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FEDERAL RESERVE SYSTEM

12 CFR Part 215

[Regulation O; Docket No. R-0939]

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

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending its Regulation O, which limits how much and on what terms a bank may lend to its own insiders and insiders of its affiliates, in order to permit insiders of a bank and of the bank's affiliates to obtain loans under company-wide employee benefit plans. This amendment conforms the regulation to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, which was recently passed by Congress. Currently, participation in such plans is prohibited when loans under such plans are on terms not available to the general public.

The Board also is amending Regulation O to simplify the procedure for a bank's board of directors to exclude executive officers and directors of an affiliate from policymaking functions of the bank, and thereby from the restrictions of Regulation O.

EFFECTIVE DATE: November 4, 1996.

FOR FURTHER INFORMATION CONTACT: Gregory Baer, Managing Senior Counsel (202/452-3236), or Gordon Miller, Attorney (202/452-2534), Legal Division, Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

Section 22(h) of the Federal Reserve Act restricts insider lending by banks, and Regulation O implements section 22(h). 12 U.S.C. 375b; 12 CFR Part 215. Regulation O imposes quantitative limits on loans to insiders and requires that such loans not be on "preferential" terms—that is, on the same terms a person not affiliated with the bank would receive. 12 CFR 215.4(a). For this purpose, an "insider" means an executive officer, director, or principal shareholder, and loans to an insider include loans to any "related interest" of the insider, including any company controlled by the insider. 12 CFR 215.2(h). Section 22(h) also restricts lending to insiders of a bank's parent bank holding company and any other subsidiary of that bank holding company. 12 U.S.C. 22(h)(8).

Widely Available Benefit Plans

On September 30, 1996, in the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA),¹ Congress amended the preferential lending prohibition of section 22(h)(2) by adding an exception for extensions of credit made pursuant to a program that is widely available to all employees of the lending bank and does not give preference to insiders over other employees. The amendment to section 22(h) was effective September 30, 1996.

Previously, section 22(h)(2) prohibited insiders from participating in programs available to all other employees of a lending bank, such as a reduction or waiver of closing costs for home mortgage loans, because members of the general public were not entitled to obtain credit on the same terms. The legislative history of EGRPRA indicates that Congress amended section 22(h) because participation by insiders in programs as described above would not affect any of the core restrictions on insider lending under the statute.² In other words, participation by an insider in a plan that is widely available to employees of a bank would not constitute abuse of the insider's position and would not substantially contribute

to a concentration of credit among insiders.

The Board is amending Regulation O to conform to the amendment in EGRPRA. Consistent with section 22(h)(8), the amendment also expressly includes loans to insiders of an affiliate in the new exception.³

Exclusion of Insiders of Affiliates From Policymaking at a Bank

The Board previously published for public comment a proposal to simplify the requirements for board of directors action to exclude an executive officer of an affiliate from participating in major policymaking functions of the lending bank.⁴ Currently, in order to be exempt from Regulation O, an executive officer must be excluded by resolution of the board of directors of both the lending bank and the affiliate for which the executive officer works. 12 CFR 215.2(e)(2)(i). Because a bank has full control over who participates in its policymaking, however, the Board proposed that requiring a board resolution of the affiliate in addition to a board resolution of the lending bank was superfluous and unduly burdensome. Forty-four public comments were received on the proposal, of which 18 generally supported the simplification of the resolution requirements, with no comments opposed. Accordingly, the Board is deleting this requirement from the existing exception for executive officers of affiliates.

Four commenters on the proposal also recommended that the resolution requirements be further simplified by permitting a bank to adopt a resolution listing by name or title only the insiders of the bank and its affiliates who are authorized to participate in major policymaking functions of the bank and generally excluding all other persons from participation. Currently, the regulation requires the executive officer to be excluded by name or title from participating in such functions. 12 CFR 215.2(e)(2)(i). Because a bank's board of

³ Insiders of affiliates are eligible because they are deemed to be insiders of member banks for all purposes under the statute. See 12 U.S.C. 375b(8). Thus, an insider of an affiliate would be eligible for a benefit or compensation program if the bank made the benefit or compensation widely available to employees of that affiliate, and did not give preference to insiders over other employees of that affiliate.

⁴ 61 FR 19683 (May 3, 1996).

¹ Pub. L. 104-208, section 2211 (1996).

² See S. Rep. No. 104-185, 104th Cong., 1st Sess. 25 (1995).

directors has formal control over who participates in the bank's policymaking, the Board believes that an affirmative resolution of the board should accurately identify all persons participating. Accordingly, the Board is amending the resolution requirement to provide for such a resolution.

Some commenters also proposed that the board of directors of a bank holding company be permitted to adopt a resolution on behalf of its subsidiaries. The Board does not consider this procedure to be appropriate, however, in view of the formal responsibility of a bank's own board of directors to set the bank's policy and the variations that exist among bank holding companies in the degree of influence they exercise over internal policymaking at their subsidiary banks. Another commenter suggested that the requirement for a board of directors resolution be dropped entirely. The Board believes that the resolution requirement should be retained, in order to ensure that a bank's major policymakers are identified at a level within the bank that is qualified to address the issue authoritatively.

Simultaneously with this notice, as a result of a change in the exemptive authority of the Board under EGRPA, the Board also is proposing an amendment to Regulation O to permit a bank to exempt directors of an affiliate from the restrictions of Regulation O. The amended procedures described above concerning the resolution requirements to exempt executive officers of an affiliate also are included in the proposed amendment to exempt directors of an affiliate. Public comment on the amended procedures is requested as part of that proposed rulemaking.

Determination of Effective Date

Because the final rule is a substantive rule that grants an exemption or relieves a restriction, and the final rule concerning participation by insiders and insiders of affiliates in employee benefit plans is intended solely to conform the regulation to section 22(h), as amended effective September 30, 1996, the Board has determined, for good cause, that the final rule will become effective immediately upon the date of Board action adopting the amendment. See 5 U.S.C. 553(d). The final rule imposes no additional reporting, disclosure, or other new requirements on insured depository institutions. See 12 U.S.C. 4802(b).

Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires an agency to publish a final regulatory flexibility analysis when the agency publishes a final rule. Two of the requirements of a

final regulatory flexibility analysis (5 U.S.C. 604(b))—a succinct statement of the need for, and the objectives of, the rule, and a summary of the issues raised by the public comments received, the agency assessment thereof, and any changes made in response thereto—are contained in the supplementary information above. No significant alternatives to the final rule were considered by the agency.

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the Board certifies that the amendment to Regulation O will not have a significant economic impact on a substantial number of small entities, and that any impact on those entities should be positive. The amendment will reduce the regulatory burden for most banks by permitting insiders of banks and insiders of their affiliates to participate in lending programs generally available to employees and by simplifying the procedures for exempting insiders of affiliates from the insider lending restrictions in general.

Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1980 (44 U.S.C. Ch. 35; 5 CFR Part 1320, Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget.

The recordkeeping requirements are authorized by 12 U.S.C. 375b(10). This information is required to evidence compliance with the requirements of section 22(h) of the Federal Reserve Act. The amendment is estimated to result in some reduction in the annual burden of recordkeeping associated with Regulation O for state member banks.

The Federal Reserve System may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The OMB control number is 7100-0036.

List of Subjects in 12 CFR Part 215

Credit, Federal Reserve System, Penalties, Reporting and recordkeeping requirements.

For the reasons set forth in the preamble, and pursuant to the Board's authority under section 22(h) of the Federal Reserve Act (12 U.S.C. 375b), the Board is amending 12 CFR Part 215, subpart A, as follows:

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

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

Authority: 12 U.S.C. 248(i), 375a(10), 375b(9) and (10), 1817(k)(3) and 1972(2)(G)(ii); Pub. L. 102-242, 105 Stat. 2236.

2. Section 215.2 is amended by revising paragraph (e)(2)(i) to read as follows:

§ 215.2 Definitions.

* * * * *

(e) * * *

(2) * * *

(i) The board of directors of the member bank adopts a resolution identifying (by name or by title) all persons authorized to participate in major policymaking functions of the member bank, and the executive officer of the affiliate is not included in the resolution and does not actually participate in such major policymaking functions; and

* * * * *

3. Section 215.4 is amended as follows:

a. Paragraphs (a) introductory text, (a)(1) and (a)(2) are redesignated as paragraphs (a)(1) introductory text, (a)(1)(i) and (a)(1)(ii), respectively;

b. A heading is added to newly designated paragraph (a)(1); and

c. A new paragraph (a)(2) is added. The additions read as follows:

§ 215.4 General prohibitions.

(a) *Terms and creditworthiness*—(1) *In general.* * * *

(2) *Exception.* Nothing in this paragraph (a) shall prohibit any extension of credit made pursuant to a benefit or compensation program—

(i) 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

(ii) 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.

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By order of the Board of Governors of the Federal Reserve System, November 4, 1996.
William W. Wiles,
Secretary of the Board.

[FR Doc. 96-28720 Filed 11-7-96; 8:45 am]

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