Legal Interpretations

Frequently Asked Questions about Regulation O

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

Staff of the Board of Governors of the Federal Reserve System has developed the following frequently asked questions (FAQs) to assist entities in complying with the Board's Regulation O. Except as noted below, these FAQs are staff interpretations and have not been approved by the Board of Governors. Staff may supplement or revise these FAQs as necessary or appropriate in the future. Any questions regarding these FAQs, or requests for modification, rescission, or waiver, should be submitted through the Board's Contact Us form.

Although Regulation O applies by its terms to "member banks," or institutions that are members of the Federal Reserve System, state banks that are not members of the Federal Reserve System and savings associations also are subject to the requirements in Regulation O that implement sections 22(g) and 22(h) of the Federal Reserve Act. Accordingly, although the following FAQs use the term "member bank," they also clarify the application of Regulation O to these entities.

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Q2: May a member bank offer a discount on loan origination fees to an insider if the discount is not available to members of the public?

12 CFR 215.5 (Additional restrictions on loans to executive officers of member banks)

Q1: What types of properties and how many properties may qualify as a "residence" of an executive officer for purposes of the "residence" exception to the restrictions on extensions of credit to executive officers?

In General

Q1: What types of institutions are covered by these FAQs?

A1: National banks, state banks, savings associations, and insured branches of foreign banking organizations.

By their terms, sections 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. §§ 375a and 375b) and Regulation O set forth restrictions for "member banks," which includes national banks and state banks that are members of the Federal Reserve System. However, other provisions of federal law subject state banks that are not members of the Federal Reserve System and savings associations to sections 22(g) and 22(h) of the Federal Reserve Act in the same manner and to the same extent as member banks. In addition, as discussed in Q1 for 12 CFR 215.2, sections 22(g) and 22(h) also apply to the insured branches of foreign banking organizations.

Source: 12 U.S.C. §§ 1468(b) and 1828(j); 12 CFR 215.12.

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Q2: When do the requirements of Regulation O apply to extensions of credit to a person that becomes an insider after the member bank made the extension of credit (transition loans)?

A2: Transition loans need not conform to the requirements of Regulation O until such extensions of credit are renewed, revised, or extended, at which time the extensions of credit would be treated as a new extension of credit and therefore subject to all of the requirements of Regulation O. However, transition loans must be counted toward the individual and aggregate lending limits of Regulation O as soon as the borrower becomes an insider.

This same treatment would apply to extensions of credit to a director or principal shareholder that later becomes an executive officer. Such extensions of credit need not conform to the provisions of Regulation O that apply only to executive officers until such extensions of credit are renewed, revised, or extended. However, the amount of any such extensions of credit count toward the quantitative limits for loans to executive officers in section 215.5 of Regulation O as soon as the director or principal shareholder becomes an executive officer.

Many lines of credit by a member bank to an insider must be approved by the bank's board of directors every 14 months. Each such approval constitutes a new extension of credit. Accordingly, transition loans that are lines of credit generally must conform to the requirements of Regulation O within 14 months of the borrower becoming an insider.

Notwithstanding the general principles noted above, the treatment described here does not apply to extensions of credit made by a member bank in contemplation of the borrower becoming an insider or executive officer. Under such circumstances, the extension of credit should comply with all requirements of Regulation O at the time it is made.

Source: FRRS 3-1036 (citing 1936 Fed. Res. Bull. 121); Letter from J. Virgil Mattingly, Jr., to N. P. Van Maren, Jr. (September 16, 1992), available here; 62 Fed. Reg. 13294, 13296 n. 11 (March 20, 1997).

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12 CFR 215.2 (Definitions)

Q1: Does Regulation O apply to extensions of credit to insiders made by U.S. branches or agencies of foreign banks?

A1: Regulation O applies to FDIC-insured U.S. branches of foreign banks but does not apply to uninsured U.S. branches or to U.S. agencies of foreign banks. See 12 U.S.C. § 1828(j)(2).

Source: FRRS 3-1085.5 .

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Q2: Could an estate or trust that owns or controls voting securities of a member bank be considered an insider of the member bank?

A2: Yes. If an estate or trust, directly or indirectly, or acting in concert with one or more persons owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank, the estate or trust is a principal shareholder, and therefore an insider, of the member bank. Any loan made by a member bank to such an estate or trust, or any company controlled by the estate or trust, would be an extension of credit subject to Regulation O.

Source: FRRS 3-1062.1 (citing a letter from Neal L. Petersen, General Counsel of the Board, to John P. Amershadian (May 23, 1980), available here).

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Q3: Is the executor of an estate that owns more than 10 percent of a member bank a principal shareholder of the member bank?

A3: Yes. A principal shareholder of a member bank is any person that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the member bank. Shares of a member bank held by an estate are controlled indirectly by the executor of the estate. Accordingly, if an estate owns more than 10 percent of a class of voting securities of a member bank, the estate's executor has the power indirectly to control such shares and is thus a principal shareholder of the member bank.

Source: FRRS 3-1062.1 (citing a letter from Neal L. Petersen, General Counsel of the Board, to John P. Amershadian (May 23, 1980), available here).

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12 CFR 215.3 (Extension of credit)

Q1: Would a guarantee by an insider for an extension of credit by a member bank to a third party be treated as an extension of credit to the insider?

A1: Yes. The definition of "extension of credit" in section 215.3(a)(4) of Regulation O includes any evidence of indebtedness upon which an insider may be liable as guarantor. 12 CFR 215.3(a)(4). The amount of such an extension of credit to the insider equals the amount of the indebtedness for which the insider has provided a guarantee.

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Q2: When is an extension of credit to an estate or trust treated as being made to a beneficiary of the estate or trust?

A2: The tangible economic benefit rule in section 215.3(f) of Regulation O provides that an extension of credit to a third party will be treated as having been made to an insider to the extent that the proceeds are transferred to, or used for the tangible economic benefit of, an insider. Extensions of credit to an estate or trust inure to the benefit of the beneficiaries of the trust or estate. For purposes of Regulation O, an extension of credit to a trust or estate in which an insider has a present or contingent beneficial interest of 25 percent or more will be treated as made to the insider-beneficiary.

Source: FRRS 3-1062.1 (citing a letter from Neal L. Petersen, General Counsel of the Board, to John P. Amershadian (May 23, 1980), available here).

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Q3: Would a bank's payment of premiums as part of a split dollar life insurance arrangement constitute an extension of credit to an insider?

A3: No, provided certain conditions are satisfied. Under a split dollar life insurance arrangement, a bank pays the premiums on a policy insuring the life of an employee of the bank. Split dollar life insurance arrangements can take many forms. For example, the insurance policy can be owned by the bank, the employee, or a third party (typically a trust). Regardless of form, the bank is entitled to receive from the proceeds of the insurance policy a prenegotiated amount upon the death of the insured or when the insured surrenders the policy.

When the bank provides this arrangement for an insider, a split dollar life insurance arrangement does not give rise to an extension of credit to the insider where (i) the bank is not entitled to payment in an amount greater than the premiums paid by the bank (for example, the bank is not entitled to payment of the premiums plus some assessed interest), and (ii) the insider has no independent obligation to repay the premiums to the bank, other than out of the proceeds of the insurance policy.

Source: 12 CFR 215.3(a)(7); Letter from J. Virgil Mattingly, Jr., General Counsel of the Board, to Jeffrey S. Kane (April 13, 1995).

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12 CFR 215.4 (General prohibitions)

Q1: How does Regulation O apply to restructurings or workouts of an existing extension of credit?

A1: A renewal, restructuring, or workout of a loan is an extension of credit that must comply with Regulation O. Under Regulation O, an extension of credit to an insider must: (i) be made on substantially the same terms as, and following credit underwriting procedures no less stringent than, comparable transactions with non-insiders; and (ii) not involve more than the normal risk of repayment or present other unfavorable features. 12 CFR 215.4(a). To comply with these requirements, restructured loans to insiders may, but do not have to, be compared to extensions of credit to non-insiders that are not part of a workout. Instead, restructured loans to insiders may be compared to restructured loans to non-insiders.

An extension of credit to an insider does not per se violate the requirements of Regulation O simply because the loan is or becomes classified.

Source: Letter from Millard E. Sweatt, Jr., Vice President and General Counsel of the Federal Reserve Bank of Dallas, to Mr. R. Bruce Laboon (May 24, 1984), available here.

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Q2: May a member bank offer a discount on loan origination fees to an insider if the discount is not available to members of the public?

A2: No, with one exception, explained below. Regulation O prohibits a member bank from extending credit to an insider that is not made on substantially the same terms

as, or is made without following credit underwriting procedures that are at least as stringent as, comparable transactions with persons that are non-insiders and not employees of the bank. 12 CFR 215.4(a)(1). This provision does not, however, prohibit a member bank from extending credit to an insider as part of a benefit or compensation program that (i) is widely available to employees of the member bank and (ii) does not give preference to any insider of the member bank over other employees of the member bank. 12 CFR 215.4(a)(2).

Source: FRRS 3-1089.11 (citing Letter from J. Virgil Mattingly, General Counsel of the Board, to Gary S. Dubrow, Esq. (June 3, 1993), available here).

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12 CFR 215.5 (Additional restrictions on loans to executive officers of member banks)

Q1: What types of properties and how many properties may qualify as a "residence" of an executive officer for purposes of the "residence" exception to the restrictions on extensions of credit to executive officers?

A1: The prohibition on extensions of credit to an executive officer does not apply to an extension of credit used to refinance, purchase, construct, maintain, or improve a residence of the executive officer. This exception is available only for one property of an executive officer, and only for a property used as a residence of the executive officer. The property must be a house, condominium, cooperative, mobile home, house trailer, houseboat, or other similar property that has sleeping, cooking, and toilet facilities. The exception may be used for a property that is not a primary residence so long as the executive officer uses the property as a residence and does not use this exception for any other property. 12 CFR 215.5(c)(2).

Source: 12 U.S.C. § 375a(2); Letter from J. Virgil Mattingly, General Counsel of the Board, to Charles R. Haley (March 30, 1995), available here.

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