

Department of the Treasury

Regulatory Bulletin

RB 37-12

Handbook: Examination Handbook

Subject: Management



Section: 380

Transactions with Affiliates and Insiders

Summary: This Regulatory Bulletin provides Examination Handbook Section 380, Transactions with Affiliates and Insiders. This section replaces Thrift Activities Handbook Section 380.

For Further Information Contact: Your Office of Thrift Supervision (OTS) Regional Office or the Holding Company and Affiliate Policy Division of OTS, Washington, DC. You may access this bulletin and the handbook section at our web site: www.ots.treas.gov.

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SUMMARY OF CHANGES

OTS is issuing Examination Handbook Section 380, Transactions with Affiliates and Insiders. We provide a summary of changes below.

380 Transactions with Affiliates and Insiders

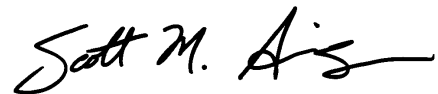
We revised this section to incorporate changes pursuant to the Board of Governors of the Federal Reserve System's (FRB's) final TWA Rule effective November 2003. The revised Section 380:

- Incorporates applicable provisions of FRB's Regulation W. The revised section:
 - Uses the definition of control in Regulation W instead of the prior practice of relying on OTS regulations at Part 574.
 - Outlines exemptions for intraday extensions of credit, general purpose credit cards, internal corporate reorganizations, step transactions, and other exemptions.
 - Clarifies certain exemptions. For example, the old 250.250 exemption for purchases of extensions of credit was revised. Other existing exemptions continue to apply including the de novo exemption, the Bank Merger Act exemption, and the sister thrift/bank exemption.
 - Redefines low quality assets.
 - Recognizes additional types of collateral that may not be used to satisfy requirements under section 23A.

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- Explains that certain aspects of Regulation W do not apply to savings associations, such as the concept of financial subsidiaries.
- Revises several OTS interpretations under section 11(a)(1) of the HOLA, which prohibit a savings association from making a loan to an affiliate that is engaged in non-bank holding company activities. Specifically, OTS:
 - No longer treats reverse repurchase agreements as loans.
 - No longer requires a savings association to attribute the activities of a subsidiary of an affiliate to that affiliate when it determines whether the affiliate is engaged in non-bank holding company activities.
 - Clarifies that a loan to a third party is not prohibited merely because proceeds are used for the benefit of, or are transferred to, an affiliate.
 - May determine that any transaction is, in substance, a loan to an affiliate that is engaged in non-bank holding company, and prohibit it under section 11.

We also deleted Appendix A, the TWA Checklist, and replaced it with a revised version of the former Appendix B, Regulation O.



*Managing Director
Examinations, Supervision, and Consumer Protection*

Transactions with Affiliates and Insiders

Affiliate relationships and transactions with insiders can significantly affect a savings association's operations and overall financial condition. Your review of these transactions is a critical component of savings association and holding company examinations. However, the rules on affiliate transactions and transactions with insiders are complex and, at times, confusing. This Section will give you a basic understanding of these rules. You should carefully review all such transactions to identify any potential risks they pose to the savings association and ultimately to the deposit insurance fund.

L I N K S

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As competition among providers of financial services has increased, companies have pursued opportunities to enhance operating synergies among affiliated entities and to leverage expertise and resources throughout their overall organizational structure. Such relationships can present unique challenges for regulators, for example, in identifying the flow of funds among entities and assessing internal controls for oversight of savings association/affiliate

arrangements.

In many cases, it is appropriate and beneficial for an association to engage in business transactions with its affiliates and insiders. Statutes and OTS rules, however, may limit or prohibit these affiliate transactions. Additionally, OTS may prohibit any transaction when contrary to the association's best interests, based on safety and soundness grounds and even abuse. Accordingly, you must distinguish appropriate transactions from abusive or potentially abusive transactions, or transactions that are otherwise inconsistent with safe and sound operations.

The association's affiliate transactions should meet the following criteria:

- Not be abusive or detrimental to the savings association. (You should be alert to any transaction that subjects the association to unreasonable pressure from management or an affiliate.)
- Be based on safe and sound practices.
- Comply with applicable statutory and regulatory standards. You may find OTS transactions with affiliates rules at 12 CFR § 563.41. Restrictions on transactions with insiders (i.e., association or affiliate directors, executive officers, principal shareholders, and related interests) are at 12 CFR § 563.43.

This Section should help you evaluate the following areas:

- Acceptability of transactions with affiliates.
- Permissibility of transactions with insiders.

TRANSACTIONS WITH AFFILIATES

Affiliate transactions occur when an association engages in a transaction with its holding company, a subsidiary of the holding company, any other affiliate or, under certain circumstances, an unrelated third person. You may find evidence of such transactions at any association, but the volume of affiliate transactions is usually greater in a holding company structure since inter-company transactions are often an integral part of a company's operations.

Due to the potential risk from these transactions, associations are subject to the following regulatory standards:

- Individual and aggregate ceilings on the dollar amount of affiliate transactions. These ceilings are based on a percentage of capital and surplus.
- Arms-length dealings requirement.
- Prohibition of acquisitions of low-quality assets from affiliates.
- Collateralization requirements for affiliate credit transactions.
- Prohibition of certain activities.

Compliance with Statutory and Regulatory Standards

Section 11 of the Home Owners' Loan Act (HOLA) applies §§ 23A and 23B of the Federal Reserve Act (FRA) to savings associations "in the same manner and to the same extent" as if the association were a member bank. Section 11 also applies two additional prohibitions to associations. Specifically, § 11 prohibits associations from purchasing or investing in securities issued by affiliates (other than with respect to shares of a subsidiary), and from making loans or extensions of credit to affiliates engaged in non-bank holding company activities.

The Board of Governors of the Federal Reserve System's (FRB) Regulation W (12 CFR Part 223) implements §§ 23A and 23B of the FRA for member banks. The OTS rule (12 CFR § 563.41) requires savings associations to comply with Regulation W as if they were member banks, interprets Regulation W to apply it to savings associations, and implements the additional restrictions in § 11 of the HOLA.

The intent of 23A and 23B is to protect against a depository institution suffering losses in transactions with affiliates and to limit the ability of a depository institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net.

Compliance with § 23A of the FRA and the additional prohibitions under § 11 of the HOLA

You should consider the following questions when you determine whether a particular transaction complies with § 23A of the FRA and the two additional prohibitions under § 11 of the HOLA. We discuss compliance with § 23B of the FRA later in this Handbook Section.

- Is the transaction with an affiliate?
- Is the transaction a covered transaction?
- Is the transaction exempt?
- Does the covered transaction meet the quantitative restrictions?
- Does the transaction meet the qualitative restrictions (including collateral requirements, if it is a loan)?

We will review each of these considerations in the following pages.

Is the Transaction with an Affiliate?

As a first step, you must identify all of the association's affiliates.

Affiliates. Generally, affiliates include the following companies. (*Note:* individuals are not “affiliates” for the purposes of the transaction with affiliates restrictions.)

- *Parent companies*. Any company that controls the savings association.
- *Companies under common control by a parent company*. Any company that is controlled by a company that controls the association.
- *Companies under other common control*. Any company controlled, directly or indirectly, by trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the savings association or any company that controls the savings association. For example, if an individual (that is, not a company) controls an association and another company, that company would be an affiliate.
- *Companies with interlocking directorates*. Any company in which a majority of directors, trustees, or general partners (or individuals exercising similar functions) constitute a majority of the persons holding any such office with the savings association or any company that controls the savings association.

- *Sponsored or advised companies.* Any company, including a real estate investment trust, that the savings association or any affiliate sponsors and advises on a contractual basis.
- *Investment companies.* Any investment company for which a savings association or any affiliate serves as an investment advisor as defined in the Investment Company Act of 1940 (15 USC 80a-2(a)(20); or any unregistered investment fund for which a savings association or any affiliate serves as an investment advisor, if the savings association and its affiliates own or control in the aggregate more than five percent of any class of voting securities or of the equity capital of the fund.
- *Certain subsidiaries of savings associations.* Subsidiaries are discussed below.
- *Companies held under merchant banking or insurance company investment authority.* Any company in which the savings association's holding company owns or controls, directly or indirectly, or acting through one or more persons 15 percent or more of the equity capital under the merchant banking or insurance company investment authority at section 4(k)(4)(H) or (I) of the Bank Holding Company Act. This category is subject to several safe harbors and has a limited applicability to most associations. It applies only if the association is controlled by a holding company that was not a savings and loan holding company (or did not have a savings and loan holding company application in process) before May 4, 1999.
- *Partnerships.* Any partnership, if the association or an affiliate serves as a general partner or causes any director, officer, or employee of the association or affiliate to serve as a general partner.
- *Subsidiaries of affiliates.*
- *Other companies identified by OTS.* Any company that OTS determines, by regulation or order:
 - To have a relationship with the savings association, or any affiliate of the savings association, such that covered transactions by the savings association with that company may be affected by the relationship to the detriment of the savings association; or
 - To present a risk to the safety or soundness of the savings association.

Subsidiaries generally are not affiliates, and are considered equivalent to the association.

Subsidiaries. Subsidiaries (i.e., companies that are controlled by a savings association) generally are not affiliates, and are considered equivalent to the association. As a result, transactions between an association and its subsidiaries are generally not subject to the transactions with affiliate restrictions. At the same time, any affiliate of the savings association is also an affiliate of these savings association subsidiaries. A transaction between these subsidiaries and the association's affiliates are subject to affiliate restrictions.

Certain subsidiaries of a savings association, however, are affiliates. Subsidiaries that are affiliates include:

- *An insured depository institution that is a subsidiary of the savings association.* Please note however, that several exemptions including the sister bank/savings association exemption, limit the application of the affiliates rules to transactions with these associations.
- *A company that is also directly controlled by one or more affiliates* (other than an insured depository institution affiliate) of the savings association. For example, if an association owns 50 percent of the voting shares of its subsidiary and its holding company owns the remaining shares, the subsidiary would be treated as an affiliate.
- *A company that is also directly controlled by a shareholder* (or a group of shareholders) that also controls the association.
- *An employee stock option plan, trust, or similar organization* that exists for the benefit of the shareholders, partners, members, or employees of the savings association or any of its affiliates.
- *Any subsidiary that OTS determines to be an affiliate.*

You should be aware that Regulation W states that “financial subsidiaries” of member banks are affiliates. (See 12 CFR § 223.3(p) for a definition of this term.) OTS determined that savings associations do not have financial subsidiaries.

Control.

A fundamental concept underlying the definition of affiliate is “control.” For the purposes of the affiliates restrictions, a company or shareholder has control over another company if:

- The company or shareholder, directly or indirectly, or by acting through one or more other persons, owns, controls, or has the power to vote, 25 percent or more of any class of voting securities of the other company.
- The company or shareholder owns or controls 25 percent or more of the equity capital of the other company, unless the company or shareholder demonstrates to OTS that it does not control the other company.
- The company or shareholder controls in any manner the election of the majority of the directors, trustees, or general partners (or individuals exercising similar functions).
- The OTS determines, after notice and opportunity for a hearing, that the company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company.

In determining whether a company controls another, you should apply the following rules:

- A company controls securities, assets, or other ownership interests that are owned or controlled, directly or indirectly, by any subsidiary of the company.
- A company does not control another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in the “companies under other common control” description above, or if the company owning or controlling shares is a business trust.
- A company or shareholder controls securities if it owns or controls instruments (including options or warrants) that are convertible or exercisable into the securities at the option of the holder or owner, unless the company or shareholder demonstrates to OTS that it does not control the security.

Please note that OTS used to apply the definitions and rebuttable presumptions of control in 12 CFR Part 574 to affiliate transactions. In 2003, OTS revised the affiliates rules to incorporate the concepts described above, and to delete references to Part 574. The scope of “control” may be broader or narrower under revised rule depending on the circumstances. If you have any questions, you should contact your regional counsel.

Companies that are not considered to be affiliates. Notwithstanding the definitions of affiliate discussed above, a company is not an affiliate if it meets any of the following criteria:

- The company engages solely in holding the premises of the savings association.
- The company engages solely in conducting a safe deposit business.
- The company engages solely in holding certain United State government securities.
- Control of the company is the result of the exercise of rights resulting from a bona fide debt previously contracted. Such entities, however, are not considered to be affiliates only for a limited period of time.

Transactions with third parties. A transaction between an association and any person will be treated as a transaction with an affiliate if the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate. Under this “third party attribution rule,” for example, a loan to an unaffiliated third party will be attributed to an affiliate if the individual uses the funds to purchase an asset from an affiliate.

A transaction between an association and a third party will be treated as a transaction with an affiliate if the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.

Certain third party transactions are exempt from most § 23A restrictions. For example, if a third party uses a general purpose credit card issued by an association to purchase products and services from an affiliate, the association does not have to attribute the loan to the affiliate. To be a general purpose credit card, a

credit card must be widely accepted for the purchases of products and services by merchants that are not affiliates, and purchases from affiliates must be less than 25 percent of the total value of products and services purchased with the card by all cardholders (12 CFR § 223.16(c)(4)). These transactions are subject to safety and soundness requirements under § 23A and market terms requirements under § 23B.

Subject to certain conditions, OTS also does not apply the third-party attribution rule to the following transactions:

- Extensions of credit used to purchase assets through an affiliate that acts exclusively as an agent or broker in the transaction.
- Extensions of credit used to purchase securities through a security affiliate (that is, a registered broker-dealer) that acts exclusively as a riskless principal in the transaction.
- Brokerage commissions, agency fees, and riskless principal mark-ups in connection with these agency and riskless principal transactions.
- Preexisting lines of credit used to purchase securities from or through securities affiliates.

These transactions are subject to various conditions that are more fully described at 12 CFR § 223.16(b) and (c).

Is the Transaction a "Covered Transaction?"

Once you determine that a transaction is with an affiliate, you must determine if it is a covered transaction.

Transactions that are subject to § 23A restrictions. If you answer "yes" to any of the following questions, the transaction is a covered transaction and is subject to the standards in § 23A.

Has the association made a loan or extension of credit to an affiliate? This category includes making or renewing a loan, granting a line of credit, or extending credit in any manner. Loans or extensions of credit include:

- Intraday credit.
- Leases that are the functional equivalent of a loan.
- Advances via an overdraft, cash item, or otherwise.
- The sale of Federal funds to an affiliate.
- The acquisition of a note or other obligation of an affiliate.

- An increase in the amount, extension of maturity, or adjustment to material terms of an extension of credit.
- Other similar transactions.

Certain less-obvious transactions may also constitute the equivalent of extensions of credit or other types of covered transactions. For example, intercompany payable/ receivable transactions, rent subsidies, and use of the association's personnel, premises, funds, or equipment without adequate compensation. Generally, if the association conducts such transactions on an arms-length basis, consistent with how they conduct transactions with a nonaffiliated party, OTS does not consider transactions "de facto" extensions of credit or covered transactions. However, you should review all such transactions to determine whether § 23A applies and, if so, whether the association complies with the applicable restrictions. You should also review the transactions for general safety and soundness concerns regardless of whether they are considered extensions of credit.

Has the association purchased assets, including assets subject to recourse or a repurchase agreement, from an affiliate? A purchase of assets means an acquisition of an asset in exchange for cash or any other consideration, including an assumption of liabilities. The merger of an affiliate into a savings association is a purchase of assets if the association assumes any liabilities of the affiliate, or pays any other form of consideration in the transaction.

Has the association accepted securities issued by an affiliate as collateral security for a loan or extension of credit to any person or company? Securities include, for example, stocks, bonds, debentures, notes, or similar obligations (including commercial paper).

Has the association issued a guarantee, acceptance, or letter of credit on behalf of an affiliate? This category includes, for example, an endorsement or standby letter of credit on behalf of an affiliate, a confirmation of a letter of credit issued by an affiliate, and a cross-affiliate netting agreement. The category also includes credit derivatives that are the functional equivalent of a guarantee, such as credit derivatives between an association and a nonaffiliate in which the association protects the nonaffiliate from a default on, or decline in value of, an obligation of an affiliate.¹

Please note that the definition of covered transaction under Regulation W also includes the purchase of, or investment in, securities issued by an affiliate. Section 11 of HOLA generally prohibits these transactions for savings associations. See the following discussion.

Prohibited Transactions. For savings associations, § 11 of the HOLA prohibits two types of covered transactions. If you answer "yes" to either of the following questions, the transaction is prohibited.

¹ FRB has not yet determined whether other types of derivatives are covered transactions. If an association engages in such transactions with affiliates, however, it must establish policies and procedures to manage the credit exposures in a safe and sound manner. At a minimum, the policies and procedures must provide for monitoring and controlling the credit exposure (including imposing appropriate credit limits, mark to market requirements, and collateral requirements), and must ensure that derivative transactions with affiliates comply with the market terms requirements of § 23B. See 12 CFR § 223.33.

Has the association purchased or invested in securities issued by any affiliate, other than shares of a subsidiary? For the purposes of this prohibition, a subsidiary includes a bank or savings association.

Has the association made a loan or extension of credit to an affiliate that is engaged in any activity that is impermissible for a bank holding company?

OTS does not generally apply the third-party attribution rule to the § 11 loan prohibition. Thus, we will not prohibit a loan to a third party merely because proceeds are used for the benefit of, or transferred to, an affiliate that is engaged in nonbank holding company activities. However, if you determine that a loan to a third party is a prearranged step in a series of transactions designed to channel funds to such an affiliate, or is otherwise designed to circumvent the loan prohibition, you may inform the association that the transaction is, in substance, a prohibited loan. You may direct the association to divest the loan, unwind the transaction, or take other appropriate action.

Please note that OTS revised some long-standing interpretations of the § 11 loan prohibition in 2003. For example, OTS used to treat certain repurchase agreements as prohibited loans. OTS now treats repurchase agreements as asset purchases. While these transactions are no longer prohibited, they remain subject to §§ 23A and 23B restrictions. OTS also used to attribute activities of subsidiary companies to certain parent companies in determining whether the parent is engaged in impermissible bank holding company activities. OTS no longer attributes activities among affiliates.

OTS used to treat repurchase agreements as prohibited loans; we now treat them as asset purchases.

Is the Transaction Exempt?

Regulation W exempts certain covered transactions from affiliate restrictions under § 23A. Pay particular attention to the scope of each exemption. All of the exemptions, for example, relieve associations from complying with the quantitative limits and applicable collateral requirements. All covered transactions remain subject to the safety and soundness requirements. Depending on the exemption, however, the low-quality asset purchase restriction may or may not apply. Exemptions from the market terms requirements under § 23B also vary and are discussed separately below.

The following transactions are exempt from the 10 and 20 percent quantitative limits on transactions with affiliates and the collateral requirements. These transactions are subject to safety and soundness requirements and prohibitions on purchases of low-quality assets:

- *Sister Bank/Savings Association Exemption.* Transactions with an insured depository institution if:
 - The savings association controls at least 80 percent of the voting securities of the depository institution;
 - The depository institution controls at least 80 percent of the voting securities of the savings association; or

— A company controls at least 80 percent of the voting securities of both institutions (12 CFR § 223.41(a) and (b)).

- *Purchases of nonrecourse loans from affiliated depository institutions.* This exemption applies to all affiliated insured depository institutions, including those that do not meet the 80 percent ownership requirement for the sister bank/savings association exemption (12 CFR § 223.41(c)).
- *Internal corporate reorganizations.* Purchasing assets from an affiliate where the transaction is a part of an internal corporate reorganization of a holding company and involves the transfer of all, or substantially all, of the shares or assets of an affiliate or a division or department of an affiliate. This exception is subject to various requirements, including a prior written notice to OTS and a limitation on the amount of the transaction (12 CFR § 223.41(d)).²

The following transactions are exempt from the 10 and 20 percent quantitative limits on transactions with affiliates, collateral requirements, and the low quality asset purchase prohibition. These transactions are subject to safety and soundness requirements and to other requirements contained in the cited references to Regulation W:

- *Correspondent banking.* Making a deposit in an affiliated insured depository institution (or an affiliated foreign bank) that represents an ongoing working balance maintained in the ordinary course of correspondent business (12 CFR § 223.42(a)).
- *Uncollected items.* Giving immediate credit to an affiliate for uncollected items received in the ordinary course of business (12 CFR § 223.42(b)).
- *Credit transaction secured by deposits or U.S. government securities.* Engaging in a credit transaction with an affiliate to the extent that the transaction is and remains secured by any of the following:
 - Obligations of the United States or its agencies.
 - Obligations fully guaranteed as to principal and interest by the United States or its agencies.
 - A segregated, earmarked deposit account with the savings association that is for the sole purpose of securing credit transactions between the savings association and its affiliates, and is identified as such.

² A related provision exempts mergers and acquisitions that are step transactions. In step transactions, the association ultimately intends to acquire the company, but for various reasons, another affiliate acquires the company before transferring to the association. To qualify for the related exemption, the transaction must satisfy 12 CFR § 223.31(d). Unlike the internal corporate reorganization exemption, a step transaction is not subject to the prohibition on the purchase of low-quality assets.

If a loan is partially secured by collateral identified above, the portion of the loan that is secured by the collateral is exempt. The amount beyond the collateral's value is not exempt (12 CFR § 223.42(c)).

- *Purchase of securities of a servicing affiliate.* Purchasing securities of any company that is engaged solely in providing specified services, such as holding property used by the association, processing data, providing personnel services, performing accounting and auditing activities, and handling advertising and public relations (12 CFR § 223.42(d)).
- *Purchase of certain liquid assets.* Purchasing an asset having a readily identifiable and publicly available market quotation if the asset is purchased at (or below) that market quotation. An asset has a readily identifiable and publicly available market quotation if the asset's price is quoted routinely in a widely disseminated publication that is readily available to the general public, such as the Wall Street Journal (12 CFR § 223.42(e)).
- *Purchase of certain marketable securities.* Purchasing marketable securities from a securities affiliate (i.e., a registered broker-dealer). Among other requirements, the security must have a "ready market," may not be a low-quality asset, and must be eligible for purchase by a state member bank. Additionally, the purchase may not occur during or within 30 days of an underwriting if an affiliate is the underwriter, and the security's price must be electronically quoted in real-time by an unaffiliated quotation system (12 CFR § 223.42(f)).
- *Purchase of municipal securities.* Purchasing municipal securities from a securities affiliate (i.e., a registered broker-dealer). Among other requirements, the security must have a rating if the issuance does not exceed \$25 million and must be eligible for purchase by a state member bank. In addition, the securities price must be electronically quoted in real-time by an unaffiliated quotation system, verified by reference to two or more actual, current price quotes from unaffiliated broker-dealers, or verified by reference to a written summary provided by the syndicate manager to syndicate members (12 CFR § 223.42(g)).
- *Purchase of an extension of credit subject to a repurchase agreement.* Purchasing an extension of credit from an affiliate that the savings association originated and sold to the affiliate subject to a repurchase agreement or with recourse (12 CFR § 223.42(h)).
- *Purchase of assets by a newly formed savings association.* Purchasing an asset from an affiliate, if OTS approved the asset purchase in connection with its review of the formation of the savings association (12 CFR § 223.42(i)).
- *Transactions approved under the Bank Merger Act.* Mergers or consolidations between a savings association and an affiliated insured depository institution (or U.S. branch or agency of a foreign bank), and acquisitions of assets or assumptions of deposit liabilities by a savings association from such entities, if the transaction was approved under the Bank Merger Act (12 CFR § 223.42(j)).

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- *Purchases of extensions of credit.* Purchasing an extension of credit from an affiliate, on a nonrecourse basis, if all of the following requirements are met:
 - The affiliate must originate the extension of credit.
 - The association must perform its own independent evaluation of the creditworthiness of the borrower before the affiliate makes or commits to make the extension of credit.
 - The association must commit to purchase the extension of credit before the affiliate makes or commits to make the extension of credit.
 - The association may not make a blanket advance commitment to purchase extensions of credit from the affiliate.
 - The association may not purchase more than 50 percent of the total dollar amount of the extensions of credit originated by the affiliate, calculated on a rolling 12-month basis. OTS may impose a lower percentage (12 CFR § 223.42(j)).

This exemption was formerly codified at 12 CFR § 250.250. As a result, it is commonly referred to as the “250.250 exemption.”

- *Intraday extensions of credit.* Making intraday extensions of credit to an affiliate. An intraday extension of credit is a loan that the association expects to be repaid, sold, terminated, or fall within another exemption by the end of the business day. To qualify for this exemption, the savings association must comply with all of the following:
 - Establish and maintain policies and procedures reasonably designed to manage the credit exposure arising from the intraday extensions of credit to affiliates in a safe and sound manner, and to ensure compliance with market terms requirements at § 23B.
 - Have no reason to believe that the affiliate will have difficulty in repaying the extension of credit in accordance with its terms.
 - Cease to treat the extension of credit as intraday at the end of the association’s business day (12 CFR § 223.42(l)).
- *Riskless principal transactions.* Purchasing a security from a securities affiliate (i.e., a registered broker-dealer) if the association or the securities affiliate is acting exclusively as a riskless principal in the transaction, and the security is not issued, underwritten, or sold as principal (other than as riskless principal) by any affiliate of the association (12 CFR § 223.42(m)).

Does the Covered Transaction Meet Quantitative Restrictions?

Covered transactions with an affiliate are subject to quantitative restrictions. Through a review of internal records, you should verify that the association's aggregate amount of covered transactions is within both of the following quantitative limits:

- 10 percent of the association's capital stock and surplus with any single affiliate. An association may not enter into a covered transaction with the affiliate if the association would exceed this limit. You should be aware that OTS used to require associations to include all covered transactions with an affiliate's subsidiaries in determining the amount of covered transactions for the affiliate. OTS no longer requires this attribution.
- 20 percent of the association's capital stock and surplus with all affiliates. An association may not enter into a covered transaction with any affiliate if the association would exceed this limit.

Capital stock and surplus means unimpaired capital and unimpaired surplus as defined in the LTOB rule at 12 CFR § 560.93(b)(11).

In calculating compliance with the quantitative limits, you should attribute covered transactions with third parties to an affiliate to the extent that proceeds are used for the benefit of, or transferred to, the affiliate. You should also refer to the valuation and timing principles at 12 CFR § 223.21 (credit transactions); § 223.22 (asset purchases); § 223.24 (extensions of credit secured by affiliate securities); and § 223.31 (acquisitions of affiliates that become nonaffiliated subsidiaries after the acquisition).

Does the Covered Transaction Meet Qualitative Restrictions?

Covered transactions are also subject to various qualitative restrictions including a prohibition against purchases of low-quality assets; collateral requirements for credit transactions; and a general safety and soundness requirement.

Low-quality asset purchases. An association may not purchase a low-quality asset from an affiliate, unless the association made an independent credit evaluation and committed itself to purchase the asset before the affiliate acquired the asset. An association, however, may renew a loan participation involving certain problem loans if the transaction meets the requirements at 12 CFR § 223.15(b).

A savings association may not purchase a low-quality asset from an affiliate, unless the association made an independent credit decision to purchase the asset before the affiliate acquired the asset.

A low-quality asset includes:

- An asset (including a security) that is classified as substandard, doubtful, loss, special mention, or other transfer risk problems in the most recent report of examination or inspection prepared by a federal or state supervisor, or in any internal classification system used by the association or its affiliate.

- An asset in a nonaccrual status.
- An asset on which principal or interest payments are more than 30 days past due.
- An asset with renegotiated or compromised terms due to the deteriorating financial condition of the obligor.
- An asset acquired through foreclosure, repossession, or in satisfaction of a debt previously contracted, if the asset has not yet been reviewed in an examination or inspection.

Collateralization. A savings association must ensure that all credit transactions with affiliates are adequately collateralized.

The following types of transactions must be adequately collateralized: a loan, an extension of credit, the issuance of a guarantee, acceptance or letter of credit (including an endorsement or standby letter of credit on behalf of an affiliate and a confirmation of a letter of credit issued by an affiliate) and a cross-affiliate netting arrangement.

The collateral requirements do not apply to any of the following:

- Acceptances that are already fully secured by attached documents or by other property that is involved in the transaction and has an ascertainable market value.
- Unused portions of extensions of credit to an affiliate if the association has no legal obligation to advance additional funds until the affiliate provides the required collateral.

The collateral must have a market value equal at least equal to one of the following:

- *100 percent of the amount of the transaction* if the collateral consists of:
 - Obligations of the United States or its agencies.
 - Obligations fully guaranteed by the United States or its agencies as to principal and interest.
 - Notes, drafts, bills of exchange, or bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank.
 - A segregated, earmarked deposit account with the savings association. The segregated, earmarked deposit must be for the sole purpose of securing credit transactions between the association and its affiliates and must be identified as such.
- *110 percent of the amount of the transaction* if the collateral consists of obligations of any State or political subdivision of any State.

- *120 percent of the amount of the transaction* if the collateral consists of other debt instruments, including loans and other receivables.
- *130 percent of the amount of the transaction* if the collateral consists of stock, leases, or other real or personal property.

The following assets are not acceptable collateral:

- Low-quality assets (defined above).
- Securities issued by an affiliate.
- Equity securities issued by the association.
- Debt securities issued by the association that represent the association's regulatory capital.
- Intangible assets, including servicing assets (unless specifically approved by FRB).
- Guarantees, letters of credit, and other similar instruments.

If the association does not maintain a first priority security interest in the collateral, it will be required to make certain deductions from the value of the collateral.

The association must maintain a security interest in the collateral that is perfected and enforceable under applicable law, including in the event of default resulting from bankruptcy, insolvency, liquidation, or similar circumstances. If the association does not maintain a first priority security interest in the collateral, it will be required to make certain deductions from the value of the collateral (12 CFR § 223.14(d)).

You should verify compliance with these collateral requirements through a review of the credit transaction and the types and levels of collateral established and maintained. The affiliate must replace collateral that is subsequently retired or amortized with additional eligible collateral where needed. This keeps the percentage of the collateral value relative to the amount of the outstanding credit transaction equal to the minimum percentage required at the beginning of the transaction.

Safety and soundness. An association may not engage in a covered transaction, including transactions that are exempt, unless the transaction is on terms and conditions that are consistent with safe and sound banking practices.

Compliance with § 23B

In addition to a review of affiliate transactions to determine compliance with § 23A of the FRA and § 11 of the HOLA, you must determine whether transactions comply with § 23B of the FRA. Section 23B imposes market terms requirements on various covered transactions and prohibits certain other transactions.

Market Terms Requirement

Covered transactions must take place on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the association, as those prevailing at the time for comparable transactions with nonaffiliates. In the absence of comparable transactions, the transaction must be on terms and under circumstances that, in good faith, would be offered to, or would apply to, nonaffiliates. In applying the market terms test:

- Is the transaction with an affiliate?
- Is it a covered transaction?

Is the Transaction with an Affiliate?

Sections 23A and 23B use similar definitions of affiliate, with one exception. Under § 23B, affiliate excludes any insured depository institution. Please note that this exclusion is broader than the sister bank/savings association exemption under § 23A because there is no percentage-of-ownership test. Therefore, it is possible that a transaction between a savings association and an affiliated bank or savings association may be covered under § 23A because the 80 percent ownership criteria for the sister bank/ savings association exemption is not met. However, the transaction would not be subject to § 23B.

Like § 23A, § 23B has a third-party attribution rule. As a result, you must treat a transaction with a third party as a transaction with an affiliate if the proceeds from the transaction are used for the benefit of, or transferred to, the affiliate.

Is the Transaction a Covered Transaction?

A covered transaction under § 23B is broadly defined to include the following transactions:

- A covered transaction under § 23A. Certain transactions that are exempt under § 23A are also exempt under § 23B. These include the exemptions for credit for uncollected items, credit transactions secured by deposits or U.S. government securities, purchases of securities of a servicing affiliate, purchases of certain liquid assets, purchases of an extension of credit subject to a repurchase agreement, asset purchases by a newly formed savings associations, and transactions approved under the Bank Merger Act. See 12 CFR § 223.52.
- A sale of securities or other assets to the affiliate, including assets subject to a repurchase agreement.
- A payment of funds or the furnishing of services to the affiliate under contract, lease or otherwise.
- A transaction in which an affiliate acts as an agent or broker or the affiliate receives a fee for its services to the association or any other person.

- A transaction with a third party when the affiliate has a financial interest, or is a participant, in the transaction or a series of transactions.

Prohibited Transactions

Section § 23B prohibits the following transactions:

Purchases as fiduciary

An association may not purchase, as fiduciary, any securities or other assets from any affiliate unless the purchase is permitted under the instrument creating the fiduciary relationship, by court order, or by law of the jurisdiction governing the fiduciary relationship.

Purchases of securities underwritten by an affiliate

An association may not knowingly purchase or acquire a security, as principal or fiduciary, during the existence of any underwriting or selling syndicate where an affiliate is a principal underwriter of the security.

This prohibition does not apply if a majority of the association's directors:

- Approves the acquisition or purchase before the security is initially offered for sale to the public. The directors must base their approval on their determination that the purchase is a sound investment for the association, or for the person on whose behalf the association is acting as fiduciary; or
- Approves standards for acquisitions of such securities based on the determination that purchases under the standards would fulfill the sound investment requirement. Each acquisition must meet the standards. A majority of the directors must periodically review the standards to ensure they meet the sound investment requirement and review acquisitions to ensure that they meet the standards.

Advertisements

Generally, an association and its affiliates may not publish any advertisement or enter into any agreement stating or suggesting that the association will in any way be responsible for the obligations of its affiliates. Nonetheless, an association may issue a guarantee, acceptance, or letter of credit on behalf of an affiliate, confirm a letter of credit issue by an affiliate, or enter into a cross-affiliate netting arrangement, if the transaction is otherwise permissible under § 23A. Since the association may enter into these transactions, it may also describe these transactions in disclosure documents if required by other laws.

Compliance with Recordkeeping Requirements

An association must make and retain records that reflect, in reasonable detail, all transactions with its affiliates or with any other person to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.

At a minimum, the records must:

- Identify the affiliate.
- Indicate the dollar amount of the transaction and show that the amount is within the applicable quantitative limitations specified in § 23A, or that the transaction is not subject to those limitations.
- Indicate whether the transaction involves a low-quality asset.
- Identify the type and amount of any collateral involved in the transaction and show that the collateral complies with the collateral requirements in § 23A, or demonstrate that the transaction is not subject to the collateral requirements.
- Demonstrate that the terms and circumstances of the transaction comply with the standards in § 23B, or that the transaction is not subject to those requirements.
- Show that loans and extensions of credit to affiliates are only made to affiliates that engage solely in activities permissible for bank holding companies.
- Be readily accessible for examination and other supervisory purposes.

Compliance with Notice Requirements

OTS may require a savings association to notify the agency before it engages in transactions with affiliates (other than exempt transactions) or its subsidiaries. OTS may impose this notice requirement if:

- The savings association is in troubled condition. (That is, the savings association has a composite CAMELS rating of 4 or 5; is the subject of a capital directive, a cease and desist order, a consent order, a formal written agreement, or a prompt corrective action directive related to its safety and soundness or financial viability; or OTS informed the association that it is in troubled condition based on information available to OTS.)
- The savings association does not meet its regulatory capital requirements.
- The savings association commenced *de novo* operations within the past two years.

- OTS approved an application or notice under Part 574 involving the association or its holding company during the preceding two years.
- The savings association entered into a consent to merge or a supervisory agreement in the past two years.
- OTS or another banking agency has initiated a formal enforcement proceeding against the savings association and the proceeding is pending.

If OTS has imposed this notice requirement, the association must provide at least 30 days advance written notice to OTS before entering into any transaction with an affiliate or subsidiary. The notice must contain a full description of the proposed transaction. If OTS does not object during the 30-day period, the association may proceed with the transaction.

TRANSACTIONS WITH INSIDERS

In addition to the affiliate transaction restrictions, you must verify an association's compliance with standards for extensions of credit to insiders. Section 563.43 applies FRB's Regulation O (12 CFR Part 215) to savings associations, their subsidiaries

Regulation O generally defines an extension of credit as making or renewing any loan, granting a line of credit, or extending credit in any manner.

and insiders (directors, executive officers, principal shareholders, and related interests). Specifically, § 563.43 applies the restrictions of 12 CFR Part 215, Subparts A and B (with the exception of § 215.13), to savings associations and their subsidiaries and insiders in the same

manner and to the same extent as if the association were a bank and a member bank of the Federal Reserve System.

General Requirements

Regulation O applies various restrictions on extensions of credit to executive officers, directors, and principal shareholders of the association and its affiliates ("insiders") and to the related interests of these executive officers, directors, and principal shareholders. Beyond direct extensions of credit to insiders, an extension of credit is made to an insider if the proceeds of the extension of credit are transferred to the insider or used for the tangible economic benefit of the insider.³

Regulation O generally requires that most extensions of credit to insiders and their related interests meet the following criteria:

³ There is an exception to the tangible economic benefit rule if both of the following criteria are met:

- The association extends the credit on terms prevailing at the time for comparable transactions with noninsiders (that would satisfy the standards set forth in § 215.4(a)) and that do not involve more than the normal risk of repayment).
- The borrower uses the proceeds of the extension of credit in a bona fide transaction to acquire property, goods, or services from the insider.

- Advance approval by a majority of the disinterested board of directors of the association.
- No preferential terms, does not involve more than the normal risk of repayment, and does not present other unfavorable features.
- Does not exceed aggregate individual and overall lending limits.

In addition, Regulation O imposes additional restrictions on extensions of credit to executive officers, and various reporting and recordkeeping requirements.

Extension of Credit

Regulation O generally defines an extension of credit as making or renewing any loan, granting a line of credit, or extending credit in any manner. An extension of credit, as defined at § 215.3, includes the following transactions:

- A *purchase under repurchase agreement* of securities, other assets, or obligations.
- An *advance* by means of an overdraft, cash item, or otherwise.
- Issuance of a *standby letter of credit (or other similar arrangement)* regardless of name or description) or an ineligible acceptance, as these terms are defined in § 208.24.
- An *acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange*, or other evidence of indebtedness upon which an insider may be liable as maker, drawer, endorser, guarantor, or surety.
- An *increase of an existing indebtedness*, but not if the association advances additional funds for its own protection for any of the following:
 - Accrued interest.
 - Taxes, insurance, or other expenses incidental to the existing indebtedness.
- An *advance of unearned salary* or other unearned compensation for a period in excess of 30 days.
- Any *other similar transaction* that results in a person becoming obligated to pay money (or its equivalent) to an association, whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

A transaction becomes an extension of credit at the time the association enters into a binding commitment to make the extension of credit. OTS considers a participation without recourse an extension of credit by the participating association, not by the originating bank or association.

Section 215.3 excludes certain transactions from the definition of an extension of credit. An extension of credit does not include any of the following transactions:

- An *advance against accrued salary or other accrued compensation*, or an advance for the payment of authorized travel or other expenses incurred or to be incurred on behalf of the association.
- A *receipt by an association of a check deposited in or delivered to the association in the usual course of business* unless it results in the carrying of a cash item for or the granting of an overdraft (other than an inadvertent overdraft in a limited amount that is promptly repaid, as described in § 215.4(e), which we discuss below).
- An *acquisition of a note, draft, bill of exchange, or other evidence of indebtedness* through any of the following means:
 - A merger or consolidation of depository institutions, or a similar transaction in which an association acquires assets and assumes liabilities of a bank, another association, or similar organization.
 - Foreclosure on collateral or similar proceeding for the protection of the association. The association, however, must not hold such indebtedness for more than three years from the date of the acquisition, unless OTS grants an extension for good cause.
- An *endorsement or guarantee for the protection of an association* of any loan or other asset the association previously acquired in good faith, or any indebtedness to an association for the purpose of protecting the association against loss or of giving financial assistance to it.
- *Indebtedness of \$15,000 or less* resulting from any general arrangement in which an association acquires charge or time credit accounts or makes payments to or on behalf of participants in a credit card plan, check credit plan, or similar open-ended credit plan, provided that both of the following conditions apply:
 - The indebtedness does not involve prior individual clearance or the association's approval other than to determine authority to participate in the arrangement and comply with any dollar limit under the arrangement.
 - The indebtedness is incurred under terms that are not more favorable than those offered to the general public.
- *Indebtedness of \$5,000 or less resulting from an existing or previously established interest-bearing overdraft credit plan* described in § 215.4(e), which we discuss below.
- A discount of promissory notes, bills of exchange, conditional sales contracts, or other similar paper, without recourse.

- Non-interest-bearing deposits to the credit of an association or bank are not considered loans, advances, or extensions of credit to the association or bank of deposit. The giving of immediate credit to an association or bank upon uncollected items received in the ordinary course of business is not considered a loan, advance, or extension of credit to the depositing association or bank.

Insiders

Part 215 defines the terms executive officer, director, principal shareholder, and related interest, which we summarize below.

It is important to note that Part 215 defines affiliate differently than §§ 23A and 23B as discussed earlier in this section under transactions with affiliates. Section 215.2(a) defines affiliate to include only the savings association's holding company, and any other subsidiary of that holding company. Similarly, § 215.2(c) defines "control" by a company or a person separately.

Executive Officer (§ 215.2(e))

Regulation O defines an executive officer of an association (or company) as a person who participates or has the authority to participate in the major policymaking functions of the association (or the company) regardless of title and regardless

Regulation O defines an executive officer as a person who participates or has the authority to participate in the major policymaking functions of the association (or company) regardless of title.

of whether the officer serves without salary or compensation. Insider does not include persons who may have official titles and exercise a measure of discretion in the performance of their duties, including discretion in the making of loans, but who do not participate in the major policymaking functions of the association or company. For example, the term executive officer does not include a manager or assistant manager of a branch of an association unless that individual participates, or the association authorizes that individual to participate, in major policymaking functions. Regulation O, however, presumes individuals with the following titles are executive officers of the association (or company):

- Chairman of the Board
- President
- Every Vice President
- Cashier
- Secretary
- Treasurer.

Regulation O does not generally consider directors, other than the Chairman of the Board, to be executive officers unless they serve in dual capacities as both a director and an executive officer.

Individuals presumed to be executive officers may be excluded from the definition of executive officer of the association (or company) if the following circumstances exist:

- A resolution of the board of directors or the bylaws of the association (or company), excludes the officer from participating in policy-making functions of the association (or company). The resolution or bylaws may list excluded individuals by name or title or may exclude a person by not including that person on a list of persons authorized to participate.
- The officer does not actually participate in policy-making functions of the association (or company).

Additionally, executive officers of an affiliate of an association are not subject to § 215.4 (General Prohibitions), § 215.6 (Prohibition on knowingly receiving extensions of credit), and § 215.8 (Records) if all of the following criteria are met:

- A resolution of the board of directors or the bylaws of the association, excludes the officer of the affiliate from participation in major policy-making functions of the association, and the executive officer does actually participate in such functions.
- The affiliate does not control the association.
- As determined annually, the assets of the affiliate do not constitute more than ten percent of the consolidated assets of the company that:
 - controls the association; and
 - is not controlled by any other company.
- The officer is not otherwise subject to §§ 215.4, 215.6, and 215.8.

Director (§ 215.2(d))

A director of an association or company includes any person who is designated as a director, or who performs duties as a director regardless of compensation. Director includes trustees, but does not include advisory directors, if they meet all of the following conditions:

- The shareholders do not elect them.
- They are not authorized to vote on matters before the board of directors.
- They provide solely general policy advice to the board of directors.

Directors of an affiliate of an association are not subject to § 215.4 (General prohibitions), § 215.6 (Prohibition on knowingly receiving extensions of credit), and § 215.8 (Records) if all of the following criteria are met:

- A resolution of the board of directors or the bylaws of the association excludes the director of the affiliate from participation in major policy-making functions of the association, and the director does not actually participate in such functions.
- The affiliate does not control the savings association.
- As determined annually, the assets of the affiliate do not constitute more than ten percent of the consolidated assets of the company that:
 - controls the association; and
 - is not controlled by any other company.
- The director is not otherwise subject to §§ 215.4, 215.6, and 215.8.

Principal Shareholder (§ 215.2(m))

A principal shareholder of an association does not include any company of which the association is a subsidiary.

Regulation O defines a principal shareholder of an association (or company) as a person (other than an insured association or insured bank) that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than ten percent of any class of voting securities of the association (or company). Shares that a member of an individual's immediate family (as defined at 215.2(g)) owns or controls are considered as held by the individual.

A principal shareholder of an association does not include any company of which the association is a subsidiary. For example, principal shareholder excludes parent savings association holding companies.

Related Interests (§ 215.2(n))

Regulation O defines a related interest of a person to include any company that the person controls. It also includes a political or campaign committee that the person controls, or the funds or services of a political or campaign committee that benefit that person.

Restrictions on Extensions of Credit

Section 215.4 of Regulation O contains four restrictions on extensions of credit with insiders:

- Lending limits.
- Prior approval requirements.
- Qualitative factors.
- Overdraft provisions.

Lending Limits (§§ 215.4(c) and 215.4(d))

Regulation O imposes both an aggregate and an individual lending limit on extensions of credit to insiders.

Aggregate Lending Limit — General Limit

An association may not extend credit to any of its insiders or insiders of its affiliates in an amount that, when aggregated with the amount of all other extensions of credit by the association to all such insiders, exceeds the association's unimpaired capital and unimpaired surplus. In other words, the aggregate amount of all extensions of credit to all insiders may not exceed 100 percent of the association's unimpaired capital and surplus.

Aggregate Lending Limit — Small Savings Associations

Savings associations with less than \$100 million in deposits may make extensions of credit to insiders up to 200 percent of unimpaired capital and unimpaired surplus if all of the following circumstances exist:

- The board of directors determines by an annual resolution that a higher limit is consistent with safe and sound banking practices in light of the association'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.
- The board resolution discloses the facts and reasons for the board's findings noted above, including the amount of insider extensions of credit as a percentage of unimpaired capital and unimpaired surplus as of the date of the board resolution.
- The association meets or exceeds all applicable capital requirements.
- The association received a satisfactory composite CAMELS rating in its most recent report of examination.

If the association subsequently fails to meet capital requirements or does not maintain a satisfactory composite rating, it cannot extend any additional credit (including a renewal of an existing extension of credit) to any insider of the association or its affiliates unless it is within the general aggregate lending limit.

Exceptions to the Aggregate Lending Limit

The aggregate lending limits do not apply to extensions of credit that meet any of the criteria listed as follows. Extensions of credit that are:

- 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.
- Extended 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.
- Secured by a perfected interest in a segregated deposit account in the lending savings association.
- Arise from the discount of negotiable or nonnegotiable installment consumer paper acquired from an insider that carries a full or partial recourse endorsement or guarantee by the insider, provided that it meets all of the following criteria:
 - The financial condition of each maker of such consumer paper is reasonably documented in the association's files or known to its officers.
 - An officer of the association designated for that purpose by the board of directors of the association certifies in writing that the association is relying primarily upon the responsibility of each maker for payment of the obligation and not upon any endorsement or guarantee by the insider.
 - The maker of the instrument is not an insider.

Individual Lending Limit

An association may not extend credit to any of its insiders or to any insider of its affiliates in an amount that, when aggregated with the amount of all other extensions of credit by the association to that person and to all related interests of that person, exceeds the loans to one borrower (LTOB) lending limits.

The LTOB rule limits the total of all loans and extensions of credit by a savings association to one borrower, outstanding at one time, to 15 percent of the association's unimpaired capital and surplus. An association may extend an additional ten percent of unimpaired capital and surplus to one borrower if the additional amount comprises only loans and extensions of credit that are fully secured by readily marketable collateral. See 12 CFR § 560.93.

The National Banking Act (12 USC § 84(c) (1)-(10)) provides a list of ten exceptions to the percentage ceilings for certain secured extensions of credit. The additional exceptions to association LTOB

limitations contained in § 5(u) of HOLA are not available to compute the individual lending limit for extensions of credit to association insiders and related interests.

Prior Board of Director Approval Requirement (§ 215.4(b))

When the amount of an extension of credit exceeds certain thresholds, Regulation O requires prior board approval. In obtaining prior approval, all of the following actions must occur:

- A majority of the entire board of directors of the association approves the extension of credit in advance.
- The interested party abstains from participating directly or indirectly in the voting. Participation in the discussion or any attempt to influence the voting on the extension of credit will constitute indirect participation in the voting.

Prior approval, as described above, is not necessary for extensions of credit up to the higher of \$25,000 or five percent of the association's unimpaired capital and unimpaired surplus. However, prior approval is always necessary for extensions of credit over \$500,000. In determining compliance with these thresholds, the association must aggregate all extensions of credit to that person and to all related interests of that person.

Regulation O does not require board approval for any extension of credit the association makes pursuant to a line of credit the board of directors approved during the preceding 14 months.

Regulation O does not require board approval for an extension of credit the association makes pursuant to a line of credit the board of directors approved during the preceding 14 months.

Qualitative Restrictions (§ 215.4(a))

An association may not extend credit to any of its insiders or insiders of its affiliates unless the association makes the extension of credit on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions the association makes with other persons that are not insiders or otherwise employed by the association. The association must also follow its standard credit underwriting procedures, and cannot use less stringent underwriting procedures. Regulation O also requires that the extension of credit not involve more than the normal risk of repayment or present other unfavorable features.

This requirement does not prohibit an association from making a "preferential" extension of credit to an insider of the association (or its affiliate) if the association makes the extension of credit pursuant to an employee benefit or compensation program that is widely available to employees of the association (or the affiliate). The benefit program cannot give preference to any insider over other employees.

Overdrafts (§ 215.4(e))

An association may not pay an overdraft on an account of one of its executive officers or directors, or an executive officer or director of its affiliates. Exceptions include the payment of funds that are:

- Inadvertent, less than \$1,000 in the aggregate, overdrawn for five business days or less, and subject to the same fee charged to other customers in similar circumstances.
- Paid in accordance with a written, preauthorized, interest-bearing extension of credit plan that specifies a method of repayment.
- Funded by a written, preauthorized transfer of funds from another account of the account holder at the association.

Additional Restrictions on Extensions of Credit to Executive Officers

Additional restrictions apply to extensions of credit to the association's executive officers. Specifically, a savings association is prohibited from extending credit to its executive officers except in the amounts and for the purposes described below.

A saving association may extend credit to its own executive officers in any amount, subject to compliance with LTOB limitations, if the extension of credit is one of the following types:

- Finances the education of the executive officer's children.
- Finances or refinances the purchase, construction, maintenance, or improvement of a residence of the executive officer, provided two conditions occur:
 - A first lien on the residence secures the extension of credit and the executive officer owns the residence (or expects to own the residence after the extension of credit).
 - In the case of refinancing, the refinance amount includes only the amount used to repay the original extension of credit, together with the closing costs of the refinancing, and any additional amount used to finance the purchase, construction, maintenance, or improvement of a residence.

Note: Extensions of credit on vacation or second homes the executive officer owns or expects to own qualify as a residential loan, but only one loan to an executive officer may qualify for this category. Extensions of credit for other purposes, even if secured by a residence, either must fall within one of the other categories listed in these bullets or will be subject to limits on the "other purpose" loans under 12 CFR § 215.5(c)(4). The total outstanding amount of the other purpose category is subject to the dollar limits set forth below.

- 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.
- 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.
- Secured by a perfected interest in a segregated deposit account in the lending savings association.

Section 215.5(c)(4) limits the aggregate loan amount for all other extensions of credit to the greater of 2.5 percent of unimpaired capital and unimpaired surplus or \$25,000, but in no event more than \$100,000. In addition, § 215.5(b) limits to these same amounts, extensions of credit to a partnership in which one or more of the association's executive officers are partners and, either individually or together, constitute a majority interest, regardless of the purpose of the extension of credit or the type of collateral. For purposes of this limitation, the total amount of the extension of credit to a partnership is attributed to each officer of the association, individually, who is also a member of the partnership.

A savings association must meet all of the following requirements when extending credit to an executive officer:

- Report the extension of credit promptly to the association's board of directors.
- Ensure that the extension of credit complies with the terms and creditworthiness standards of § 215.4(a) (that is, not on preferential terms or involve more than the normal risk of repayment or other unfavorable features).
- Obtain a detailed current financial statement from the borrower before extending credit.
- At the option of the association, make the extension of credit subject to a written condition that it become due and payable at any time the officer becomes indebted to any other bank(s) or association(s) in an aggregate amount greater than the permissible ceiling for a category of borrowings cited above (as outlined in § 215.5(c)).

Miscellaneous Standards (§§ 215.6, 215.8, 215.9, 215.10, 215.11, and 215.12)

These sections and recordkeeping standards in Part 215 deal primarily with the reporting requirements for various transactions with insiders. Also, § 215.6 prohibits insiders from knowingly violating applicable restrictions on extensions of credit to insiders and related interests.

Provisions Governing Indebtedness to Correspondent Banks

You should also determine whether an association complies with the provisions that generally prohibit preferential extensions of credit to insiders of correspondent banks and imposes certain recordkeeping requirements (See [Appendix A](#)).

REFERENCES

United States Code (12 USC)

National Banking Act

§ 84(c) Lending Limits Exceptions

Federal Reserve Act

§ 371c Banking Affiliates (§ 23A of the FRA)

§ 371c-1 Restrictions on Transactions with Affiliates (§ 23B of the FRA)

§ 375a Loans to Executive Officers (§ 22(g) of the FRA)

§ 375b Extensions of Credit to Executive Officers, Directors and Principal Shareholders (§ 22(h) of the FRA)

Home Owners' Loan Act

§ 1467a Regulation of Holding Companies (§ 10 of the HOLA)

§ 1468 Transactions with Affiliates, Insider Loans (§ 11 of the HOLA)

Bank Holding Company Act

§ 1972(2)(H) Correspondent Accounts Definitions

United States Code (15 USCA)

Investment Company Act

80a-2(a)(20) Investment Adviser

Code of Federal Regulations (12 CFR)

OTS Regulations

- § 560.93 Loans to One Borrower
- § 563.41 Transactions with Affiliates
- § 563.43 Loans by Savings Associations to Their Executive Officers, Directors and Principal Shareholders
- § 563.200 Conflicts of Interest
- § 563.201 Corporate Opportunity
- § 584.2-2 Permissible Bank Holding Company Activities

Federal Reserve Board Regulations

- Part 215 Regulation O (Insider Loans)
- Part 223 Regulation W (Transactions between Member Banks and Their Affiliates)
- §§ 225.24 Permissible Bank Holding Company Activities
and 225.28

Transactions with Affiliates and Insiders Program

EXAMINATION OBJECTIVES

Determine if transactions with affiliates (TWA) and insiders are in regulatory compliance and not detrimental to the safety and soundness of the savings association.

Evaluate the extent and degree of influence of affiliations on the savings association.

EXAMINATION PROCEDURES

LEVEL I

WKP. REF.

1. Review examination scoping materials related to transactions with affiliates and insiders. If another regulator performs the review of scoping materials, obtain a written or verbal summary of the review(s) concerning this program. Refer to the examiner-in-charge (EIC).

Scoping materials might include:

- The prior examination report.
- Prior exception sheets and work papers.
- Review of internal/external audit reports, supervisory analysis, correspondence, the business plan, minutes of the meetings of the board of directors, PERK information, etc.

-
2. Review the preceding report of examination and all TWA-related exceptions and determine whether management has taken appropriate corrective action.

-
3. Evaluate the savings association's policies and procedures for transactions with affiliates and insiders by reviewing policy statements, procedure manuals, board and committee minutes, and other pertinent documents.
-

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

Transactions with Affiliates and Insiders Program

WKP. REF.

4. Obtain and review the Management Questionnaire. Based on the review of minutes and any additional interviews with management, determine the completeness and accuracy of the answers to this questionnaire.
-

5. Verify that transactions with affiliates and insiders are in compliance with applicable regulations:

- § 563.41 (applies the Board of Governors of the Federal Reserve System's (FRB) Regulation W at Part 223 to savings associations).
- § 563.43 (applies the FRB's Regulation O at Part 215 to savings associations).

Note: Appendix A, Regulation O Summary of Reporting/Recordkeeping Requirements, is a useful tool to determine regulatory compliance.

6. Evaluate the association's documentation and recordkeeping to determine compliance with minimum standards.
-

7. Review Level II procedures and perform those necessary to test, support, and confirm conclusions derived from performance of Level I procedures.
-

LEVEL II

1. Evaluate the extent and degree of influence of outside affiliations on the savings association.
-

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

Transactions with Affiliates and Insiders Program

WKP. REF.

2. From the review of information, determine which transactions, if any, you should review for evidence of self-dealing or conflicts of interest or other safety and soundness concerns. Provide instructions to the examiners reviewing the appropriate areas.
-

3. Ensure that the examination meets the Objectives of this Handbook Section. State your findings, conclusions, and recommendations for any necessary corrective measures, on the appropriate work papers and report pages.
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EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

REGULATION O SUMMARY OF REPORTING/
RECORDKEEPING REQUIREMENTS

12 C.F.R. Section

Requirement

215.8

Records of Institution

A savings association must maintain records necessary for compliance with Regulation O. Any recordkeeping method adopted by the association must identify its insiders through an annual survey. The recordkeeping method must also identify insiders of affiliates through an annual survey; by a borrower inquiry method at the time the association makes an extension of credit; or by any alternative method acceptable to OTS.

The recordkeeping method adopted by the association must also include records of all extensions of credit to such persons, including the amount and terms of each extension of credit made to these persons and their related interests. Records must be sufficient to demonstrate compliance with applicable lending restrictions.

215.9

Reports by Executive Officers

Executive officers of the association must provide a written report to the association's board of directors within ten days of becoming indebted to any other bank or association in an aggregate amount that exceeds the amounts specified in § 215.5(c). The report must state the lender's name, the origination date, the amount of each extension of credit, the collateral or security for the debt, and the purpose of each extension of credit.

215.10

Reports on Credit to Executive Officers

An association must report in Schedule SI of its quarterly TFR all extensions of credit to its executive officers since the date of the previous TFR.

215.11

Disclosure of Credit to Executive Officers and Principal Shareholders

Upon written request from the public, the association must provide a list of outstanding extensions of credit to its executive officers, principal shareholders, and related interests of the executive officers and principal shareholders. The list must be as of the previous quarter end and should

include all aggregate extensions to one party and its related interests that are five percent or more of the association's capital and surplus or \$500,000, whichever is less. The association need not disclose specific amounts of individual extensions of credit. If the aggregate amount of all extensions of credit outstanding at such time to the executive officer or principal shareholder and the related interests does not exceed \$25,000, the association is not required to make a disclosure.

215.12 **Reporting Requirement for Credit Secured by Certain Bank Stock**

Executive officers or directors of associations whose shares are not publicly traded must annually report to the board of directors any outstanding credit that is secured by shares of the association.

215.22 **Reports by Executive Officers and Principal Shareholders or Their Related Interests**

On or before January 31 of each year, executive officers and principal shareholders must submit a written report to the board of directors regarding their outstanding extensions of credit from correspondent banks of the association. The association must notify executive officers and principal shareholders of this requirement, provide a list of the correspondent banks, and maintain the reports for three years. Associations may use FFIEC Form 004 (attachment to OTS TB 64-1c) or maintain the information in a similar format.

215.23 **Disclosure of Credit from Correspondent Banks to Executive Officers and Principal Shareholders**

Upon written request from the public, the association must provide the names of its executive officers, principal shareholders, and related interests that had outstanding extensions of credit from a correspondent bank at any time during the previous calendar year. The list must include the amount of the extension of credit if, when aggregated with all other outstanding extensions of credit from all correspondent banks to the executive officer or principal shareholder and the related interest, equaled or exceeded five percent of capital and surplus or \$500,000, whichever is less. The association need not disclose specific amounts of individual extensions of credit. If the aggregate amount of all extensions of credit outstanding from all correspondent banks to the executive officer or principal shareholder and its related interests does not exceed \$25,000 at any time during the calendar year; the association is not required to make a disclosure.