FEDERAL RESERVE SYSTEM

12 CFR part 215

[Regulation O; Docket No. R-1271]

Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks

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

ACTION: Final rule.

SUMMARY: The Board is adopting amendments to the Board's Regulation O to eliminate certain reporting requirements. These amendments implement section 601 of the Financial Services Regulatory Relief Act of 2006.

DATES: This final rule is effective on [INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Mark E. Van Der Weide, Senior Counsel (202-452-2263), or Amanda K. Allexon, Attorney (202-452-3818), Legal Division. Users of Telecommunication Device for the Deaf (TTD) only, contact (202) 263-4869.

SUPPLEMENTARY INFORMATION:

Background

Section 22(h) of the Federal Reserve Act ("FRA") restricts the ability of member banks to extend credit to their executive officers, directors, principal shareholders, and to related interests of such persons.[1] Section 22(g) of the FRA imposes some additional limitations on extensions of credit made by member banks to their executive officers.[2] Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 ("BHC Act Amendments") adds further restrictions on extensions of credit to an executive officer, director, or principal shareholder of a bank from a correspondent bank.[3] The Board's Regulation O implements sections 22(g) and 22(h) of the FRA, as well as section 106(b)(2) of the BHC Act Amendments.[4] Sections 22(g) and 22(h) and Regulation O apply, by their terms, to all banks that are members of the Federal Reserve System.[5] Other Federal law subjects Federally insured state non-member banks and

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[1] 12 U.S.C. 375b.

[2] 12 U.S.C. 375a.

[3] 12 U.S.C. 1972(2).

[4] 12 CFR part 215.

[5] Section 106(b)(2) of the BHC Act Amendments applies by its terms to insured banks, mutual savings banks, savings banks, and savings associations.

Federally insured savings associations to sections 22(g) and 22(h) and Regulation O in the same manner and to the same extent as if they were member banks.[6]

Section 601 of the Financial Services Regulatory Relief Act of 2006 ("Act") (Pub. L. No. 109-351) removed several statutory reporting requirements relating to insider lending by member banks. These amendments, which became effective on October 13, 2006, eliminated the statutory provisions that:

- require a member bank to include a separate report with its quarterly Reports of Condition and Income ("Call Report") on any extensions of credit the bank has made to its executive officers since its last Call Report (12 U.S.C. 375a(9));

- require an executive officer of a member bank to file a report with the member bank's board of directors whenever the executive officer obtains an extension of credit from another bank in an amount that exceeds the amount the executive officer could obtain from the member bank (12 U.S.C. 375a(6));

- require an executive officer or principal shareholder of a depository institution to file an annual report with the institution's board of directors during any year in which the officer or shareholder has an outstanding extension of credit from a correspondent bank of the institution (12 U.S.C. 1972(2)(G)(i)); and

- authorize the Federal banking agencies to issue regulations that require the reporting and public disclosure of information related to extensions of credit received by an executive officer or principal shareholder of a depository institution from a correspondent bank of the institution (12 U.S.C. 1972(2)(G)(ii)).

In December 2006, the Board adopted, and sought public comment on, an interim rule that implemented the changes made by section 601 of the Act.[7] In particular, the interim rule eliminated:

- Section 215.9 of Regulation O, which requires an executive officer of a member bank to file a report with the member bank's board of directors whenever the executive officer obtains certain extensions of credit from another bank;

- Section 215.10 of Regulation O, which requires a member bank to include a separate report with its quarterly Call Report on any extensions of credit the bank has made to its executive officers since its last Call Report; and

- Subpart B of Regulation O, which requires the reporting and public disclosure of extensions of credit to an executive officer or principal shareholder of a member bank by a correspondent bank of the member bank.

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[6] 12 U.S.C. 1828(j), 1468(b); 12 CFR 563.43.

[7] 71 FR 71472 (Dec. 11, 2006).

The interim rule also made minor conforming changes to Regulation O to reflect the removal of these provisions.

Analysis of Comments and Description of Final Rule

The Board received six comments on the interim rule: three from banks, two from bank trade associations, and one from an individual. The banks and trade associations supported the interim rule and the associated reduction in regulatory reporting burden. The individual commenter criticized the interim rule and stated that public reporting is an important device for preventing financial scandals.

After reviewing the public comments on the interim rule, the Board has determined to adopt a final rule that is identical to the interim rule. Although the Board agrees that appropriate public reporting by depository institutions can be an effective mechanism of market discipline, the Board believes that elimination of these regulatory reporting requirements is consistent with the letter and spirit of the Act. In addition, the Board has long supported eliminating these reporting provisions because the Board has found that they did not contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse.

One commenter urged the Board to take steps to ensure that depository institutions recognize that section 601 of the Act and this final rule do not alter the underlying substantive insider lending restrictions in Federal law. The Board shares the concern expressed by this commenter. The Board notes that the changes made by section 601 and the final rule do not alter the substantive restrictions on loans by depository institutions to their executive officers and principal shareholders found in Regulation O. In addition, section 601 and the final rule do not alter the substantive restrictions on loans made to executive officers and principal shareholders of depository institutions by their correspondent banks found at 12 U.S.C. 1972(2). To address the shared concerns of the Board and this commenter, the Board has amended the scope section of Regulation O (12 CFR 215.1(b)(4)) to remind depository institutions of the correspondent bank insider lending restrictions.

The Board also notes that elimination of these reporting requirements does not limit the authority of the appropriate Federal banking agency to take enforcement action against a depository institution or its insiders for violation of the Federal insider lending restrictions. Moreover, Regulation O would continue to require that a depository institution and its insiders maintain sufficient information to enable examiners to monitor the institution's compliance with the regulation,[8] and the Federal banking agencies would retain authority under other provisions of law to collect information regarding insider lending by depository institutions.

Two commenters requested that the Board eliminate section 215.5(d)(4) of Regulation O in light of the elimination of section 215.9 of the rule. Section 215.5(d)(4) of Regulation O requires a member bank to make any extension of credit to an executive officer "subject to the condition in writing that the extension of credit will, at the option of the member bank, become due and payable at any time that the officer is indebted to any other bank or banks" on non-

[8] 12 CFR 215.8.

mortgage, non-educational loans in excess of a specific dollar threshold (typically $100,000).[9] Section 215.9 of Regulation O previously required a member bank's executive officer to report to the bank's board of directors within 10 days of the date that the officer becomes indebted to other banks on non-mortgage, non-educational loans in excess of the same dollar threshold (typically $100,000).

The "due on demand clause" requirement contained in section 215.5(d)(4) of Regulation O derives directly from section 22(g)(1)(D) of the Federal Reserve Act.[10] Accordingly, the Board does not have authority to eliminate this Federal insider lending restriction. The Board notes, however, that the continued existence of section 215.5(d)(4) does not make the elimination of section 215.9 ineffective. A bank must continue to include the section 215.5(d)(4) "due on demand" clause in each of its extensions of credit to executive officers, but Regulation O no longer requires the specific internal reporting regime of former section 215.9 to ensure the utility of the due on demand clause. Going forward, a bank may choose to ensure the effectiveness of the due on demand clause requirement in any reasonably prudent way. For example, a bank may comply with the requirement by mandating a periodic report from its executive officer borrowers. Alternatively, a bank may decide to obtain information about an executive officer borrower's indebtedness to other banks only at the time the bank would be interested in exercising the due on demand clause (for example, when the creditworthiness of the officer has dropped materially). Either of these methods could, based on all the facts and circumstances, be a reasonable way to ensure the utility of the due on demand clause requirement.

The Board also has received numerous inquiries about how a bank can ensure compliance with the correspondent lending restrictions in 12 U.S.C. 1972(2), given that all related reporting requirements are being eliminated as part of this rulemaking. Briefly, the correspondent lending restrictions in 12 U.S.C. 1972(2) require, among other things, that extensions of credit by a bank to an insider of a correspondent bank be on market terms. In light of the elimination of the statutory and regulatory reporting requirements associated with 12 U.S.C. 1972(2), a bank may select any reasonably prudent method to ensure compliance with the restrictions. For example, a bank may establish policies and procedures to request additional information about a borrower's relationships with correspondent banks when the bank determines that a prospective extension of credit to the borrower will be on preferential terms.

Finally, one commenter asked the Board to raise the $100,000 "other purpose" loan cap in section 215.5(c)(4) of Regulation O and to raise the $500,000 prior board approval threshold in section 215.4(b)(2) of the rule.[11] The Board has determined not to raise these dollar amounts as a part of this rulemaking but intends to consider raising these limits, in consultation with the other Federal banking agencies, in connection with an upcoming comprehensive review of Regulation O.

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[9] 12 CFR 215.5(d)(4).

[10] 12 U.S.C. 375a(1)(D).

[11] See 12 CFR 215.5(c)(4) and 215.4(b)(2).

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Board certifies that the final rule would not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). Although the final rule would apply to all member banks regardless of their size, the rule would reduce the regulatory burden on member banks, including small member banks, by removing requirements to report certain types of extensions of credit to insiders and to insiders of correspondent banks. Accordingly, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 3506; 5 CFR 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 collections of information that are revised by this rulemaking are found in 12 CFR 215.9 and 215.10, and 12 CFR part 215, subpart B. This information previously was required to evidence compliance with the requirements of the Federal Reserve Act (12 U.S.C. 375a and 375b) and 12 U.S.C. 1972. The respondents/recordkeepers are for-profit financial institutions, including small businesses, and individuals.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number. The OMB control number associated with 12 CFR 215.9 and 12 CFR part 215, subpart B was 7100-0034 (FFIEC 004). The OMB control number associated with 12 CFR 215.10 was 7100-0036 (FFIEC 031 and 041).

The FFIEC 004 was discontinued as a result of this rule as of December 31, 2006. The total amount of annual burden estimated to be saved as a result of this aspect of the rule is 5,331 hours. The estimated annual cost savings are $239,895. In addition, the last page of the FFIEC 031 and 041 reporting forms (loans to executive officers), which is associated with 12 CFR 215.10, was eliminated as a result of this rule as of December 31, 2006. The total amount of annual burden estimated to be eliminated as a result of this aspect of the rule is 919 hours and there are estimated to be minimal cost savings.

For the FFIEC 004, individual respondent financial information was regarded as confidential under the Freedom of Information Act (5 U.S.C. 552(b)(4), (6) and (8)). However, until the passage of the Act and the issuance of the interim rule, upon request from the public the member bank was required to disclose the name of each executive officer and principal shareholder who, together with related interests, has loans from correspondent banks equal to a minimum of 5 percent of the member bank's capital and surplus, or $500,000, whichever was less. The FFIEC 031 and 041 data on loans to executive officers were not considered confidential.

Five of the six commenters, representing banks and bank trade associations, supported the reduction in reporting burden associated with the interim rule. One individual's comment

criticized the interim rule and noted that public reporting is an important device for preventing financial scandals. However, the Federal Reserve believes that the elimination of these reporting requirements is consistent with the letter and spirit of the Act, and will make the reporting changes, as proposed.

The Federal Reserve has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100-0034 or 7100-0036), Washington, DC 20503.

Plain Language

Section 722 of the Gramm-Leach-Bliley Act (12 U.S.C. 4809) requires the Board to use "plain language" in all rules published in the Federal Register. The Board has sought to present the final rule in a simple and straightforward manner.

List of Subjects

12 CFR part 215

Credit, Penalties, Reporting and record keeping requirements.

Authority and Issuance

For the reasons set out in the preamble, the Board amends 12 CFR part 215 to read as follows:

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

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

AUTHORITY: 12 U.S.C. 248(a), 375a(10), 375b(9) and (10), 1817(k); and Pub. L. 102–242, 105 Stat. 2236 (1991).

2. Remove the heading **Subpart A—Loans by Member Banks to Their Executive Officers, Directors, and Principal Shareholders**.

3. Section 215.1 is revised to read as follows:

§ 215.1 Authority, purpose, and scope.

(a) Authority. This part is issued pursuant to sections 11(a), 22(g), and 22(h) of the Federal Reserve Act (12 U.S.C. 248(a), 375a, and 375b), 12 U.S.C. 1817(k), and section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)).

(b) Purpose and scope—(1) This part governs any extension of credit made by a member bank to an executive officer, director, or principal shareholder of the member bank, of any company of which the member bank is a subsidiary, and of any other subsidiary of that company.

(2) This part also applies to any extension of credit made by a member bank to a company controlled by such a person, or to a political or campaign committee that benefits or is controlled by such a person.

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

(4) Extensions of credit made to an executive officer, director, or principal shareholder of a bank (or to a related interest of such person) by a correspondent bank also are subject to restrictions set forth in 12 U.S.C. 1972(2).

4. In § 215.2, the introductory text is revised to read as follows:

§ 215.2 Definitions.

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

* * * * *

5. Remove §§ 215.9 and 215.10 and redesignate §§ 215.11, 215.12, and 215.13 as §§ 215.9, 215.10, and 215.11, respectively.

6. In newly designated § 215.9:

a. In paragraph (a)(1), remove footnote 4; and

b. Paragraph (a)(2)(ii) is revised to read as follows:

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

(a) * * *

(2) * * *

(ii) Any political or campaign committee the funds or services of which will benefit a person or that is controlled by a person. For the purpose of this section, a related interest does not include a bank or a foreign bank (as defined in 12 U.S.C. 3101(7)).

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7. Newly designated § 215.11 is revised to read as follows:

§ 215.11 Civil penalties.

Any member bank, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank, that violates any provision of this part (other than § 215.9) is subject to civil penalties as specified in section 29 of the Federal Reserve Act (12 U.S.C. 504).

8. The Appendix to Subpart A of part 215 is redesignated as the Appendix to part 215.

9. Remove the heading **Subpart B—Reports on Indebtedness of Executive Officers and Principal Shareholders to Correspondent Banks**.

10. Remove §§ 215.20, 215.21, 215.22, and 215.23.

By order of the Board of Governors of the Federal Reserve System, May 25, 2007.

Jennifer J. Johnson (signed)
Jennifer J. Johnson
Secretary of the Board.