percent). Due to the data limitations noted above, these results may underestimate the number of entities potentially affected by Regulation O requirements. This trend suggests that the rapid growth of investment fund groups is at least partly responsible for the classification of fund complexes as principal shareholders of many banks.

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<sup>179</sup> Note that the aggregation of holdings in all underlying subsidiary funds for a given fund manager may not match the holdings at the parent company level specified in S&P's database for a few reasons. Preliminarily, this disparity may be attributed to regulatory guidelines and governing bodies' mandates, which do not require all portfolio managers to report their holdings; therefore, S&P largely attributes this disparity to the discretion exercised by individual portfolio managers and mandated by regulatory thresholds. Furthermore, S&P omits fund-level holdings in the detailed view because institutional managers typically report total holdings on an issuer, encompassing fund holdings along with direct holdings. The presentation of parent-level holdings is based on specific logic considering relationships between entities within the same business line to prevent duplication. Additionally, variations arise due to different reporting dates, Principal Executive Officers, and filing sources.

<sup>180</sup> Following academic and regulatory research, the RSSD ID (assigned by the Federal Reserve's National Information Center as a universal identifier for financial institutions) is used to separate banks vs. non-banks. A financial institution is typically considered a "bank" if (i) it has an RSSD or (ii) it controls an institution with an RSSD and as a result the definition would include certain entities without an RSSD such as industrial loan companies, trust companies, and credit card banks. There are data limitations due to difficulties in identifying entities that meet the second criteria (ii) but the impact is likely small. Using one quarter report of total number of controlled banks provided by one fund complex, the discrepancy of missing entities that meet the second criteria (ii) is 9%.

<sup>181</sup> 9-character CUSIP (Committee on Uniform Securities Identification Procedures) identifiers are used to identify domestic companies.

Table 1 Growth of Fund Group Ownership of Banks and Non-bank Companies

| Sample Period            | No. of Banks<br>Held by Fund Groups $\geq$<br>10% | No. of Non-bank<br>Companies Held by Fund Groups<br>$\geq$ 10% <sup>182</sup> |
|--------------------------|---------------------------------------------------|-------------------------------------------------------------------------------|
| 2004Q4                   | 19                                                | 1423                                                                          |
| 2025Q4                   | 66                                                | 2047                                                                          |
| No. Increase/(Decrease), | 47                                                | 624                                                                           |
| % Increase/(Decrease),   | 247%                                              | 44%                                                                           |

As described above, there are lending limits that apply to insiders and the companies they are presumed to control.<sup>183</sup> In light of the sharp rise in assets under management at these investment fund groups, if lending to all of these non-bank companies is counted against these lending limits it is possible that a bank may exceed the lending limits. Recognizing this issue, in December 2019, the Federal banking agencies issued a joint statement providing temporary relief to allow banks to continue to lend to certain fund complex-controlled portfolio companies, and this temporary relief has been extended through 2026. The proposal would provide permanent relief from this unintended consequence of Regulation O.

Next, the baseline analysis considers the fixed nominal thresholds that apply to certain loans and transactions with insiders. These thresholds have been unchanged since the Board last considered Regulation O in 1994.

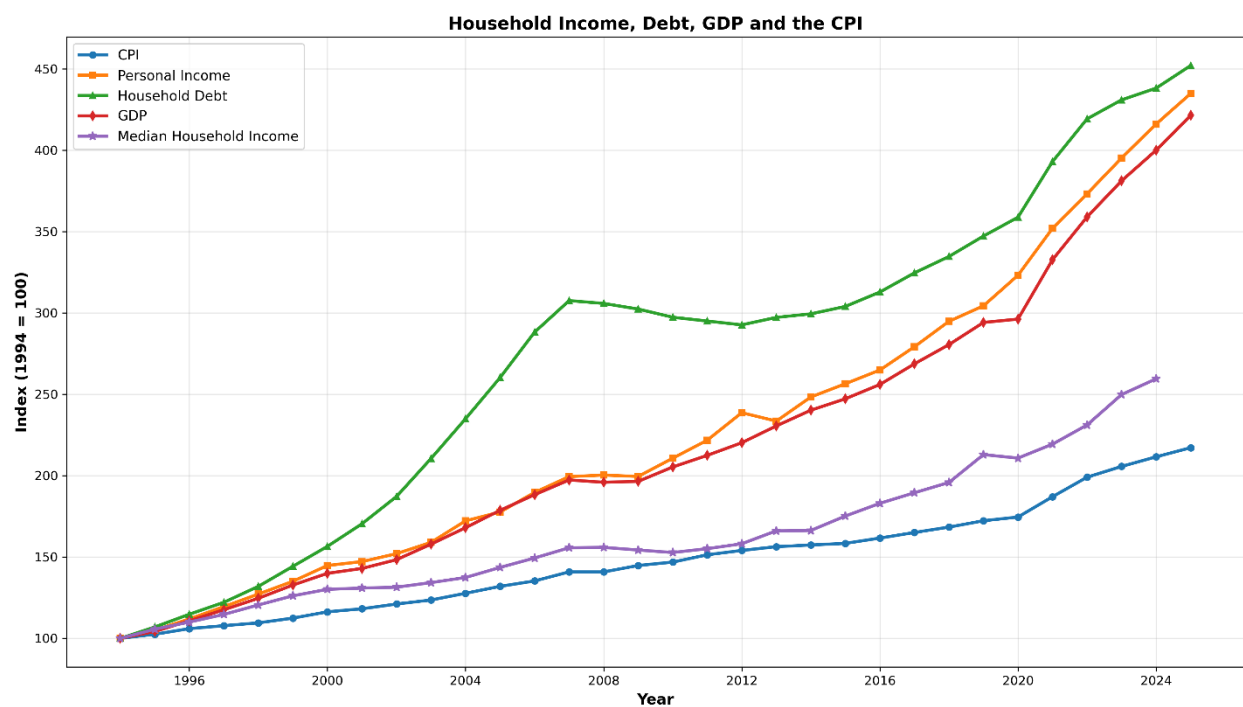
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<sup>182</sup> The data did not allow for determination of whether a specific fund complex is the largest shareholder so the number of non-banks subject to the presumption of control may be smaller than the amounts provided in the table.

<sup>183</sup> In particular, the individual lending limit, which allows for up to 15 percent of bank capital and surplus for unsecured lending and an additional 10 for secured lending, applies to a principal shareholder and *all* of its related interests.

Over time, increase in loan demand occurs due to both inflation, which drives up the cost, and economic activity, which increases the quantity of goods and services produced. For determining the appropriate indexed levels for the Regulation O dollar-based thresholds, staff considered data on household debt (need to borrow) and household income (ability to pay), relative to a number of different macroeconomic indicators such as GDP and the consumer price index (CPI).

The figure below depicts the evolution of five series: Personal Income, household debt, median household income, nominal GDP, and the CPI. All series are normalized to 100 as of 1994. The source data for these series are various U.S. statistical agencies, and the data are accessed via the St. Louis Fed's FRED® database.<sup>184</sup>



This figure shows that household debt has grown at a faster rate than nominal GDP over this period. In the early part of the period, one observes a rapid runup in household borrowing

<sup>184</sup> The specific series obtained from the FRED® database are PI, CMDEBT, MEHOINUSA646N, GDP, and CPIAUCSL, respectively.

prior to the financial crisis. Personal Income tends to closely track GDP over this period, reflecting that the former is the largest single component of Gross Domestic Income. Median household income has grown at a somewhat slower pace than GDP over this period,<sup>185</sup> due to the accumulation of economic gains by high-income individuals and because GDP includes population growth effects while median household income is measured per household. Nonetheless, these series demonstrate significantly more growth over this period than the price level, with the CPI only growing by a factor just above 2 from 1994 to 2025. An examination of the indexed values for aggregate income, debt, and GDP at the end of 2025 indicate that, for a given nominal threshold, demand for loan products that exceed that threshold may have increased by a factor of 4 or more from 1994 to 2025, demonstrating the need for revising these thresholds.

#### *Proposed Policy Changes*

The proposal includes two major policy changes that are analyzed in this economic analysis.

First, as discussed in Section III.B, the proposal would provide relief from the unintended application of Regulation O to qualifying fund complexes by exempting their portfolio companies from the presumption of control. A qualifying fund complex must meet specific criteria designed to ensure that the relationship between the fund complex and the bank is sufficiently passive such that section 22(h) and Regulation O conflict of interest concerns are minimized. These criteria include requirements that the fund complex not be affiliated with a bank, that no individual fund hold more than 10 percent of any bank, that non-index funds not

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<sup>185</sup> Data on median household income are available only up to 2024.

aggregately hold more than 10 percent of any bank, and that the fund complex not trigger any of the control presumptions under the Board's Regulation Y.

Second, as discussed in Section III.A, the proposal would increase various dollar-based thresholds in Regulation O to adjust for economic growth and inflation since the regulation was last updated. The proposal would also establish a methodology for automatically indexing these thresholds every five years going forward based on nominal GDP growth. This indexing mechanism would reduce unnecessary regulatory burden while retaining safeguards against self-dealing and conflicts of interest.

#### *Effects of Proposed Approach to Address Ownership by Fund Complexes*

This section analyzes the economic effects of the qualifying fund complex exemption described in Section III.B of this **SUPPLEMENTARY INFORMATION**. The primary benefits include maintaining access to conventional banking relationships for portfolio companies, reducing credit rationing, improving capital allocation efficiency, and substantially lowering compliance costs for both banks and fund complexes that would otherwise face burdensome monitoring, information collection, and procedural requirements. The costs are expected to be minimal, consisting primarily of regulatory arbitrage risks that are substantially mitigated by the proposal's multiple qualifying criteria. Overall, the proposal generates significant net benefits by refocusing Regulation O on its core purpose of mitigating potential for self-dealing while eliminating unnecessary restrictions on genuinely passive investors that are seeking exposure to a broad-based stock index.

#### *Benefits:*

The proposed changes would address the unintended consequences of the regulatory presumption of control on lending to companies held by fund groups.

As a result of the proposal, portfolio companies of qualifying fund complexes would retain access to conventional banking relationships that would have been unnecessarily restricted by the insider lending requirements, maintaining their ability to secure financing for ordinary business operations. Many of these portfolio companies are large, publicly traded firms with substantial credit needs and banks naturally seek to lend to creditworthy borrowers in their markets. Such relationships could become curtailed due to the unintended application of Regulation O constraints. As shown in Table 1, the proposal would directly affect a substantial volume of potential lending relationships. As of Q4 2025, fund complexes are principal shareholders of approximately 66 banks, and fund complexes might be presumed to control approximately 2047 portfolio companies. Each of the 66 affected banks could potentially have lending relationships with any of the 2047 affected portfolio companies, representing up to 135,102 (66 multiplied by 2047) possible bank-borrower pairs subject to Regulation O restrictions. While not all potential relationships would be covered or materialize into actual loans, the analysis suggests that a meaningful number of lending relationships could be affected by the current regulatory structure. Even if a small fraction of these potential relationships represent actual or desired lending relationships, the proposal could exempt a significant number of relationships between banks and portfolio companies that are otherwise affected by the requirements of Regulation O.

Facilitating lending relationships between the banks and portfolio companies currently subject to unintended Regulation O requirements will eliminate an unintended constraint on lending relationships across portfolio companies and improve economic efficiency. In the case that banks cannot lend freely to creditworthy portfolio companies due to Regulation O constraints, both banks and borrowers face costs. Banks lose profitable lending opportunities

with creditworthy borrowers while portfolio companies may face reduced access to bank credit, forcing them to use more expensive alternative financing. Such unintended restrictions on lending could prevent efficient capital allocation and some companies may forego productive investments or face delays in financing.

Reducing unnecessary barriers to lending will allow capital to flow more efficiently to productive uses, supporting business growth and economic activity. The improved capital allocation could potentially lead to more sustainable economic activity and support competitive banking markets.

*Reduced Compliance Costs:*

Banks and fund complexes would also benefit from the reduced administrative costs associated with monitoring and managing related interest restrictions. All banks with principal shareholder fund complexes exempted from the Regulation O constraints under the proposal would benefit by avoiding costs associated with continuously monitoring ownership changes, obtaining prior board approvals for certain large loans, and collecting information about related interests across potentially thousands of portfolio companies. While the Board does not have sufficient information to quantify all aspects of these savings, the proposal would likely generate significant compliance cost reductions, as discussed below.

Banks and fund complexes would face significant costs in attempting to determine whether specific portfolio companies qualify as related interests under Regulation O's existing presumptions of control. This determination requires banks to assess whether a fund complex is the largest shareholder of a portfolio company, obtain real-time ownership levels across multiple funds and portfolio companies, and monitor whether ownership changes have created or eliminated "related interest" relationships. Banks must also maintain complex systems to

aggregate exposures across numerous related interests and coordinate with fund complexes to obtain timely ownership information. The proposal would reduce these monitoring burdens and information collection costs by eliminating the need for banks to make ongoing determinations about whether portfolio companies of qualifying fund complexes trigger the presumption of control. Banks will no longer need to continuously monitor whether a qualifying fund complex remains the largest shareholder of each portfolio company or track ownership percentage changes under 25 percent.

Under current Regulation O, large extensions of credit to insiders require approval by a majority of the bank's board of directors, with interested parties required to abstain from voting. Each board approval requires preparation of materials describing the proposed extension of credit, board member time to review and vote on the transaction, and documentation of the approval process. For banks with numerous fund complex-controlled portfolio companies that are classified as related interests, compliance with this requirement could involve many such board approvals annually. The proposal would provide benefits to banks with principal shareholder fund complexes by essentially eliminating this procedural requirement for all portfolio companies where the fund complex holds less than 25 percent of voting securities. These portfolio companies would no longer be classified as related interests subject to the prior approval requirement. This reduced procedural requirement could result in meaningful cost savings.

As noted above, based on Table 1, as of the first quarter of 2025, fund complexes are principal shareholders of 66 banks and these fund complexes might be presumed to control 2047 portfolio companies. This suggests that a meaningful number of banks would benefit from the proposed compliance cost reductions.

*Costs:*

The proposed exception for qualifying fund complexes is expected to impose minimal costs relative to the substantial benefits described above. The primary costs arise from regulatory arbitrage risks that the exception could inadvertently permit some forms of preferential treatment or conflict of interest, though the proposal includes safeguards designed to prevent such outcomes.

The proposal creates a theoretical risk that fund complexes could restructure their operations or organizational forms to qualify for the exception while maintaining some degree of influence over bank lending decisions. Fund complexes might restructure voting arrangements, modify fund structures, or adjust ownership levels across individual funds in ways designed to meet the qualifying criteria while preserving elements of control or coordination that the exception is intended to exclude. However, the proposal includes multiple qualifying criteria designed to ensure that fund complexes benefiting from the exception are genuinely passive investors. Specifically, the proposal requires that no individual fund hold more than 10 percent of any bank, that non-index funds not aggregately hold more than 10 percent of any bank, and that the fund complex not be presumed to control the bank pursuant to the Board's existing control rule Regulation Y. These multiple, overlapping criteria substantially reduce the opportunity for fund complexes to restructure in ways that would qualify for the exception while maintaining meaningful control, and the Board expects that the probability of regulatory arbitrage is low. In addition, the proposal does not impact the Board's authority to determine that a fund complex has "the power to exercise a controlling influence" over a portfolio company

even if the fund complex does not meet the rebuttable presumptions of control,<sup>186</sup> which provides an additional safeguard against attempts to exercise control through subtle or indirect means.

#### *Effects of Proposed Adjustment of Thresholds*

This section analyzes the economic effects of the threshold adjustments and indexing methodology described in Section III.A of the **SUPPLEMENTARY INFORMATION**. The primary benefits include a meaningful reduction in administrative burden for banks by decreasing the frequency with which routine transactions trigger regulatory requirements, such as approvals from a bank's board of directors, as well as ongoing benefits from automatic indexing that would maintain appropriate threshold values as the economy grows. Banks of all sizes would benefit from the reduced compliance costs, and insiders would maintain appropriate access to banking services without unnecessary regulatory restrictions on certain transactions. The costs include potential increase in the risks related to insider lending. However, safeguards remain in place to mitigate potential risks from higher thresholds, including requirements that all extensions of credit to insiders be made on substantially the same terms as to non-insiders and subject to individual and aggregate lending limits.

#### *Benefits:*

Banks would benefit from raising the dollar thresholds that have not kept pace with inflation and economic growth since 1994. The proposal would reduce administrative burden by decreasing the frequency with which certain transactions with insiders trigger regulatory requirements and would establish automatic indexing to maintain appropriate threshold values as the economy grows.

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<sup>186</sup> See 12 U.S.C. 375b(9)(B)(iii).

As the economy has grown, the dollar size of typical banking transactions has increased, causing the outdated thresholds to apply to more routine transactions than originally intended. The proposed threshold increases would address this problem by updating the values to be more reflective of current economic conditions, thereby reducing the administrative burden associated with regulatory requirements that have become unnecessarily restrictive. For example, the proposed increase in the prior approval threshold from \$500,000 to \$2 million would substantially reduce the number of insider transactions requiring heightened review. Each board approval requires preparation of materials describing the proposed extension, scheduling of board meetings or obtaining written consents, board member time to review and vote on the transaction, documentation of the approval process, and associated recordkeeping. Banks' current processes to ensure timely board review could be simplified for transactions falling between the current and proposed thresholds. The savings would be particularly significant for banks with existing insider lending relationships, as these banks could experience significant reductions in the number of board approvals required annually.

Beyond addressing the immediate burden created by outdated thresholds, the proposal would establish a methodology for indexing Regulation O thresholds based on changes in nominal GDP, which would provide ongoing benefits by automatically adjusting thresholds to reflect economic activity over time. This indexing methodology would prevent the erosion of threshold values that has occurred over the past several decades when thresholds remained fixed in nominal terms. By linking thresholds to nominal GDP growth, the proposal would eliminate the need for periodic rulemakings to update threshold values as economic activity and thus transactions over a given amount increase. Without indexing, banks would face a gradually increasing number of transactions triggering regulatory requirements solely because nominal

transaction sizes grow with the economy while thresholds remain fixed. The proposed indexing would prevent this inadvertent tightening of regulatory standards.

The proposed threshold adjustments are expected to benefit member banks of all sizes, though the distribution of benefits would vary based on the scale and nature of each bank's insider lending relationships. The proposal would also benefit insiders of banks by maintaining their access to banking services at their own bank without unnecessary regulatory restrictions on routine transactions. Executive officers and directors would be able to obtain credit cards with higher limits, maintain overdraft protection plans with higher limits, and access more business credit without triggering prior approval requirements for transactions that fall within the updated thresholds. This would be particularly beneficial in small and rural markets where alternative banking relationships may be limited and where insiders' business credit needs have grown substantially with the economy over the decades since the thresholds were last updated. Moreover, one bank may be reluctant to lend to an insider of another bank, as they could potentially worry about an adverse selection problem. As such, the proposal removes an impediment to these banks attracting and retaining skilled executive officers and directors.

*Costs:*

The proposed threshold increases are designed to maintain the original calibration of regulatory requirements by adjusting for nominal GDP growth since the thresholds were last updated, thereby restoring them to approximately the same value relative to the economy as when they were originally established. However, the nominal increases could create potential risks that banks could extend larger amounts of credit to insiders without board approval or other safeguards that apply above the current thresholds. The proposal increases multiple thresholds, all by approximately fourfold to reflect nominal GDP growth since they were last updated. Most

notably, under the proposal, a bank could extend \$2 million to an insider without board approval, compared to \$500,000 under current requirements. Additionally, executive officers could obtain extensions of credit for purposes other than home mortgages or education loans up to \$400,000 (from \$100,000), credit card debt up to \$60,000 (from \$15,000) would be exempt from the definition of " "extension of credit," and inadvertent overdrafts up to \$4,000 (from \$1,000) would be permitted. These increased thresholds could potentially allow for larger transactions that present conflicts of interest or self-dealing concerns to occur without the board oversight or other safeguards that the current requirements are designed to provide.

These potential risks are mitigated by several factors that ensure the threshold adjustments do not create meaningful new opportunities for self-dealing or conflicts of interest. First, the thresholds account for the increase in economic activity from the fourth quarter of 1994 to the fourth quarter of 2025, meaning that transactions requiring board approval today represent the same relative size and risk profile as transactions requiring board approval when the thresholds were last considered. Thus, the proposed thresholds are specifically calibrated to maintain the original value and the original regulatory requirements rather than creating new opportunities for larger transactions relative to typical bank capital levels and commercial lending activity in the economy. Second, all extensions of credit to insiders remain subject to the fundamental requirement that they be made on substantially the same terms as extensions to non-insiders and not involve more than normal risk of repayment, regardless of the size of the extension. Third, extensions of credit remain subject to the individual and aggregate lending limits in Regulation O, which constrain the total amount of credit that can be extended to any insider regardless of whether board approval is required. These continuing requirements ensure

that the threshold adjustments do not create meaningful new risks of self-dealing or conflicts of interest.

In addition, the ongoing indexing of thresholds would create compliance costs by requiring banks to update their systems and procedures every five years to reflect adjusted threshold amounts based on changes in nominal GDP. However, this cost is expected to be marginal.

### *Conclusion*

The proposed amendments to Regulation O are expected to generate substantial benefits by addressing two significant issues with the current regulatory framework. First, the exemption for portfolio companies of qualifying fund complexes from the presumptions of control would maintain access to conventional banking relationships for portfolio companies, improve capital allocation efficiency, and substantially reduce compliance costs for both banks and fund complexes, while preserving Regulation O's core purpose of preventing self-dealing through multiple qualifying criteria and safeguards. Second, the adjustment of dollar-based thresholds to reflect nominal GDP growth from the fourth quarter of 1994 to the fourth quarter of 2025 would reduce administrative burden for banks by making thresholds more reflective of current economic conditions. The establishment of ongoing indexing based on nominal GDP growth would prevent future erosion through a transparent, predetermined method.

The proposed threshold adjustments are designed to maintain the original calibration of regulatory requirements by restoring thresholds to approximately the same value relative to the economy in 1994, thereby preserving prudential safeguards against self-dealing and conflicts of interest. In addition to updating the calibration, the proposal preserves important safeguards by

requiring that all extensions of credit to insiders be made on substantially the same terms as to non-insiders and remain subject to individual and aggregate lending limits.

Overall, the analysis demonstrates that the benefits of the proposal justify the costs, as the proposal refocuses Regulation O on transactions that genuinely present conflicts of interest while reducing unnecessary restrictions on passive investors and routine transactions that have grown with the economy.

## **VII. Regulatory Analysis**

### **A. Paperwork Reduction Act**

Certain provisions of the proposal contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3521) (PRA). In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The information collection affected by this rulemaking is the Recordkeeping and Disclosure Requirements Associated with Regulation O (FR O; OMB No. 7100-0382). This Board proposes to extend this information collection for three years, with revision. The Board reviewed the proposal under the authority delegated to the Board by OMB.

Comments are invited on:

- a. Whether the collections of information are necessary for the proper performance of the Board’s functions, including whether the information has practical utility;
- b. The accuracy of the Board’s estimate of the burden of the information collections, including the validity of the methodology and assumptions used;
- c. Ways to enhance the quality, utility, and clarity of the information to be collected;

d. Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

e. Estimates of capital or startup costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the ADDRESSES section of this document. A copy of the comments may also be submitted to the OMB desk officer for the Board by mail to U.S. Office of Management and Budget, 725 17th Street NW, #10235, Washington, DC 20503; facsimile to (202) 395-6974; or email to [oira\\_submission@omb.eop.gov](mailto:oira_submission@omb.eop.gov), Attention, Federal Banking Agency Desk Officer.

#### *Current actions*

The proposed rule would modify the disclosure requirement currently codified in section 215.9 of Regulation O. This section requires a bank, in response to a written request from a member of the public, to identify the executive officers and principal shareholders of the bank (and the related interests of such persons) that have outstanding extensions of credit in an amount equal to the lower of 5 percent of the bank's capital and unimpaired surplus or \$500,000 as of the end of the latest previous quarter. No disclosure is required if the amount of the extensions of credit to a person and the person's related interests does not exceed \$25,000.<sup>187</sup>

The proposed rule, restated at 215.31, would amend the threshold in this section for the amount of extensions of credit to be the lesser of 5 percent of the bank's unimpaired capital and

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<sup>187</sup> 12 CFR 215.9.

unimpaired surplus and \$2.0 million. The proposed rule would continue not to require disclosure when the amount of extensions of credit to an executive officer or principal shareholder, or to their related interests, does not exceed \$25,000. The proposed rule also would amend the definition of “principal shareholder” for purposes of the disclosure requirement. Specifically, a bank’s holding company no longer would be a principal shareholder. In addition, a foreign bank no longer would be excluded from the definition of principal shareholder. Taken together, the list of persons that must be disclosed by banks subject to Regulation O likely will be smaller under the proposed rule than under Regulation O as it currently is written.

The proposed rule also would create recordkeeping and disclosure requirements to ensure compliance by banks with the correspondent lending restrictions in 12 U.S.C. 1972. Under the proposal, member banks would be required to maintain records of extensions of credit to insiders of the member bank’s correspondent or respondent bank. The proposed rule would permit banks with correspondent or respondent banks to use one of two methods prescribed by the rule to procure the information necessary to satisfy these recordkeeping requirements, or to propose an alternative to the bank’s appropriate federal banking agency. The two methods set forth by the proposed rule are the survey method, whereby a bank sends an annual survey to each of its correspondent or respondent banks to identify their insiders; or the borrower inquiry method, whereby a bank asks all persons seeking an extension of credit to identify whether they are insiders of the bank’s respondent or correspondent banks. Each of these methods would require the member bank to request the disclosure by third-parties of certain information to the bank.

The proposed amendments also relate to certain existing data items collected in the Federal Financial Institutions Examination Council (FFIEC) Reports of Condition and Income

(Call Reports; FFIEC 031, 041, and 051). Any amendments to the Call Reports would be proposed separately by the FFIEC.

Proposed Extension for Three Years, with Revision, of the Following Information Collection

*Collection title:* Recordkeeping and Disclosure Requirements Associated with Regulation O.

*Collection identifier:* FR O.

*OMB control number:* 7100-0382.

*General description of collection:* The Board's Regulation O - Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (12 CFR Part 215) governs any extension of credit made by a member bank to an executive officer, director, or principal shareholder of the member bank and any related interests of such persons or entities (insiders). Regulation O prohibits such extensions of credit to insiders unless they are made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions by the bank with other persons who are not employed by the bank and do not involve more than the normal risk of repayment or present other unfavorable features. In addition, Regulation O limits extensions of credit by a member bank to individual insiders and to all insiders, requires a member bank's board of directors to approve certain large extensions of credit, and sets forth recordkeeping and disclosure requirements

Pursuant to section 215.8 of the current Regulation O, respondents must maintain records necessary for compliance with the regulation. Under section 215.9 of the current Regulation O, upon receipt of a written request from the public, a respondent must make available certain

information regarding extensions of credit that exceed a certain threshold. These two provisions are restated at 215.30 and .31.

*Frequency:* Event-generated.

*Respondents:* Insured depository institutions and uninsured member banks.

*Total estimated number of respondents:*

Recordkeeping

Section 215.30 - 4,464.

Section 215.31 - 608.

Disclosure

Section 215.31 - 608.

*Estimated average hours per response:*

Recordkeeping

Section 215.30 - 3.

Section 215.31 - 1.

Disclosure

Section 215.31 - 2.

*Total estimated annual burden hours:* 15,216.

## **B. Regulatory Flexibility Act**

The Board is providing an initial regulatory flexibility analysis with respect to this proposed rule. The Regulatory Flexibility Act<sup>188</sup> (RFA), requires an agency to consider whether the rules it proposes will have a significant economic impact on a substantial number of small

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<sup>188</sup> 5 U.S.C. 601 *et seq.*

entities.<sup>189</sup> In connection with a proposed rule, the RFA generally requires an agency to prepare and invite comment on an initial regulatory flexibility analysis describing the impact of the rule on small entities, unless the agency certifies that the proposed rule, if promulgated, would not have a significant economic impact on a substantial number of small entities. An initial regulatory flexibility analysis must contain (1) a description of the reasons why action by the agency is being considered; (2) a succinct statement of the objectives of, and legal basis for, the proposed rule; (3) a description of, and, where feasible, an estimate of the number of small entities to which the proposed rule will apply; (4) a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; (5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap with, or conflict with the proposed rule; and (6) a description of any significant alternatives to the proposed rule which accomplish its stated objectives and minimize any significant economic impact of the proposed rule on small entities.<sup>190</sup>

The Board has considered the potential impact of the proposed rule on small entities in accordance with the RFA. Based on its analysis and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial

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<sup>189</sup> Under regulations issued by the U.S. Small Business Administration (SBA), a small entity includes a depository institution with total assets of \$850 million or less. *See* 13 CFR 121.201. Consistent with the SBA's General Principles of Affiliation, the Board includes the assets of all domestic and foreign affiliates toward the applicable size threshold when determining whether to classify a particular entity as a small entity. *See* 13 CFR 121.103. As of the first quarter of 2026, there were approximately 3,134 small state member banks, based on Call Report data as of March 31, 2026.

<sup>190</sup> 5 U.S.C. 603(b)-(c).

number of small entities. Nevertheless, the Board is publishing and inviting comment on this initial regulatory flexibility analysis.

As discussed in this **SUPPLEMENTARY INFORMATION**, the proposed rule would amend Regulation O to incorporate existing statutory requirements that are not currently reflected in the regulation and would clarify certain definitions, exemptions, and other matters to reflect longstanding interpretations and to harmonize Regulation O with other Board regulations. The proposed amendments also would update several outdated dollar-based thresholds in Regulation O and index these thresholds going forward. In addition, the proposed amendments would address the application of Regulation O to member banks that lend to companies that are presumed to be controlled by large asset management companies through passive investment funds. Finally, the proposed amendments would revise and reorganize the regulation to streamline the text and make it more accessible. Some of these changes may require changes to reporting forms that would occur separately from this rulemaking.

The Board has broad authority under sections 22(g) and 22(h) to establish regulations restricting extensions of credit from a bank to its insiders, consistent with statutory requirements. The Board has codified these restrictions into its Regulation O. However, subsequent interpretations and statutory updates have clarified and expanded restrictions on bank extensions of credit. The proposed regulatory amendments would conform Regulation O to existing statutes and interpretations and, therefore, would provide necessary clarity to banks regarding their obligations.

Regulation O applies, by its terms, to all member banks, regardless of their size. The regulation affects all insured depository institutions, however, because other Federal law subjects insured nonmember banks and insured savings associations to sections 22(g) and 22(h) as if they

were member banks. The rule also applies indirectly to the “insiders” of insured depository institutions, which, for RFA purposes, includes only insiders that are either (1) small business concerns; (2) small organizations, which are not-for-profit enterprises that are independently owned and operated and not dominant in their field; or (3) small governmental jurisdictions. The number of small entities affected by Regulation O is estimated to include 3,134 depository institutions.<sup>191</sup> The Board does not collect data on all insiders of depository institutions at this time. Accordingly, the exact number of small entities affected by the rule would require additional surveys or reports, which would increase the burden on the public and are not necessary for implementation of the rule. However, as discussed in more detail in section VII.A. of this **SUPPLEMENTARY INFORMATION**, the proposal would not include additional reporting requirements imposing any measurable burden. Any changes to reporting requirements would be limited to codifying existing statutory requirements, simplifying definitions applicable to disclosure requirements in Regulation O, scoping foreign banks into disclosure requirements as a result of Regulation O simplification, and consolidating certain disclosure requirements codified in Regulation O and Regulation Y into Regulation O. Although there is an additional recordkeeping requirement resulting from the codification of statutory correspondent lending restrictions, these methods are nearly identical to the methods set forth in Regulation O for a bank to maintain records to ensure compliance with Regulation O of loans to insiders of the bank’s affiliates.

The Board is aware of no other Federal rules that duplicate, overlap, or conflict with the proposed changes to Regulation O. In addition, as indicated above, the proposal would not include additional reporting requirements imposing any measurable burden and, with respect to

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<sup>191</sup> Small entity information is from Call Report data as of March 31, 2026.

the proposed amendments to exempt portfolio companies of qualifying fund complexes from the presumptions of control and to adjust and index the dollar-based thresholds to account for economic growth and inflation, the proposal would provide relief and reduce regulatory burden. Accordingly, the Board is aware of no significant alternatives to the proposed rule that would reduce economic impact on small entities supervised by the Board.

For these reasons, the proposed rule is not expected to have a significant economic impact on a substantial number of small entities.

The Board welcomes written comments regarding this initial regulatory flexibility analysis, and requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

### **C. Riegle Community Development and Regulatory Improvement Act of 1994**

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA),<sup>192</sup> in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions (IDIs), the federal banking agencies must consider, consistent with the principle of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on IDIs generally to take effect on the first day of a calendar quarter that begins on

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<sup>192</sup> 12 U.S.C. 4802(a).

or after the date on which the regulations are published in final form, with certain exceptions, including for good cause.<sup>193</sup>

The proposed rule would modify the disclosure requirements related to extensions of credit by banks to their principal shareholders and executive officers, and any related interests of such persons, as discussed in section VII.A of this **SUPPLEMENTARY INFORMATION**.

This modification likely will decrease the amount of information that most banks must disclose under the rule. The proposed rule otherwise does not include additional reporting requirements.

The proposed amendments relate to certain existing data items collected in the Federal Financial Institutions Examination Council (FFIEC) Reports of Condition and Income (Call Reports; FFIEC 031, 041, and 051). Any amendments to the Call Reports would be proposed separately by the FFIEC.

The Board invites comment on all aspects of the proposed rule and analysis related to RCDRIA.

#### **D. Solicitation of Comments on the Use of Plain Language**

Section 722 of the GLB Act requires the federal banking agencies to use plain language in proposed and final rulemakings published after January 1, 2000.<sup>194</sup> The Board has sought to present the proposed rule in a simple and straightforward manner and invites comment on the use of plain language in this proposal.

*Question 98: Has the Board organized the proposal in a clear way? If not, how could the proposal organized more clearly?*

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<sup>193</sup> 12 U.S.C. 4802.

<sup>194</sup> 12 U.S.C. 4809(a).

*Question 99: Are the requirements of the proposed rule clearly stated? If not, how could they be stated more clearly?*

*Question 100: Does the proposal contain unclear technical language or jargon? If so, which language requires clarification?*

*Question 101: Would a different format (such as a different grouping and ordering of sections, a different use of section headings, or a different organization of paragraphs) make the regulation easier to understand? If so, what changes would make the proposal clearer?*

*Question 102: What else could the Board do to make the proposal clearer and easier to understand?*

## **E. Providing Accountability Through Transparency Act of 2023**

The Providing Accountability Through Transparency Act of 2023 (5 U.S.C. 553(b)(4)) requires that a NPR include the internet address of a summary of not more than 100 words in length of the proposed rule, in plain language, that shall be posted on the internet website under section 206(d) of the E-Government Act of 2002 (44 U.S.C. 3501 note).

In summary, the Board proposes to amend its Regulation O (Loans To Executive Officers, Directors, And Principal Shareholders Of Member Banks) to update and modernize the regulation, clarify requirements and incorporate existing interpretations, and reduce regulatory burden. The proposal also would incorporate existing statutory requirements; update, and index going forward, several outdated dollar-based thresholds in Regulation O; and address the application of Regulation O to member banks that lend to companies presumed to be controlled by large asset management companies through passive investment funds. Finally, the proposal would revise and reorganize the regulation to make it more accessible.

The proposal and such a summary can be found at <https://www.regulations.gov> and <https://www.federalreserve.gov/supervisionreg/reglisting.htm>.

## **List of Subjects**

### **12 CFR Part 215**

Administrative practice and procedure, banks, banking, credit, Federal Reserve System, holding companies, investments, penalties, reporting and recordkeeping requirements, and securities.

### **Authority and Issuance**

For the reasons stated in the **SUPPLEMENTARY INFORMATION**, the Board of Governors of the Federal Reserve System proposes to amend 12 CFR chapter II as follows:

1. Revise Part 215 to read as follows:

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

#### **Sec.**

#### Subpart A – General Provisions

§ 215.1 – Authority, purpose, and scope.

§ 215.2 – Definitions.

§ 215.3 – Extension of credit.

§ 215.4 – Timing of application of requirements.

§ 215.5 – Valuation principles.

#### Subpart B – Requirements for Extensions of Credit to All Insiders

§ 215.11 – Terms and creditworthiness.

§ 215.12 – Prior approval.

§ 215.13 – Lending limits.

§ 215.14 – Prohibition on knowingly receiving an unauthorized extension of credit.

## Subpart C – Requirements for Extensions of Credit and other Transactions with Certain Insiders

§ 215.20 – Additional restrictions on extensions of credit to executive officers of a member bank.

§ 215.21 – Additional restrictions on paying overdrafts on accounts of directors and executive officers of a member bank and its affiliates.

§ 215.22 – Additional restrictions for extensions of credit related to existing and potential correspondent accounts.

§ 215.23 – Prohibitions on asset purchases and sales between an insured depository institution and an insider.

## Subpart D – Recordkeeping and Disclosure Requirements

§ 215.30 – Records of member banks.

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

§ 215.32 – Disclosure requirement for credit secured by certain bank and holding company stock.

## Subpart E – Civil Penalties

§ 215.40 – Civil penalties.

Authority: 12 U.S.C. 248(a), 375a(10), 375b(9) and (10), 1468, 1817(k), 1828(z), 1972(2), and 5412; Pub. L. 102-242, 105 Stat. 2236 (1991) (12 U.S.C. 1811 note).

## Subpart A – General Provisions

### **§ 215.1 – Authority, purpose, and scope.**

(a) *Authority.* This part is issued pursuant to sections 11(a), 22(g), and 22(h) of the Federal Reserve Act (12 U.S.C. 248(a), 375a, and 375b), 12 U.S.C. 1817(k), section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102-242, 105 Stat.

2236 (1991)), section 11 of the Home Owners' Loan Act (12 U.S.C. 1468), section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972), and sections 312(b)(2)(A) and 615(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 1828(z)(2) and 5412).

(b) *Purpose and scope*—(1) This part governs:

(i) Any extension of credit by a member bank to an executive officer, director, or principal shareholder of the member bank or of any affiliate of the member bank;

(ii) Any extension of credit by a member bank to a company controlled by such a person, or to a political or campaign committee that benefits or is controlled by such a person;

(iii) Asset purchases and sales between an insured depository institution and an insider of the insured depository institution described in paragraph (b)(1) or (2) of this section; and

(iv) Extensions of credit by a depository institution to an executive officer, director, or principal shareholder of another depository institution (or to a related interest of such person), if either institution maintains or seeks to maintain a correspondent account with the other institution.

(2) The Federal Deposit Insurance Act (12 U.S.C. 1828(j)) applies sections 22(g) and 22(h) of the Federal Reserve Act to insured State nonmember banks and insured branches of foreign banks in the same manner and to the same extent as if they were member banks, and the Home Owners' Loan Act (12 U.S.C. 1468(b)) applies sections 22(g) and 22(h) to insured savings associations in the same manner and to the same extent as if they were member banks.

(3) This part also implements the reporting and disclosure requirements of 12 U.S.C. 1817(k) concerning extensions of credit by a member bank to its executive officers or principal shareholders (or to the related interests of such persons).

## **§ 215.2 – Definitions.**

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

*Acting in concert* has the meaning given in § 225.41(b)(2) of this chapter. For purposes of this part, the persons set forth in § 225.41(d)(1)-(6) of this chapter are presumed to be acting in concert, except that, for purposes of § 225.41(d)(2) of this chapter, the term “immediate family” has the meaning given in this section.

*Affiliate* means any company of which a member bank is a subsidiary or any other subsidiary of that company, but does not include a subsidiary of the member bank that is not a financial subsidiary (as defined in § 223.3 of this chapter).

*Appropriate Federal banking agency* with respect to a member bank or company has the meaning given in 12 U.S.C. 1813.

*Board* means the Board of Governors of the Federal Reserve System.

*Carrying value* with respect to a security means (unless otherwise provided) the value of the security on the financial statements of the member bank, determined in accordance with GAAP.

*Class of voting securities* has the meaning given in § 225.2 of this chapter.

*Company* means any corporation, limited liability company, partnership, trust (business or otherwise), association, joint venture, pool syndicate, sole proprietorship, unincorporated organization, or any other form of business entity not specifically listed herein. However, the term does not include:

- (1) An insured depository institution; or
- (2) A corporation, the majority of the shares of which are owned by the United States or by any State.

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

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

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

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

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

(i) (A) The person is an executive officer or director of the company or bank; and

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

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

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

(iii) In the case of a company or bank that is a trust:

(A) The person is a trustee of the trust; or

(B) The person is a settlor, appointer, or beneficiary of the trust, and has the power to:

(1) Remove or replace a trustee of the trust; and

(2) Limit the power of a trustee of the trust to purchase, sell, or exchange any investment or asset of the trust; and

(iv) The company or bank is controlled by an estate for which the person serves as executor.

(3) The presumptions of control in paragraph (2) of this definition do not apply for the purpose of determining whether a qualified fund complex controls a company through one or more investment funds for purposes of determining whether the company is a related interest of the qualified fund complex that is a principal shareholder of a member bank.

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

(5) A person may rebut a presumption established by paragraph (2) of this definition by submitting to the appropriate Federal banking agency written materials that, in the agency's judgment, demonstrate an absence of control. The appropriate Federal banking agency should consult with the Board in considering such a request.

*Derivative transaction* has the meaning given in 12 U.S.C. 84(b).

*Derivative netting set* means all derivative transactions with an individual counterparty that are governed by a qualifying master netting agreement (as defined in § 217.2 of this chapter).

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

- (1) Is not elected by the shareholders of the company or bank;
- (2) Is not authorized to vote on matters before the board of directors; and
- (3) Provides solely general policy advice to the board of directors.

(4) Notwithstanding the definition of “member bank” in this section, a person is not a director of a member bank solely because the person is a director of a subsidiary of the member bank.

*Executive officer of a company or bank* (1) means a person who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions of the company or bank, whether or not the officer has an official title, the title designates the officer an assistant, or the officer is serving without salary or other compensation.

(2) The chair of the board, president, treasurer, chief executive officer, chief financial officer, chief lending officer, and chief investment officer of a company or bank are considered executive officers, unless the officer is excluded, by resolution of the board of directors or by the bylaws of the company or bank, from participation (other than in the capacity of a director) in major policymaking functions of the company or bank, and the officer does not actually participate therein.

(3) Executive officer of a company or bank does not include persons who may have official titles and may exercise a certain measure of discretion in the performance of their duties, including discretion in the making of loans, but who do not participate in the determination of major policies of the company or bank and whose decisions are limited by policy standards fixed by the senior management of the company or bank.

(4) Executive officer of a company or bank does not include a manager or assistant manager of a branch of the company or bank unless that individual participates, or is authorized to participate, in major policymaking functions of the bank or company.

(5) Notwithstanding the definition of “member bank” in this section, a person is not an executive officer of a member bank solely because the person is an executive officer of a subsidiary of the member bank.

*Exempt official* (1) means a person that:

- (i) Is a director or executive officer of an affiliate of a member bank;
- (ii) Is not a director or executive officer of the member bank; and
- (iii) With respect to all positions as director or executive officer of an affiliate of a member bank:

(A) The director or executive officer is excluded, by resolution of the board of directors or by the bylaws of the member bank, from participation in major policymaking functions of the member bank, and the director or executive officer does not actually participate in such functions;

(B) The affiliate does not control the member bank; and

(C) As determined annually, the assets of the affiliate do not constitute more than 10 percent of the consolidated assets of the company that:

(1) Controls the member bank; and

(2) Is not controlled by any other company.

(2) For purposes of paragraph (1)(iii)(A) of this definition, a resolution of the board of directors or a corporate bylaw may:

(i) Include the director (by name or by title) in a list of persons excluded from participation in such functions; or

(ii) Not include the director in a list of persons authorized (by name or by title) to participate in such functions.

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

*GAAP* means generally accepted accounting principles as used in the United States.

*GDP growth adjustment* means the most recent scalar published by the Board equal to the ratio of:

(1) The nominal United States gross domestic product in the 4th quarter of the calendar year prior to publication of the scalar, as reflected by the most current estimates published by the Bureau of Economic Analysis on or before September 30th of the year of the publication of the scalar, or a comparable value; to

(2) The nominal United States gross domestic product in the 4th quarter of the calendar year prior to [the effective date of a final rule], as reflected by the most current estimates published by the Bureau of Economic Analysis.

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

*Insider* of a member bank or company means:

(1) An executive officer or director of the member bank or company (other than an exempt official);

(2) A principal shareholder of the member bank or company; and

(3) Any related interest of a person described in paragraphs (1) or (2) of this definition.

*Insured depository institution* has the meaning given in 12 U.S.C. 1813.

*Investment fund* means an investment company registered under the Investment Company Act of 1940, as well as collective investment trusts, separately managed institutional accounts, and other pooled investment vehicles.

*Member bank* means any banking institution that is a member of the Federal Reserve System and includes any subsidiary of such banking institution. The term includes insured branches of foreign banks, as defined by 12 U.S.C. 1813(s), but does not otherwise include a foreign bank that maintains a branch in the United States.

*Non-index fund* (1) means an investment fund that does not:

(i) Have an investment objective of tracking the risk and return characteristics of a previously specified third-party broad-based market 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

(ii) Use rules-based investing to track that broad-based market index by holding all of its constituent assets or an automatically selected representative sample of those assets in order to replicate the risk and return characteristics of the index.

(2) 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;

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

*Person* means an individual or a company.

*Principal shareholder* (1) means a person that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank or company. For clarification, shares

owned or controlled by a member of an individual's immediate family are considered to be owned or controlled by the individual.

(2) A principal shareholder of a member bank or company does not include:

(i) A company of which the member bank is a subsidiary; or

(ii) The member bank.

*Qualified fund complex* (1) means a company that:

(i) Sponsors, manages, or advises investment funds that invest in voting securities of a regulated company;

(ii) 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);

(iii) Does not meet any of the conditions that would give rise to a rebuttable presumption of control over a regulated company under § 225.32 of this chapter;

(iv) Does not sponsor, manage, or advise any investment fund that owns or controls more than 10 percent of any class of voting securities of a regulated company; and

(v) Does not sponsor, manage, or advise non-index funds that in the aggregate own or control more than 10 percent of any class of voting securities of a regulated company.

(2) For purposes of paragraph (1)(iv) of this definition, investment funds that share the same or substantially the same investment objective and asset composition are treated as a single investment fund.

*Regulated company* means an insured depository institution, a bank holding company (as defined in § 225.2 of this chapter), or a savings and loan holding company (as defined in § 238.2 of this chapter).

*Related interest* of a person means:

- (1) A company that is controlled by that person; or
- (2) A political or campaign committee that is controlled by that person or the funds or services of which will benefit that person.

*Securities financing transaction* means any repurchase agreement, reverse repurchase agreement, securities borrowing transaction, or securities lending transaction, including a transaction in which a member bank acts as agent for a customer and indemnifies the customer against loss caused by the default of the bank's counterparty.

*Subsidiary* has the meaning given in 12 U.S.C. 1841(d).

*Unimpaired capital and unimpaired surplus* of a member bank equals the sum of:

- (1) The bank's tier 1 and tier 2 capital included in the bank's risk-based capital under the capital rule of the appropriate Federal banking agency, based on the bank's most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3); and

- (2) The balance of the bank's allowance for loan and lease losses or adjusted allowance for credit losses, as applicable, not included in the bank's tier 2 capital for purposes of the calculation of risk-based capital by the appropriate Federal banking agency, based on the bank's most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3).

- (3) For a bank that is subject to the community bank leverage ratio framework (as defined in the capital rule of the appropriate Federal banking agency), unimpaired capital and unimpaired surplus means the bank's tier 1 capital (as defined in the capital rule of the appropriate Federal banking agency and as calculated in accordance with the community bank leverage ratio framework of the appropriate Federal banking agency) plus allowance for loan and lease losses or adjusted allowance for credit losses, as applicable.

### **§ 215.3 – Extension of credit.**

(a) An extension of credit to an insider is a making or renewal of any loan to an insider, a granting of a line of credit to an insider, or an extending of credit in any manner whatsoever to an insider, and includes:

(1) An advance to an insider by means of paying an overdraft on an account, cash item, or otherwise;

(2) Issuance of a guarantee, acceptance (including an ineligible acceptance as defined in § 208.24 of this chapter), or letter of credit, including an endorsement or standby letter of credit (as defined in § 208.24 of this chapter), on behalf of an insider, or a confirmation of a letter of credit issued by an insider;

(3) An advance to an insider of unearned salary or other unearned compensation for a period in excess of 30 days;

(4) A lease to an insider that is the functional equivalent of an extension of credit;

(5) An acquisition by purchase, discount, exchange, or otherwise of a note or other obligation, including commercial paper or debt securities, upon which an insider is liable as maker, drawer, endorser, guarantor, or surety;

(6) Any increase in the amount of, extension of maturity of, or adjustment to the interest rate term or other material term of, an extension of credit to an insider;

(7) A derivative transaction, derivative netting set, or securities financing transaction with an insider, the value of which (as calculated pursuant to § 215.5) is greater than zero; and

(8) Any other similar transaction as a result of which an insider becomes obligated to pay money (or its equivalent) to the member bank, whether the obligation arises directly or

indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

(b) An extension of credit does not include:

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

(2) A receipt by a bank of a check deposited in or delivered to the bank in the usual course of business, unless it results in the carrying of a cash item for an insider or the paying of an overdraft on an account to an insider;

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

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

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

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

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

(5) Aggregate indebtedness of an insider of \$60,000, multiplied by the GDP growth adjustment, or less arising by reason of any general arrangement by which a bank:

(i) Acquires charge or time credit accounts; or

(ii) Makes payments to or on behalf of participants in a bank credit card plan, check credit plan, or similar open-end credit plan, provided:

(A) The indebtedness does not involve prior individual clearance or approval by the bank other than for the purposes of determining authority to participate in the arrangement and compliance with any dollar limit under the arrangement; and

(B) The indebtedness is incurred under terms that are not more favorable than those offered to the general public;

(6) Aggregate indebtedness of an insider of \$20,000, multiplied by the GDP growth adjustment, or less arising by reason of a written, preauthorized, interest-bearing overdraft protection plan that specifies a method of repayment;

(7) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper owned by an insider, without recourse to the insider; or

(8) An advance of funds that increases an existing indebtedness of an insider, if the additional funds are advanced by the bank for its own protection for:

(i) Accrued interest; or

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

(9) Except for purposes of § 215.20 of this part, a loan:

(i) Made pursuant to the “Paycheck Protection Program” in which the participation by the Small Business Administration on a deferred basis is 100 percent;

(ii) For which material terms, including the maturity and the interest rate, are set by the Small Business Administration;

(iii) That is made during the “covered period,” as that term is defined in 15 U.S.C. 636(a)(36)(A)(iii), but in no case later than March 31, 2022; and

(iv) That would not be prohibited by 13 CFR 120.110(o) or rules or interpretations thereof issued by the Small Business Administration.

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

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

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

(2) *Beneficiaries of trusts and estates*. For purposes of this part, the proceeds of an extension of credit to a trust or estate are treated as being transferred to an insider or used for the tangible economic benefit of the insider if the insider has a 25 percent or more present or contingent beneficial interest in the trust or estate.

(3) *Spouse of an insider*. For purposes of this part, the proceeds of an extension of credit to a spouse of an insider or to the related interest of such spouse are treated as being transferred to the insider or used for the tangible economic benefit of the insider, unless:

- (i) The spouse or related interest is independently creditworthy;
- (ii) Repayment of the extension of credit is not predicated on the insider's income or assets; and

(iii) In the case of an extension of credit to a related interest of the spouse of an insider, the insider does not have a financial or ownership interest in, or participate in the management of, the related interest.

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

(i) The credit is extended on terms that would satisfy the standard set forth in § 215.11(a) for extensions of credit to insiders; and

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

**§ 215.4 – Timing of application of requirements.**

(a) *Timing of an extension of credit.* An extension of credit to an insider by a member bank is considered to have been made at the time the bank enters into a binding commitment to make the extension of credit.

(b) *Extensions of credit to noninsiders that later become insiders.* An extension of credit by a member bank to a noninsider that later becomes an insider is not subject to this part if:

(1) The member bank includes the amount of the extension of credit towards any quantitative limit in this part for purposes of determining whether a future extension of credit to the insider would comply with the quantitative limit; and

(2) The member bank did not enter into the transaction in contemplation of the noninsider becoming an insider.

(c) *Lines of credit.* Paragraph (b) of this section ceases to apply to a line of credit beginning 14 months after the date that the noninsider becomes an insider.

## **§ 215.5 – Valuation principles.**

(a) *Extensions of credit.* (1) Except as provided in paragraphs (a)(2), (a)(3), (b), or (c) of this section, an extension of credit to an insider must be valued at the greater of:

- (i) The principal amount of the extension of credit;
- (ii) The amount owed by the insider to the member bank under the transaction; or
- (iii) The sum of:
  - (A) The amount provided to, or on behalf of, the insider in the transaction; and
  - (B) Any additional amount that the member bank could be required to provide to, or on behalf of, the insider under the terms of the transaction.

(2) If a member bank acquires an extension of credit to an insider, the extension of credit must be valued at the sum of:

- (i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the extension of credit; and
- (ii) Any additional amount that the member bank could be required to provide to, or on behalf of, the insider under the terms of the transaction.

(3) A member bank's purchase of or investment in a debt security issued by an insider must be valued at the greater of:

- (i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the security, reduced to reflect amortization of the security to the extent consistent with GAAP; or
- (ii) The carrying value of the security.

(b) *Derivative transaction or derivative netting set.*

(1) Except as provided in paragraph paragraphs (b)(2) of this section, a credit exposure from a derivative transaction or derivative netting set with an insider must be valued using any of the methods that the member bank is authorized to use under the capital rule issued by the member bank's appropriate Federal banking agency;

(2) A credit derivative between a member bank and a third-party in which the member bank provides credit protection to the third-party with respect to an obligation of an insider of the member bank is a guarantee by a member bank on behalf of an insider for purposes of this regulation. A credit exposure from a transaction in such credit derivatives would be valued at the greater of (i) the notional principal amount or (ii) the maximum potential loss to the member bank on the transaction. Such derivatives would include:

(i) An agreement under which the member bank, in exchange for a fee, agrees to compensate the third-party for any default of the underlying obligation of the insider;

(ii) An agreement under which the member bank, in exchange for payments based on the total return of the underlying obligation of the insider, agrees to pay the third-party a spread over funding costs plus any depreciation in the value of the underlying obligation of the insider;

(iii) An equity derivative under which the member bank, in exchange for a fee, agrees to compensate a third-party for any depreciation in the value of an equity security of the insider;  
and

(iv) A total return swap, whether funded or unfunded, under which the member bank, in exchange for a fee, agrees to compensate a third-party for any loss or depreciation in the value of a security or debt obligation issued by an insider.

(c) *Securities financing transaction.* A securities financing transaction with an insider must be valued using:

(1) Any of the methods that the member bank is authorized to use under the capital rule issued by the member bank's appropriate Federal banking agency;<sup>195</sup> or

(2) The simplified amount calculated pursuant to paragraph (d) of this section.

(d) *Simplified amount.* The simplified amount for a securities financing transaction equals:

(1) The market value of cash and securities transferred by the member bank to the insider as part of the transaction; *less*

(2) The market value of cash in a segregated deposit account with the member bank in which the bank has a perfected security interest and any obligations of, or fully guaranteed as to principal and interest by, the United States or its agencies, transferred by the insider to the member bank as part of the transaction.

#### **§ 215.6 – Indexing dollar-based thresholds.**

(a) *In general.* The Board will publish a GDP growth adjustment and adjusted thresholds every five years starting with [the effective date of a final rule].

(b) *Rounding.* When adjusting thresholds under paragraph (a) of this section, each threshold shall be rounded based on the size of the threshold (e.g., thousands, millions) to the nearest number with two significant digits, such that:

(1) Each threshold in the thousands shall be rounded to the nearest number with one significant digit; and

(2) Each threshold in the millions shall be rounded to the nearest number with two significant digits.

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<sup>195</sup> 12 CFR part 3 (Office of the Comptroller of the Currency); 12 CFR part 208 (Board); 12 CFR part 324 (Federal Deposit Insurance Corporation).

(c) *Exception.* Notwithstanding paragraph (a) of this section, the Board will not publish an updated GDP growth adjustment if the five-year cumulative growth of nominal U.S. GDP is negative.

## **Subpart B – Requirements for Extensions of Credit to All Insiders**

### **§ 215.11 – Terms and creditworthiness.**

(a) *In general.* A member bank must not extend credit to any insider of the bank or insider of its affiliates unless the extension of credit:

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

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

(b) *Exception.* Nothing in this section or § 215.21(b)(3)(ii) shall prohibit any extension of credit made pursuant to a benefit or compensation program—

(1) That is widely available to employees of the member bank and, in the case of extensions of credit to an insider of its affiliates, is widely available to employees of the affiliates at which that person is an insider; and

(2) That does not give preference to any insider of the member bank over other employees of the member bank and, in the case of extensions of credit to an insider of its affiliates, does not give preference to any insider of its affiliates over other employees of the affiliates at which that person is an insider.

### **§ 215.12 – Prior approval.**

(a) A member bank must not extend credit (which term includes granting a line of credit) to any insider of the bank or insider of its affiliates in an amount that, when aggregated with the amount of all other extensions of credit to that person and to all related interests of that person, exceeds the lower of 5 percent of the member bank's unimpaired capital and unimpaired surplus, or \$2,000,000, multiplied by the GDP growth adjustment, unless:

(1) The extension of credit has been approved in advance by a majority of the entire board of directors of that bank; and

(2) Any interested party has abstained from participating directly or indirectly in the voting.

(b) Approval by the board of directors under paragraph (a) of this section is not required for an extension of credit that is made pursuant to a line of credit that was approved under paragraph (a) of this section within 14 months of the date of the extension of credit. The extension of credit must also be in compliance with the requirements of § 215.11.

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

### **§ 215.13 – Lending limits.**

(a) *Individual lending limit*—(1) *In general.* A member bank must not extend credit to an insider of the bank or insider of its affiliates if the amount of the extension of credit, when aggregated with the amount of all other extensions of credit by the bank to that person and to all related interests of that person would exceed:

(i) The limit of loans to a single borrower established by 12 U.S.C. 84(a), which is 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured, and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the loan. This limit also includes any higher amounts that are permitted by 12 U.S.C. 84(c) and (d) for the types of obligations listed therein as exceptions to the limit established by 12 U.S.C. 84(a).

(ii) In the case of a State member bank, any lending limit set forth by State law applicable to the bank.

(2) *Line of credit.* For purposes of paragraph (a)(1) of this section, the unused portion of a line of credit will be deemed to have been collateralized if the member bank that makes the line of credit does not have any legal obligation to advance funds pursuant to the line of credit until the insider provides the amount of collateral required by paragraph (a)(1) of this section with respect to the entire used portion (including the amount of the requested draw) of the line of credit.

(b) *Aggregate lending limit—(1) General limit.* A member bank must not extend credit to any insider of the bank or insider of its affiliates unless the extension of credit is in an amount that, when aggregated with the amount of all outstanding extensions of credit by that bank to all such insiders, does not exceed the bank's unimpaired capital and unimpaired surplus.

(2) *Member banks with deposits of less than \$100,000,000.* (i) A member bank with deposits of less than \$100,000,000 may by an annual resolution of its board of directors increase

the general limit specified in paragraph (b)(1) of this section to a level not to exceed two times the bank's unimpaired capital and unimpaired surplus, if:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**§ 215.14 – Prohibition on knowingly receiving an unauthorized extension of credit.**

An executive officer, director, or principal shareholder of a member bank or any of its affiliates (other than an exempt official) must not knowingly receive (or knowingly permit any of

that person's related interests to receive) from a member bank, directly or indirectly, any extension of credit not authorized under this part.

### **Subpart C – Requirements for Extensions of Credit and other Transactions with Certain Insiders**

#### **§ 215.20 – Additional restrictions on extensions of credit to executive officers of a member bank.**

(a) *Scope.* The restrictions in this section on extensions of credit by a member bank to any of its executive officers apply in addition to any restrictions on extensions of credit by a member bank to its insiders or insiders of its affiliates set forth elsewhere in this part. The restrictions of this section apply only to executive officers of the member bank and not to executive officers of its affiliates or to related interests of executive officers of the member bank. For purposes of this section, however, an extension of credit by a member bank to a related interest of an executive officer must be treated as having been made to the executive officer, if the related interest:

- (1) Is the alter ego of the executive officer; and
- (2) Has no independent means to repay the extension of credit.

(b) A member bank must not extend credit to any of its executive officers, and an executive officer of a member bank must not borrow from or otherwise become indebted to the bank, except in the amounts, for the purposes, and upon the conditions specified in paragraphs (d) and (e) of this section.

(c) A member bank must not extend credit in an aggregate amount greater than the amount permitted in paragraph (d)(4) of this section to a partnership in which one or more of the bank's executive officers are partners and, either individually or together, hold a majority

interest. For the purposes of paragraph (d)(4) of this section, the total amount of credit extended by a member bank to such partnership is considered to be extended to each executive officer of the member bank who is a member of the partnership.

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

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

(2) In any amount to finance or refinance the purchase, construction, maintenance, or improvement of a single residence of the executive officer, provided:

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

(ii) The property is not used for investment purposes, including renting or leasing out any portion of the property for income;

(iii) The executive officer lives at the property for at least three months each year; and

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

(3) In any amount, if the extension of credit is secured in a manner described in § 215.13(b)(3)(i)(A)-(C); and

(4) For any other purpose not specified in paragraphs (d)(1)-(3) of this section, if the aggregate amount of extensions of credit to that executive officer under this paragraph (d)(4) does not exceed at any one time the lower of 2.5 percent of the member bank's unimpaired capital and unimpaired surplus or \$400,000, multiplied by the GDP growth adjustment.

(e) Any extension of credit by a member bank to any of its executive officers must be:

(1) Promptly reported to the member bank's board of directors;

(2) In compliance with the requirements of § 215.11;

(3) Preceded by the submission of a detailed current financial statement of the executive officer; and

(4) Made subject to the condition in writing that the extension of credit will, at the option of the member bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in paragraph (d) of this section.

**§ 215.21 – Additional restrictions on paying overdrafts on accounts of directors and executive officers of a member bank and its affiliates.**

(a) *Scope.* This section applies to payments of overdrafts by a member bank on an account of an executive officer or director of the member bank, or on an account of an executive officer or director of its affiliates that is not an exempt official. This section does not apply to payments of overdrafts on an account of a related interest of such an executive officer or director.

(b) A member bank must not pay an overdraft on an account of an executive officer or director of the member bank, or executive officer or director of its affiliates that is not an exempt official, unless the payment is made:

(1) Pursuant to a written, preauthorized, interest-bearing overdraft protection plan that specifies a method of repayment;

(2) Pursuant to a written, preauthorized transfer of funds from another account of the account holder at the member bank; or

(3) Inadvertently, if:

- (i) The account is not overdrawn for more than five business days;
- (ii) The member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances; and
- (iii) The aggregate amount of all payments of overdrafts on an account of the account holder pursuant to paragraph (b)(3) of this section does not exceed \$4,000, multiplied by the GDP growth adjustment.

**§ 215.22 – Additional restrictions for extensions of credit related to existing and potential correspondent accounts.**

- (a) For purposes of this section:
  - (1) The term “bank” has the meaning given in 12 U.S.C. 1841(c) and includes a mutual savings bank, a savings bank, a savings association (as those terms are defined in 12 U.S.C. 1813), and any subsidiary of the foregoing;
  - (2) The term “correspondent account” means an account that is maintained by a bank with another bank for the deposit or placement of funds; and
  - (3) The term “insider” of a bank means:
    - (i) An executive officer or director of the bank;
    - (ii) (A) A person that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the bank;
    - (B) Shares owned or controlled by a member of an individual’s immediate family are considered to be owned or controlled by the individual; and
  - (iii) Any related interest of a person described in paragraphs (a)(3)(i) and (a)(3)(ii) of this section.

(b) A bank must not extend credit to the insider of a second bank if the bank maintains a correspondent account in the name of the second bank, or the second bank maintains a correspondent account in the name of the bank, unless the extension of credit is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and does not involve more than the normal risk of repayment or present other unfavorable features; and

(c) A bank must not open a correspondent account at a second bank if the bank has an outstanding extension of credit to an insider of the second bank or the second bank has an outstanding extension of credit to an insider of the bank, unless the extension of credit is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and does not involve more than the normal risk of repayment or present other unfavorable features.

**§ 215.23 – Prohibitions on asset purchases and sales between an insured depository institution and an insider.**

(a) For purposes of this section the term “purchase an asset” means the acquisition by an insured depository institution of an asset from an insider in exchange for cash or any other consideration, including an assumption of liabilities. The merger of an insider into an insured depository institution is a purchase of assets by the insured depository institution from an insider if the insured depository institution assumes any liabilities of the insider or pays any other form of consideration in the transaction.

(b) An insured depository institution must not purchase an asset from, or sell an asset to, an insider of the institution unless:

(1) The purchase or sale:

(i) Is on terms and under circumstances that are 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; or

(ii) In the absence of comparable transactions, is on terms and under circumstances that in good faith would be offered to, or would apply to, persons that are not insiders of the insured depository institution; and

(2) The transaction has been approved in advance by a majority of the members of the board of directors of the insured depository institution who are not an interested party with respect to the transaction, if the amount of the purchase or sale represents more than 10 percent of the unimpaired capital and unimpaired surplus of the insured depository institution.

(c) Participation in the discussion, or any attempt to influence the voting, by the board of directors regarding a purchase or sale of assets subject to this section constitutes indirect participation in the voting by the board of directors on the purchase or sale of assets.

#### **Subpart D – Recordkeeping and Disclosure Requirements**

##### **§ 215.30 – Records.**

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

(b) *Safe harbors.*

(1) A member bank that uses one of the methods set forth in paragraphs (d)(1) or (d)(2) of this section satisfies the requirements of paragraph (d) of this section.

(2) A member bank that uses one of the methods set forth in paragraphs (e)(1) or (e)(2) of this section satisfies the requirements of paragraph (e) of this section.

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

- (1) Identify, through an annual survey, all insiders of the bank itself; and
- (2) Maintain records of all extensions of credit to insiders of the bank itself, including the amount and terms of each such extension of credit.

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

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

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

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

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

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

(e) *Recordkeeping for insiders of a correspondent or respondent bank.* For purposes of this paragraph (e), the term insider has the meaning set forth in § 215.22(a)(3). Any

recordkeeping method adopted by a member bank must maintain records of extensions of credit to insiders of the member bank's correspondent or respondent bank by:

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

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

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

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

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

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

**§ 215.31 – Disclosure of credit from member banks to executive officers and principal shareholders.**

(a) *Public disclosure.* (1) Upon receipt of a written request from the public, a member bank must make available the names of each of its executive officers and each of its principal shareholders to whom, or to whose related interests, the member bank had outstanding as of the end of the latest previous quarter of the year, an extension of credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such person and to all related interests of such person, equaled or exceeded 5 percent of the member bank's unimpaired capital and unimpaired surplus or \$2,000,000, multiplied by the GDP growth adjustment, whichever amount is less. No disclosure under this paragraph is required if the aggregate amount of all extensions of credit outstanding at such time from the member bank to the executive officer or principal shareholder of the member bank and to all related interests of such a person does not exceed \$25,000.

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

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

**§ 215.32 – Disclosure requirement for credit secured by certain bank and holding company stock.**

(a) *Bank stock.* Each executive officer or director of a member bank that does not have any class of equity securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) must disclose annually to the board of directors of the member bank the

outstanding amount of any extension of credit to the executive officer or director that is secured by shares of the member bank or by shares of a company of which the member bank is a subsidiary.

(b) *Holding company stock.* Each executive officer or director of a company of which the member bank is a subsidiary and that does not have any class of equity securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) must disclose annually to the board of directors of the company the outstanding amount of any extension of credit to the executive officer or director that is secured by shares of the company or by shares of the subsidiary member bank. In addition, each executive officer or director of a member bank must disclose annually to the board of directors of the member bank the outstanding amount of any extension of credit to the executive officer or director that is secured by shares of the holding company, if the holding company does not have any class of equity securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l).

#### **Subpart E – Civil Penalties**

##### **§ 215.40 – Civil penalties.**

Any member bank, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank, that violates any provision of this part (other than § 215.31) is subject to civil penalties as specified in section 29 of the Federal Reserve Act (12 U.S.C. 504).

#### **PART 225— BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)**

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

12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3906, 3907, and 3909; 15 U.S.C. 1681s, 1681w, 6801 and 6805.

**§225.4 Corporate practices. (Amended)**

3. In §225.4, remove and reserve § 225.4(e).

***Nomenclature Changes***

**PART 207—(Amended)**

4. The authority citation for Part 207 continues to read as follows:

Authority: 12 U.S.C. 1831y.

**§207.11 (Amended)**

5. In §207.11(e), remove “§ 215.2(e)(1)” and add “§ 215.2” in its place.

**PART 208 – (Amended)**

6. The authority citation for Part 208 continues to read as follows:

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1817(a)(3), 1817(a)(12), 1818, 1820(d)(9), 1833(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, 3905-3909, 5371, and 5371 note; 15 U.S.C. 78b, 78I(b), 78I(i), 780-4(c)(5), 78q, 78q-1, 78w, 1681s, 1681w, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

**Part 208 (Amended)**

7. In the table below, for each part or section indicated in the left column, remove the current section referenced in the middle column from wherever it appears, and add “§ 215.2” as indicated in the right column:

| Part or Section               | Remove        | Add     |
|-------------------------------|---------------|---------|
| § 207.11(e)                   | § 215.2(e)(1) | § 215.2 |
| Part 208 – Appendix D-1(B)(4) | § 215.2(c)    | § 215.2 |

|                               |               |         |
|-------------------------------|---------------|---------|
| Part 208 – Appendix D-1(B)(5) | § 215.2(d)    | § 215.2 |
| Part 208 – Appendix D-1(B)(6) | § 215.2(d)(1) | § 215.2 |
| Part 208 – Appendix D-1(6)    | § 215.2(l)    | § 215.2 |

**PART 238 – (Amended)**

8. The authority citation for Part 238 continues to read as follows:

Authority: 5 U.S.C. 552, 559; 12 U.S.C. 1462, 1462a, 1463, 1464, 1467, 1467a, 1468, 5365; 1813, 1817, 1829e, 1831i, 1972, 15 U.S.C. 78 l.

**§§ 238.119, 122 (Amended)**

9. In the table below, for each part or section indicated in the left column, remove the current section referenced in the middle column from wherever it appears, and add “§ 215.2” as indicated in the right column:

| Section                | Remove        | Add     |
|------------------------|---------------|---------|
| § 238.119(a)(4)(ii)(B) | § 215.2(e)(1) | § 215.2 |
| § 238.122(a)(4)(ii)(B) | § 215.2(e)    | § 215.2 |

**PART 248 – PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS (REGULATION VV)**

10. The authority citation for Part 248 continues to read as follows:

Authority: 12 U.S.C. 1851, 12 U.S.C. 221 et seq., 12 U.S.C. 1818, 12 U.S.C. 1841 et seq., and 12 U.S.C. 3103 et seq.

**§248.10 (Amended)**

11. In § 248.10(d)(3), remove “§ 215.2(e)” and add “§ 215.2” in its place.

**PART 252– ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)**

12. The authority citation for Part 252 continues to read as follows:

Authority: 12 U.S.C. 321-338a, 481-486, 1467a, 1818, 1828, 1831n, 1831o, 1831p-1, 1831w, 1835, 1844(b), 1844(c), 3101 et seq., 3101 note, 3904, 3906-3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

**§§252.22, 252.33, 252.144, 252.147, 252.153, 252.155 (Amended)**

13. In the table below, for each part or section indicated in the left column, remove the current section referenced in the middle column from wherever it appears, and add “§ 215.2” as indicated in the right column:

| Section                                                                    | Remove        | Add     |
|----------------------------------------------------------------------------|---------------|---------|
| § 252.22(a)(4)(ii)(B)<br>§ 252.33(a)(4)(ii)(B)<br>§ 252.144(b)(1)(v)(B)(2) | § 215.2(e)(1) | § 215.2 |
| § 252.147(e)(2)(iv)(B)(2)<br>§ 252.155(a)(5)(ii)(B)                        | § 215.2(e)    | § 215.2 |
| § 252.153(e)(3)(iv)(B)(2)                                                  | § 215.2(e)(1) | § 215.2 |

By order of the Board of Governors of the Federal Reserve System.

*(signed) Benjamin W. McDonough*

**Benjamin W. McDonough,**  
*Secretary of the Board.*