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FEDERAL RESERVE SYSTEM

12 CFR Part 215

[Regulation O; Docket No. R–0875]

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

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting an amendment to Regulation O to conform the definition of unimpaired capital and unimpaired surplus used in calculating a bank's Regulation O lending limit to the definition of capital and surplus recently adopted by the Office of the Comptroller of the Currency in calculating the limit on loans by a national bank to a single borrower. The final rule will reduce the regulatory burden for member banks monitoring lending to their insiders.

EFFECTIVE DATE: Effective July 1, 1995.

FOR FURTHER INFORMATION CONTACT: Gregory Baer, Managing Senior Counsel (202/452–3236), or Gordon Miller, Attorney (202/452–2534), Legal Division; or William G. Spaniel, Assistant to the Director (202/452–3469), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION:

Background

The Board's Regulation O (12 CFR Part 215) implements the insider lending prohibitions of section 22(h) of the Federal Reserve Act. Section 215.2(i) of the regulation (12 CFR 215.2(i)) defines the limit for loans to any insider of a member bank and insider of the bank's affiliates as an amount equal to the limit on loans to a single borrower established by the National Bank Act (12 U.S.C. 84). That amount is 15 percent of the bank's unimpaired capital and unimpaired surplus for loans that are not fully secured, and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus for loans that are fully secured by certain readily marketable collateral.[1]

Although Regulation O adopts the percentage limits used in the National Bank Act, Regulation O provides its own definition of what constitutes unimpaired capital and unimpaired surplus. Unimpaired capital and unimpaired surplus have been defined as the sum of (i) ''total equity capital'' as reported on the bank's most recent consolidated report of condition, (ii) any subordinated notes and debentures that comply with requirements of the bank's primary regulator for inclusion in the bank's capital structure and are reported on the bank's most recent consolidated report of condition, and (iii) any valuation reserves created by charges to the bank's income and reported on the bank's most recent consolidated report of condition. 12 CFR 215.2(i).

The Office of the Comptroller of the Currency (OCC) has recently revised its regulatory definition of unimpaired capital and unimpaired surplus for purposes of implementing the single borrower limit of the National Bank Act. *See* 60 FR 8,533, February 15, 1995. Under that revised definition, a national bank's ''capital and surplus'' are equal to Tier 1 and Tier 2 capital included in the calculation of the bank's risk-based capital together with the amount of the bank's allowance for loan and lease losses not included in this calculation. 12 CFR 32.2(b).

On April 20, 1995 (60 FR 19,689), the Board proposed to amend Regulation O to conform its definition of unimpaired capital and unimpaired surplus to the OCC's revised definition of capital and surplus. As stated in the notice of proposed rulemaking, the Board believes that in substantially all cases calculating the insider lending limits of Regulation O using the revised definition would not significantly increase or decrease a bank's insider lending limit. The elimination of the separate definition of unimpaired capital and unimpaired surplus in Regulation O therefore is expected to create minimal disruption in lending by member banks to their insiders and to insiders of their affiliates, while eliminating confusion and duplication of effort caused by requiring banks to calculate capital two different ways for two regulations.

The Board received 24 written comments, including comments from 11 banks, 3 bank holding companies, 6 Federal Reserve Banks, and 4 trade associations. Twenty-three commenters supported the Board's amendment. All commenters in support felt that the amendment would make recordkeeping simpler and more consistent, and several also noted that the amendment would not significantly change their lending level. Two commenters noted that the amendment would both greatly reduce its recordkeeping burden and help its compliance.

One commenter opposed the amendment and expressed concern that a bank's Tier 1 and Tier 2 capital did not include certain intangible assets, and that eliminating these assets could harm some community banks by effectively reducing their lending limits. One bank holding company supporting the amendment also noted that some of its affiliated banks would have their lending limits reduced because of the goodwill on their books. The Board believes, however, that few small community banks have a sufficient amount of intangible assets, such as goodwill or purchased mortgage servicing rights, on their books to cause a significant reduction of their insider lending limits from their current levels. Accordingly, after reviewing the public comments, the Board is adopting the amendment as proposed.

Determination of Effective Date

Because the final rule adjusts a requirement on insured depository institutions, the final rule will become effective July 1, 1995, the first day of the calendar quarter after the date of the final rule's publication. *See* 12 U.S.C. 4802(b). For the foregoing reason, the final rule will become effective without regard for the 30-day period provided for in 5 U.S.C. 553(d).

[1] The lending limit also includes any higher amounts that are permitted by the exceptions included in 12 U.S.C. 84. Where state law establishes a lower lending limit for a state member bank, that lower lending limit is the lending limit for the state member bank.