

## REGULATION O: LOANS TO EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL SHAREHOLDERS OF BANKS

### Core Analysis Procedures

*Examiners are to consider these procedures but are not expected to perform every procedure at every institution. Examiners should complete only the procedures relevant for the institution's activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures not included below. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.*

#### Considerations and Background

The purpose of Regulation O<sup>1</sup> is to prevent insiders from self-dealing by using their positions and leverage to procure loans on more preferential terms or conditions than would otherwise be available to other customers of the bank and to limit the risks to the deposit insurance fund due to large concentrations of credit to institution insiders, which have been seen as potential sources of bank failure.

Regulation O is made applicable to state nonmember banks by Section 18(j)(2) of the Federal Deposit Insurance Act and savings associations by section 1468(b) of the Home Owners' Loan Act. See also 12 CFR Section 337.3 (FDIC) and 12 CFR Section 215.12 (FRB).

In light of the complexity of the regulation, examiners should consult with relevant legal counsel when necessary for assistance in addressing questions regarding application or interpretation of the regulation.

#### Findings and Conclusions

*Summarize findings and conclusions here and include a summary of these findings and conclusions in the appropriate Primary or Supplemental modules.*

#### Preliminary Review

**1. Identify previous concerns by reviewing prior examination reports, file correspondence, and audits.**

**2. Review board minutes since the previous examination and note all discussions and votes related to borrowings of insiders and their related interests.**

<sup>1</sup> The Federal Reserve Board's [Regulation O](#) (12 CFR 215) governs any extension of credit by a bank to an insider, a term defined to include a director, executive officer, or principal shareholder of the bank, the bank holding company of the bank and any other subsidiary of the bank holding company. The regulation also applies to an extension of credit to insiders' related interests, which includes any company or political or campaign committee controlled by an insider. Related legislation prohibits purchasing assets from insiders on non-market terms and preferential lending by a bank to insiders of another bank when there is a correspondent account relationship between the banks.

<p><b>3. Request a list of extensions of credit to insiders and their related interests and review all internal reports used to monitor extensions of credit to insiders and their related interests.</b></p>
<p><b>4. Review internal audits and loan reviews pertaining to insider borrowings, and assess actions taken by management to address prior audit, loan review, or examination findings.</b></p>
<p><b>Policy Considerations</b></p>
<p><b>5. Determine whether the bank adopted written policies and procedures to address Regulation O requirements, such as:</b></p> <ul style="list-style-type: none"> <li>• <b>Section 215.2 - Appropriately identifying insiders<sup>2</sup></b></li> <li>• <b>Section 215.3 - Appropriately identifying all extensions of credit related to insiders, including those considered extensions under the tangible economic benefit rule</b></li> <li>• <b>Section 215.4(a) - Ensuring extensions of credit to insiders</b> <ul style="list-style-type: none"> <li>○ <b>Are made at arm’s length</b></li> <li>○ <b>Are on substantially the same terms and following underwriting procedures that are not less stringent than those used for comparable transactions</b></li> <li>○ <b>Do not give preference to any insider over other employees or third parties, and</b></li> <li>○ <b>Do not involve more than normal risk of repayment or present other unfavorable features</b></li> </ul> </li> <li>• <b>Section 215.4(b) - Ensuring appropriate prior approval of extensions of credit to insiders of the bank and its affiliates</b></li> <li>• <b>Sections 215.4(c) and 215.4(d) - Accurately aggregating extensions of credit to ensure compliance with individual and aggregate lending limits, respectively</b></li> <li>• <b>Section 215.4(e) - Identifying and monitoring transaction accounts of directors and executive officers of the bank and its affiliates to ensure compliance with overdraft requirements</b></li> <li>• <b>Section 215.5 - Ensuring that all extensions of credit to executive officers do not exceed regulatory limits</b></li> <li>• <b>Section 215.8 - Maintaining appropriate records</b></li> <li>• <b>Section 215.9 - Appropriately disclosing credit extended from banks to insiders and their related interests (when requested in writing)</b></li> <li>• <b>Section 215.10 - Ensuring directors and executive officers report annually to the board any outstanding credit secured by the shares of the bank not traded publicly</b></li> </ul>
<p><b>Management Information Systems</b></p>
<p><b>6. Determine whether management information systems accurately identify and aggregate extensions of credit to insiders and their related interests.</b></p>

<sup>2</sup> Executive officers, directors, principal shareholders, and their related interests of the bank and its affiliates.

**Determining Regulation O Limits**

*Instructions: Double click on the table below to open the Excel spreadsheet. Complete yellow cells with bank specific data. (Note: Yellow cells also have an asterisk to the right.) Do not edit blue data, which is formulated. To exit the spreadsheet, click once inside the Word portion of this ED module.*

*Use the most recent Call Report Schedule RC-R or UBPR to calculate Unimpaired Capital and Surplus as defined in [Section 215.2](#) of Regulation O.*

*Do not adjust for net unrealized gain/loss on AFS securities.*

(Amounts in Thousands)	Current Exam	
Tier 1 Capital	xx/xx/xx	*
Tier 2 Capital (note: banks that elect to report the CBLR do not report tier 2 capital)		*
ALLL/AACL not included in Tier 2 Capital (See Below)	0	
<b>Total</b>	0	
<b>Capital Treatment for the Allowance</b>		
RC-Balance Sheet Line 4c ALLL/AACL		*
RC-G - Line 3. Allowance off-balance sheet items		*
RI-B part II Memo item 1 Allocated transfer risk reserve		*
<b>Total</b>	0	
RC-R Line 30 Allowance includible in Tier 2 capital		*
Allowance not included in Tier 2 capital	0	
<b>RC-Balance Sheet Line 13a Deposits</b>		
0.5% of total deposits	0	
Minimum	100	
<b>Determine Applicable Limit</b>		*
<b>215.4 (b) Prior Approval</b>		
Loans are limited to the larger of	25	
Or 5.0% of unimpaired capital & surplus	0	
But must not exceed	500	
<b>Determine Applicable Limit</b>		*
<b>215.4 (c) Individual Lending Limit</b>		
15.0% Unimpaired capital & surplus	0	
10.0% Additional	0	
<b>215.4 (d) Aggregate Lending Limit</b>		
100% of unimpaired capital & surplus	0	
Or if bank deposits < \$100MM, then 200%	0	
<b>Determine Applicable Limit</b>		*
<b>215.5 (c)(4) Additional Restrictions - Loans to Executive Officers</b>		
Loans are limited to the larger of	25	
Or 2.5% of unimpaired capital & surplus	0	
But must not exceed	100	
<b>Determine Applicable Limit</b>		*

*While Sections 215.4(a)-(e) generally apply to insiders of the bank and insiders of the bank's affiliates, there are certain exclusions for directors and executive officers of affiliates. See Section 215.2(e)(2) for conditions under which directors and executive officers of affiliates can be excluded.*

**[Section 215.4 \(a\)](#) – General Prohibitions - Terms and Creditworthiness<sup>3</sup>**

- Review loans to insiders and their related interests and review a sample of similar loans to non-insiders. Determine whether insider loans were granted on terms and conditions more favorable than comparable transactions to non-insiders or other employees.

<sup>3</sup> In addition to the not-more-favorable terms requirements, an extension of credit to a bank insider or an insider of a bank affiliate may not involve more than the normal risk of repayment, or present other unfavorable features. The unfavorable features provision does not prohibit extensions of credit if they are part of a benefit or compensation program that is widely available to employees and do not give preference to any insider over other employees.

8. Determine whether any loans to insiders involved more than the normal risk of repayment or present other unfavorable features when compared with loans to non-insiders or other employees.

**Section 215.4 (b) – Prior Approval**

*Applies to insiders of the bank and in most circumstances to insiders of the bank’s affiliates. Approval by the board is not required under this section for an extension of credit made pursuant to a line of credit approved under this section within 14 months of the date of the extension of credit. However, this extension of credit must still comply with Section 215.4(a).*

*A majority of the board of directors must approve any extension of credit to an insider that, when aggregated with all other extensions of credit to that insider and his/her related interests, exceeds the higher of \$25,000 or 5 percent of unimpaired capital and surplus, not to exceed \$500,000 except by complying with the requirements of 215.4(b).*

9. List any insiders and related interests to whom the bank has extended aggregate credit exceeding the threshold calculated above. For relevant time periods, review board minutes to ensure that those extensions exceeding the prior approval threshold were:

- Pre-approved by a majority of the bank’s board of directors, and
- Approved without the direct or indirect participation of the insider obtaining the loan<sup>4</sup>

**Section 215.4(c) – Individual Lending Limit<sup>5</sup>**

*Applies to insiders of the bank and in most circumstances to insiders of the bank’s affiliates.*

*No bank may extend credit to an insider that, when aggregated with all other extensions to that insider and his/her related interests, exceeds the legal lending limit of the institution.*

10. Determine whether managerial reports documenting loans to insiders and their related interests accurately aggregate extensions of credit. Review totals for each insider to assess compliance with calculated limits. Verify that loans segregated in the 10 percent category are fully secured by readily marketable collateral having a reliable and continuously available market value.

11. Determine whether exceptions to the Individual Lending Limit as outlined in [Appendix to Part 215 – Section 5200](#) of the Revised Statutes Total Loans and Extensions of Credit apply to loans to insiders and their related interests.

<sup>4</sup> Minutes typically reflect that the affected insiders excused themselves during the discussions and abstained from voting on those extensions of credit.

<sup>5</sup> The legal lending limit is generally 15 percent of unimpaired capital and unimpaired surplus plus an additional 10 percent if the additional 10 percent is fully secured by readily marketable collateral. The 10 percent limitation is separate from and in addition to the initial 15 percent limitation. When state law establishes a lending limit for a bank that is lower than the amount permitted in this calculation, the state’s lending limit is the applicable lending limit for the bank.

<b><u>Section 215.4(d)</u> – Aggregate Lending Limit</b>
<i>Applies to insiders of the bank, and in most circumstances to insiders of the bank’s affiliates, and typically equal to unimpaired capital and unimpaired surplus. Refer to the regulation for some exceptions.</i>
<b>12. Determine whether extensions of credit to insiders and their related interests do not exceed the bank’s unimpaired capital and unimpaired surplus or that those banks with less than \$100 million in total deposits meet the criteria for the exception.</b>
<b>13. For banks that have adopted a resolution authorizing a higher limit but subsequently fail to meet the four requirements, verify that they have not extended any additional credit (including a renewal of any existing extension of credit) to any insider of the bank or its affiliates, unless such extensions of credit do not exceed the bank’s unimpaired capital and unimpaired surplus.</b>
<b>14. Verify that loans to insiders and their related interests are not subject to exceptions to the Aggregate Lending Limit as outlined in <u>Appendix to Part 215</u> – Section 5200(c) of the Revised Statutes Total Loans and Extensions of Credit.</b>
<b><u>Section 215.4(e)</u> - Overdrafts – Transaction Testing / Sample Review</b>
<i>Applies to executive officers and directors of the bank and in most circumstances those of its affiliates. It does not apply to related interests. It does not apply to principal shareholders, unless they are also an executive officer or director.</i>
<b>15. Review overdraft, bounce protection, check kiting, uncollected funds, and large item reports for activity related to overdrafts of executive officers and directors of the bank and its affiliates. Determine whether any overdrafts were paid in contravention of established bank policies such as no pay, all pay, or ad hoc overdraft arrangements.</b>
<b>16. Determine whether the bank has established written, preauthorized, interest bearing credit plans (overdraft protection) with executive officers or directors of the bank or executive officers or directors of its affiliates. Ensure that these plans specify a method of repayment and verify that the credit plans are performing as agreed.</b>
<b>17. Determine whether the bank has established written, preauthorized agreements for fund transfers from another account in the event of an overdraft. Determine whether any overdrafts noted in director or executive officers’ accounts are covered by a transfer agreement.</b>

<b>Additional Restrictions on Loans to Executive Officers of Banks<sup>6</sup></b>
<b>FRB: <a href="#">Section 215.5</a> FDIC: <a href="#">Section 337.3</a></b>
<b>18. Review extensions of credit made to executive officers or any partnerships in which one or more executive officers are partners, and individually or together, hold a majority interest, to determine that qualifying loans were made within applicable limits.</b>
<b>19. Review extensions of credit to executive officers and determine whether the loans were promptly reported to the board of directors. (Any extension of credit by a bank to an executive officer must be promptly reported to the bank’s board of directors, and comply with the terms and creditworthiness requirements of Section 215.4(a).) See <a href="#">215.5(d)</a></b>
<b>20. Review loans files and other relevant documentation to ensure that reportable transactions were preceded by the submission of a detailed, current financial statement of the officer and include a condition that the extension will, at the option of the bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the limit for 215.5(c). See <a href="#">215.5(d)</a></b>
<b>Recordkeeping and Reporting Requirements – <a href="#">Sections 215.8, 215.9, and 215.10</a></b>
<i>Applies to insiders of banks and their affiliates; however, there are certain exclusions for directors and executive officers of affiliates. See Section 215.2(e)(2) for specific conditions under which directors and executive officers of affiliates can be excluded.</i>
<b>21. Determine whether the recordkeeping method adopted by the bank accurately maintains records of extensions of credit to insiders and their related interests as required by Section 215.8.</b>
<b>22. Verify that the bank, upon receipt of written request from the public, has made available the names of each of its executive officers and principal shareholders to whom, or to whose related interests, the bank had an outstanding extension of credit, that when aggregated with all other outstanding extensions, equaled or exceeded 5 percent of capital and surplus, or \$500,000, whichever amount is less. Verify that requests for this information and the disposition of such requests are maintained for at least two years.<sup>7</sup></b>

<sup>6</sup> Aggregate loans to an executive officer may not exceed the higher of \$25,000 or 2.5 percent of unimpaired capital and unimpaired surplus and in no event more than \$100,000.

<sup>7</sup> Disclosure is not required if the aggregate amount of all extensions of credit outstanding, including to related interests of such person, does not exceed \$25,000.

**23. If applicable, determine whether executive officers<sup>8</sup> and directors of a bank whose shares are not publicly traded report annually to the board of directors of the bank any outstanding credit secured by shares of the bank. This requirement is only applicable to shares of bank stocks that are not publicly traded (Section 215.10).**

**24. Determine whether extensions of credit from a correspondent bank to a respondent bank insider and from a respondent bank to a correspondent bank insider, as well as accounts opened by banks with a loan to an insider of a correspondent bank, are all on market terms.<sup>9</sup> In addition, as added by the Dodd Frank Act, determine whether any purchases of assets from insiders are on market terms. See 12 U.S.C. 1828(z).**

**End of Core Analysis.**

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<sup>8</sup> Applies to executive officers and directors of the bank only.

<sup>9</sup> While the reporting requirements for lending from correspondent banks to insiders and from banks to the insiders of correspondent banks are no longer a requirement of Regulation O, the substantive restrictions remain applicable pursuant to 12 U.S.C. 1972 (2).