[Federal Register: December 28, 1994]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 337

RIN 3064-AB50

Unsafe and Unsound Banking Practices

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final rule.

SUMMARY: The Board of Directors of the Federal Deposit Insurance Corporation is amending its regulations to except loans which are fully secured by certain types of collateral from the general limit on ``other purpose'' loans to executive officers of insured nonmember banks. The amendment parallels changes by the Board of Governors of the Federal Reserve System to that agency's regulations on insider loans.

EFFECTIVE DATE: December 28, 1994.

FOR FURTHER INFORMATION CONTACT: Mark Mellon, Senior Attorney, Regulation and Legislation Section, Legal Division, (202) 898-3854, or Michael D. Jenkins, Examination Specialist, Division of Supervision, (202) 898-6896, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. The Proposed Rule

On August 16, 1994, the FDIC published for public comment a proposed revision to 12 CFR 337.3 concerning limits on extensions of credit to executive officers. 59 FR 41990 (August 16, 1994). The proposed rule sought to ease the restrictions on extensions of credit by insured nonmember banks to executive officers by creating an additional exception to the general limit on ``other purpose'' loans to executive officers.[1] This exception is for loans which are fully

secured by the following types of collateral:

\1\ The other purpose lending limit is currently 2.5 percent of the bank's capital and unimpaired surplus but in no event more than $100,000; see 12 CFR 337.3(c)(2).

(a) 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;

(b) 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; or

(c) A perfected security interest in a segregated deposit account in the lending bank.

This exception will be in addition to the statutory exceptions to the other purpose lending limit for home mortgage loans and education loans.

Section 337.3 currently provides that, with certain exceptions, insured nonmember banks are subject to the restrictions contained in Subpart A of 12 CFR Part 215 (Regulation O). 12 CFR 337.3(a). One of these exceptions, 12 CFR 215.5(c)(3), sets out the amount of extensions of credit which may be made to an executive officer for purposes other than those specifically authorized by section 22(g) of the Federal Reserve Act (FRA) (12 U.S.C. 375a) (other purpose loans). Section 22(g)(4) provides that the lending limit on other purpose loans must be set by the appropriate federal banking agency. With respect to insured nonmember banks, the appropriate federal banking agency is the FDIC. Section 337.3 must therefore specifically set out the limit on other purpose loans for insured nonmember banks, and any exceptions thereto.

Recently the Board of Governors of the Federal Reserve System made changes to Federal Reserve Board Regulation O. 59 FR 8831 (February 24, 1994). Most of these changes were immediately applicable to insured nonmember banks. The changes, however, to Sec. 215.5(c)(3) which provide that a loan may be made by a member bank to one of its executive officers in any amount if it has been secured by certain types of collateral (the same types proposed by the FDIC which are described above) can only be made available to insured nonmember banks if Sec. 337.3 is amended. As indicated above, the FDIC proposed doing so on August 16, 1994. The Board of Governors of the Federal Reserve System also concurrently redesignated the provision which sets forth the limit for other purpose loans by member banks to their executive officers as 12 CFR 215.5(c)(4). 59 FR at 8840-8841. The FDIC therefore

also proposed to amend Sec. 337.3 to cross-reference Sec. 215.5(c)(4) as one of the provisions of Regulation O that is inapplicable to insured nonmember banks.

II. Comments on the Proposed Rule

The FDIC received a total of 31 comment letters in response to its proposal. Five letters were from state or national trade associations representing depository institutions, two letters were from bank holding companies, one letter was from a state bank regulator, and the remaining 23 letters were from insured nonmember banks. All of the commenters supported the proposed revisions.

Recommended Substantive Amendments

Thirteen commenters went beyond expressions of support for the proposed amendment to recommend that the FDIC consider and implement additional exceptions to further loosen the restrictions on extensions of credit by insured nonmember banks to their executive officers. Seven commenters recommended that, in addition to the types of secured loans which were specified by the FDIC in its proposal, other categories of secured loans should be exempted from the general limit on other purpose loans. The recommendations for exemption included loans secured by marketable securities, real estate, or cash value life insurance policies.

Two commenters recommended that the $100,000 limit on other purpose loans should be adjusted to reflect inflation. Another commenter stated that the $100,000 limit should be eliminated altogether and that banks should instead be allowed to lend up to 2.5 percent of their capital and unimpaired surplus to executive officers for other purpose loans. Two other commenters stated that the FDIC should permit loans in any amount for any purpose to an executive officer provided the loans are secured by the executive officer's principal residence. One commenter who made this recommendation also stated that home equity lines of credit which are adequately collateralized by the executive officer's primary residence should be exempted from the other purpose loan limit and should be exempted from the acceleration requirement set forth in Sec. 215.5(d)(4) of Regulation O.[2] One commenter stated that unsecured personal loans for up to $5,000 should be excepted from the definition of ``extension of credit''. Another suggested that executive officers should be allowed to take out a second mortgage on their primary residence of up to $100,000.

\2\ Section 215.5(d)(4) provides that any extension of credit by a bank to an executive officer will be subject to the condition in

writing that the extension of credit 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 $100,000.

One commenter noted that community banks have experienced problems
in justifying the terms and interest rates of loans to their insiders.
The commenter contended that fear of criticism by examiners frequently
leads banks to charge higher rates to insiders and that problems arise
for small banks when they do not have ``comparable'' loans within the
bank to compare to their insider loans.[3] The commenter argued that
in small communities where the executive officer is often the most
creditworthy individual in the community and therefore likely to
qualify for the most favorable terms, the bank will often have no other
loans to compare to the insider loan. The commenter requested that
banks be allowed in such situations to look to offers of credit to
their executive officers from other depository institutions and their
terms and procedures as a substitute for comparable transactions by the
bank.

\3\ Section 215.4(a) of Regulation O states that a loan offer
from a bank to its executive officer or director must be made on
substantially the same terms as and follow the same procedures that
prevail with comparable transactions by the bank with persons not
associated with the bank.

Two commenters stated generally that executive officers should have
the same loan opportunities that insured nonmember banks provide for
their non-insider customers. One requested that banks be allowed to
make the same loans to an executive officer that they make for any
other customer as long as the executive officer owns less than fifty
percent of the bank and the institution has a return on assets of one
percent or more. The other commenter suggested that regulators might
rely on two independent appraisals of non-cash property pledged by
executive officers and directors as security for a loan to ensure
against abuse by insiders.

The FDIC welcomes suggestions that will reduce the regulatory
burden on depository institutions without affecting their safety and
soundness. Some of the suggested amendments, however, would require
amendments to Regulation O by the Board of Governors of the Federal
Reserve System. Other requested changes would require amendments by
Congress to sections 22(g) and (h) of the FRA. While those suggested
changes to the restrictions on insider lending requirements which are

within the authority of the FDIC deserve consideration, the FDIC does not think that it would be appropriate to make such changes unilaterally.

As previously indicated, the FDIC proposed the same exceptions to the limit for other purpose loans to executive officers that the Board of Governors of the Federal Reserve System promulgated for member banks. The proposal was undertaken in order to put insured state nonmember banks on an equal footing with state member banks, thus avoiding disparity of treatment among banks based upon their membership, or lack of membership, in the Federal Reserve System. Unilateral adoption by the FDIC of any of the proposed changes would result in such disparity of treatment.

Unilateral adoption of the proposed substantive amendments might also interfere with a recent directive from Congress to the federal banking agencies. Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103-325, 108 Stat. 2160) provides that the federal banking agencies must streamline their regulations, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability. The federal banking agencies are also directed to work jointly to make regulations uniform that implement common statutory or supervisory policies. Unilateral adoption by the FDIC of the suggested substantive amendments would be inconsistent with this statutory directive to make regulations uniform.

For these reasons, the Board of Directors of the FDIC declines to adopt any of the suggested substantive amendments at this time. Such proposed amendments are best considered through an interagency initiative to revise insider lending restrictions. As noted previously, the FDIC will be coordinating with the other federal banking agencies for purposes of streamlining its regulations and to eliminate unwarranted constraints on credit availability. Regulation O and 12 CFR 337.3 will be subject to review and possible amendment as part of that project. The FDIC will recommend at that time that the federal banking agencies consider those suggested substantive amendments which are within the regulatory authority of the federal banking agencies.

Recommended Procedural Amendment

In addition to the suggested substantive changes, one commenter recommended that the FDIC make Regulation O applicable to insured nonmember banks by cross-reference to Regulation O rather than through its own separately promulgated regulation. The commenter argued that this change would lessen confusion as to the applicability of amendments by the Board of Governors of the Federal Reserve System to Regulation O to insured nonmember banks.

The FDIC is not able to take this step, however. Under section 22(g)(4) of the FRA, the lending limit for other purpose loans to

executive officers must be set by the ``appropriate federal banking agency''. In addition, section 7(k) of the Federal Deposit Insurance Act (12 U.S.C. 1817(k)) directs the appropriate federal banking agency to issue rules and regulations to require the reporting and public disclosure of loans made by depository institutions to their executive officers and principal shareholders. The FDIC interprets these statutory provisions to mean that each federal banking agency must independently implement these requirements for the institutions which are subject to its supervision.[4] Incorporation of insider lending requirements for insured nonmember banks by cross-reference to Regulation O therefore would not fulfill the statutory mandates which Congress has imposed upon the FDIC, particularly since any subsequent amendment by the Board of Governors of the Federal Reserve System would then have the effect of ``automatically'' amending the FDIC's rule.

\4\ The other purpose lending limit for insured nonmember banks is established by the FDIC at Sec. 337.3(c)(2). Regulations setting forth insider loan disclosure requirements for nonmember banks are found at part 349 of the FDIC's regulations (12 CFR Part 349).

III. The Final Rule

After considering the comments received, the Board of Directors of the FDIC has decided to adopt the proposed rule to amend 12 CFR 337.3 without change. The Board of Directors of the FDIC has decided, in agreement with the conclusion of the Board of Governors of the Federal Reserve System, that extensions of credit to an executive officer pose minimal risk of loss to a bank when they are secured by the types of collateral described above. 59 FR at 8836. The Board of Directors is of the opinion that it is consistent with safe and sound banking practices to increase the amount of credit that a bank may extend to its executive officers when the credit is secured as described above. The Board of Directors has also taken into consideration the fact that the proposed rule parallels the changes to Regulation O which have already been promulgated by the Board of Governors of the Federal Reserve System and the fact that all of the comments pertaining to the proposed rule were in favor of the proposed changes.

IV. Effective Date

The rule will become effective immediately upon publication in the Federal Register. The necessity for a 30-day delay in effective date has been waived since this rule relieves a restriction. 5 U.S.C. 553(d)(1).

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), the FDIC hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. The rule will not impose burdens on depository institutions of any size and will not have the type of economic impact addressed by the Regulatory Flexibility Act.

The FDIC has reached this conclusion because the effect of the rule will be to reduce the regulatory requirements that are imposed upon small depository institutions rather than to increase them. Small depository institutions will have greater freedom of action to extend credit to executive officers as a result of the proposed rule rather than less.

VI. Paperwork Reduction Act and Regulatory Burden

No additional collections of information pursuant to section 3504(h) of the Paperwork Reduction Act (44 U.S.C. 3501 et seq.) are contained in the proposed rule. Consequently, no information has been submitted to the Office of Management and Budget for review.

Section 302 of the Regulatory Improvement Act provides that the federal banking agencies must consider the administrative burdens and benefits of any new regulations that impose additional requirements on insured depository institutions. Section 302 also requires that any regulations which impose additional reporting, disclosure, or other requirements on insured depository institutions shall take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form.

The Board of Directors of the FDIC has concluded that the final amendment to 12 CFR 337.3 does not impose additional reporting, disclosure or other requirements on insured nonmember banks. This is because the effect of the amendment is to create an exception to the limits on insider loans by such institutions rather than to impose additional restrictions. We have therefore concluded that section 302 of the Regulatory Improvement Act does not require that the effective date of these amendments be on the first day of the calendar quarter which begins on or after the date of publication of the final amendments.

List of Subjects in 12 CFR Part 337

Banks, Banking, Reporting and recordkeeping requirements, Securities.

In consideration of the foregoing, the Board of Directors amends Part 337 of Chapter III of title 12 of the Code of Federal Regulations as follows:

PART 337--[AMENDED]

1. The authority citation for Part 337 continues to read as follows:

Authority: 12 U.S.C. 375a(4), 375b, 1816, 1818(a), 1818(b), 1819, 1821(f), 1828(j)(2), 1831f, 1831f-1.

2. Section 337.3 is amended by revising paragraphs (a) and (c)(2) to read as follows:

Sec. 337.3 Limits on extensions of credit to executive officers, directors, and principal shareholders of insured nonmember banks.

(a) With the exception of 12 CFR 215.5(b), 215.5(c)(3), 215.5(c)(4), and 215.11, insured nonmember banks are subject to the restrictions contained in subpart A of Federal Reserve Board Regulation O (12 CFR Part 215, subpart A) to the same extent and to the same manner as though they were member banks.

* * * * *

(c) * * *

(2) An insured nonmember bank is authorized to extend credit to any executive officer of the bank for any other purpose not specified in Sec. 215.5(c)(1) and (2) of Federal Reserve Board Regulation O (12 CFR 215.5(c)(1) and (2)) if the aggregate amount of such other extensions of credit does not exceed at any one time the higher of 2.5 percent of the bank's capital and unimpaired surplus or $25,000 but in no event more than $100,000, provided, however, that no such extension of credit shall be subject to this limit if the extension of credit is secured by:

(i) 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;

(ii) 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; or

(iii) A perfected security interest in a segregated deposit account in the lending bank.

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By order of the Board of Directors.

Dated at Washington, D.C., this 20th day of December 1994.

Federal Deposit Insurance Corporation.
Robert E. Feldman,
Acting Executive Secretary
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