



# Compliance Check

Q&A: Regulation O: Key Points to Consider

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# Ask CrossCheck

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In the following sections, we outline the key requirements and considerations for complying with Regulation O (12 CFR 215), which is designed to prevent insider abuse in banking by limiting the amount and types of loans and other extensions of credit to bank insiders. This overview explains when credit extensions require prior board approval versus subsequent reporting, the restrictions that apply to executive officers, and the documentation and reporting obligations for all insiders. It also highlights common areas of confusion and provides guidance to help banks maintain consistent, accurate, and compliant lending practices.

# Credit Extensions to Insiders: Board Approval Rules



Which extensions of credit to insiders require prior approval by the board of directors (Board) and which extensions only require subsequent reporting to the Board after the loan is made?



When extending credit to an executive officer, director, or principal shareholder, including any related interest of such a person (insider), the bank is obligated to report the extensions to the Board, and the Board meeting minutes should reflect that it was reported. Some extensions of credit can be reported promptly after the loan is made, but others must be reported and approved by the Board prior to making the loan.

Prior Board approval is required when loans to insiders exceed certain thresholds. Any extension of credit to an insider, either individually or in the aggregate, that exceeds the higher of \$25,000 or 5% of the bank's unimpaired capital and unimpaired surplus, but in no event exceeding \$500,000, must be approved prior to funding by a majority of the full Board, with the interested party abstaining from discussing and voting on the request. Some exceptions to this rule are discussed on the next page.

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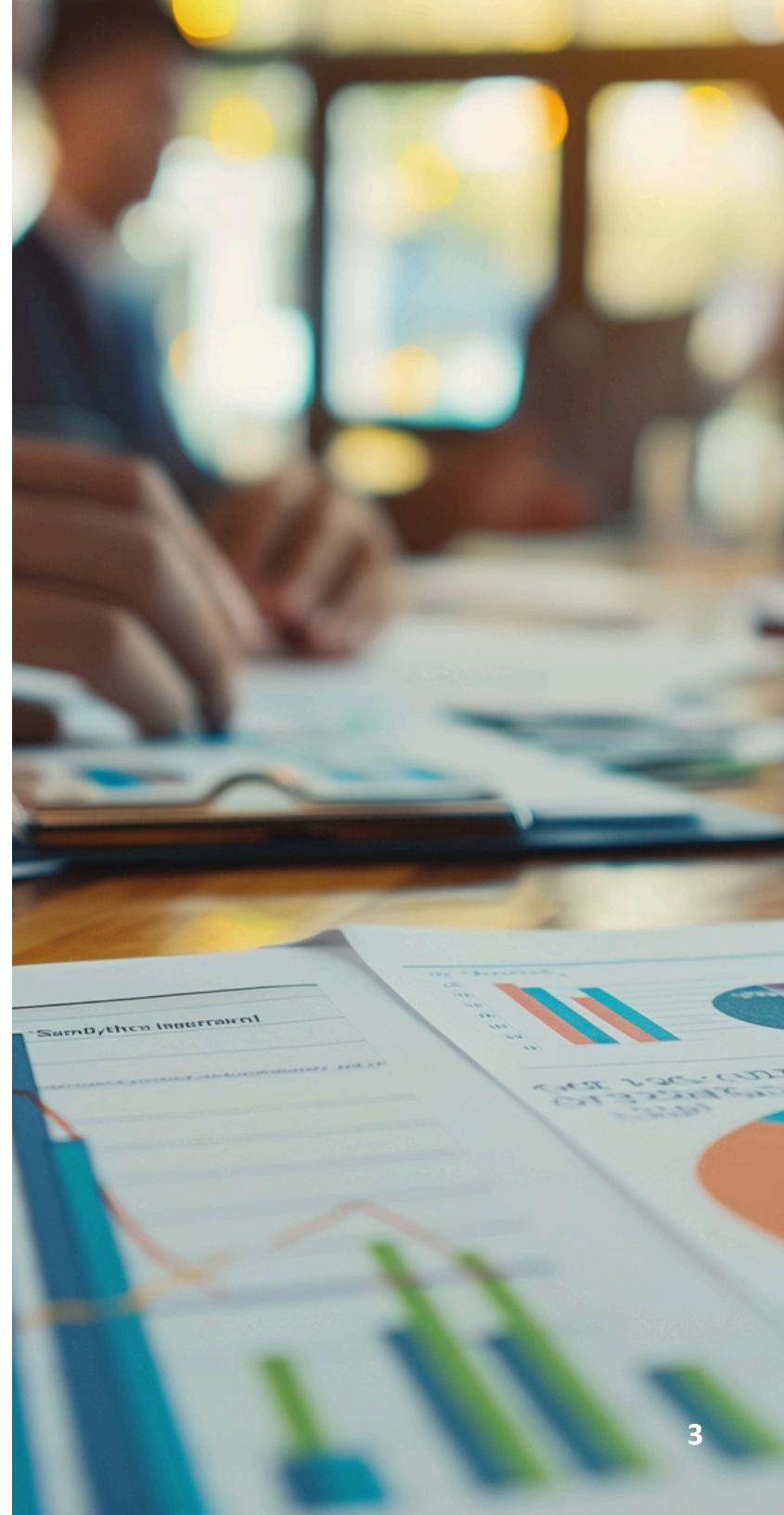


## Credit Extensions to Insiders: Board Approval Rules, *continued*



Some loans to executive officers are exempt from requiring approval prior to funding but still must be reported promptly to the Board. Examples include loans in any amount for the purpose of financing the education of the executive officer's children; the purchase, refinance, or other financing of the executive officer's residence (and secured by a first lien on the residence); and financing which is fully secured by a deposit account, bonds, U.S. Treasury bills, and/or takeout commitments and guarantees provided by the United States.

For lines of credit previously approved in advance by the Board, any extension made under the credit line does not need Board approval if it is made within 14 months of the original credit line approval (215.4(b)(3)). Any advances made more than 14 months after the original board approval of the credit line must be approved prior to the advance being made, effectively acting as a re-approval of the line itself, to ensure continued compliance and prevent preferential treatment.



# Executive Officer Loan Limitations and Rules

- What other limitations exist regarding loans to executive officers?
- Executive officers are also restricted to a maximum aggregate “other” financing limit of \$100,000. This maximum excludes the financing for education, residence financing, and other permitted exemptions noted previously, but would apply to loans such as vehicle loans, unsecured loans, and junior lien home equity credit lines of credit (HELOCs).

(First-lien HELOCs on an executive officer’s residence are generally exempt from the \$100,000 limit provided they are used for the home’s purchase, construction, maintenance, or improvement, while also following the reporting, underwriting, and terms requirements detailed in this issue.)

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## Executive Officer Loan Limitations and Rules, *continued*



In addition to the previous page, any extension of credit to an executive officer also must be:

- promptly reported to the Board and noted in the Board meeting minutes;
- made on the same terms and following the same credit guidelines as those available to the general public (except for any loan program available to bank employees and which does not give preferential treatment to the executive officer);
- supported by a detailed, current financial statement in conjunction with the credit request; and
- subject to a written condition that the credit extension may become due and payable at any time at the bank's option (often referred to as the "demand clause" language).





# Financial Statement Submission Requirements



When must financial statements be submitted to the Board?



The rules are different for executive officers and insiders as follows:

- **Bank Executive Officers:** Must provide a detailed, current financial statement before any extension of credit is made by the bank.
- **Bank Insiders:** While there is no standalone annual financial statement requirement under Regulation O, all extensions of credit to bank insiders must follow the “same terms, same procedures” principle as it relates to financial statements, which means that if the bank’s credit and underwriting policies ask other borrowers (i.e., non-insiders) for financial statements for a similar loan, then it must do so for the insider.

# Insider Overdraft Guidelines and Restrictions



Is the payment of an insider's overdraft permitted under Regulation O?



If an overdraft is inadvertent and \$1,000 or less, payment of the overdraft is permitted if the related account is not overdrawn more than 5 business days and the insider is charged the same fee(s) that would be charged to any bank customer under similar circumstances. The overdraft provisions extend to accounts where the insider is not the primary account holder, such as a joint account with the spouse or a co-owned account with the insider's child.

If an overdraft is greater than \$1,000 or otherwise does not meet the above criteria, the bank may not pay the overdraft on the account of an insider unless the payment is made from a written, pre-authorized credit plan (i.e., overdraft credit line) or a pre-authorized transfer of funds from another account held by the insider at the bank.



# Bank Practices for Regulation O Compliance



What steps can a bank take to ensure compliance with Regulation O?



By proactively implementing and maintaining the following measures, banks can help reduce the risk of Regulation O violations and ensure a culture of compliance that protects the bank and its stakeholders:

**Policies and Procedures** - Establish clear policies and procedures that define insiders, set individual and aggregate lending limits, specify loans terms and underwriting criteria (including that both must be on the same terms available to non-insiders), detail the approval process for all extensions to insiders (including reporting requirements to the Board), addresses restrictions on overdrafts and any permitted exceptions, and describes the additional purpose and amount limitations specific to credit extensions provided to executive officers.

**Recordkeeping** - Maintain accurate records of all insiders and extensions of credit made to each, including using an annual survey or other similar method to identify and track extensions to insiders of the bank. For each credit extension, ensure the loan file contains all required documentation, including approval details, loan terms, interest rates, and collateral information.

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## Bank Practices for Regulation O Compliance, *continued*

 *(Continued)* By proactively implementing and maintaining the following measures, banks can help reduce the risk of Regulation O violations and ensure a culture of compliance that protects the bank and its stakeholders:

**Internal Controls and Oversight** - Implement strong internal controls for insider loans through regular risk assessments which identify lending process control gaps and weaknesses. Ensure appropriate segregation of duties in the loan approval and processing functions to prevent conflicts of interest. Establish an internal monitoring program for insider lending activity to include aggregate loan totals and compliance with all applicable limits. Confirm effectiveness of the Regulation O compliance program and internal controls through periodic independent internal audits.

**Training** - Provide comprehensive, ongoing training on Regulation O requirements not only to bank staff involved in the lending process, but also to senior management and all bank insiders.

**Reporting** - Routinely report the results of Regulation O monitoring and audit efforts to the Board. Ensure strong processes are in place for the timely and accurate reporting of quarterly Call Reports, as well as executive officer and other insider indebtedness, to the Board through annual surveys.



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