

Comptroller of the Currency, Treasury

§ 31.2

4. Take appropriate corrective action to resolve problem assets;
 5. Consider the size and potential risks of material asset concentrations; and
 6. Provide periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk.
- H. *Earnings.* An insured depository institution should establish and maintain a system that is commensurate with the institution's size and the nature and scope of its operations to evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital and reserves. The institution should:
1. Compare recent earnings trends relative to equity, assets, or other commonly used benchmarks to the institution's historical results and those of its peers;
 2. Evaluate the adequacy of earnings given the size, complexity, and risk profile of the institution's assets and operations;
 3. Assess the source, volatility, and sustainability of earnings, including the effect of nonrecurring or extraordinary income or expense;
 4. Take steps to ensure that earnings are sufficient to maintain adequate capital and reserves after considering the institution's asset quality and growth rate; and
 5. Provide periodic earnings reports with adequate information for management and the board of directors to assess earnings performance.

I. *Compensation, fees and benefits.* An institution should maintain safeguards to prevent the payment of compensation, fees, and benefits that are excessive or that could lead to material financial loss to the institution.

III. PROHIBITION ON COMPENSATION THAT CONSTITUTES AN UNSAFE AND UNSOUND PRACTICE

A. Excessive Compensation

Excessive compensation is prohibited as an unsafe and unsound practice. Compensation shall be considered excessive when amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder, considering the following:

1. The combined value of all cash and non-cash benefits provided to the individual;
2. The compensation history of the individual and other individuals with comparable expertise at the institution;
3. The financial condition of the institution;
4. Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location,

and the complexity of the loan portfolio or other assets;

5. For postemployment benefits, the projected total cost and benefit to the institution;

6. Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution; and

7. Any other factors the agencies determine to be relevant.

B. Compensation Leading to Material Financial Loss

Compensation that could lead to material financial loss to an institution is prohibited as an unsafe and unsound practice.

[60 FR 35678, 35682, July 10, 1995, as amended at 61 FR 43950, Aug. 27, 1996]

PART 31—EXTENSIONS OF CREDIT TO INSIDERS AND TRANSACTIONS WITH AFFILIATES

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31.1 Authority.

31.2 Insider lending restrictions and reporting requirements.

APPENDIX A TO PART 31—INTERPRETATIONS

APPENDIX B TO PART 31—COMPARISON OF SELECTED PROVISIONS OF PART 31 AND PART 32 (AS OF OCTOBER 1, 1996)

AUTHORITY: 12 U.S.C. 93a, 375a(4), 375b(3), 1817(k), and 1972(2)(G).

SOURCE: 61 FR 54536, Oct. 21, 1996, unless otherwise noted.

§ 31.1 Authority.

This part is issued by the Comptroller of the Currency pursuant to 12 U.S.C. 93a, 375a(4), 375b(3), 1817(k), and 1972(2)(G), as amended.

§ 31.2 Insider lending restrictions and reporting requirements.

(a) *General rule.* A national bank and its insiders shall comply with the provisions contained in 12 CFR part 215.

(b) *Enforcement.* The Comptroller of the Currency administers and enforces insider lending standards and reporting requirements as they apply to national banks and their insiders.

Pt. 31, App. A

APPENDIX A TO PART 31—
INTERPRETATIONS

*Section 1. Loans Secured by Stock or
Obligations of an Affiliate*

A bank that makes a loan to an unaffiliated third party may take a security interest in securities of an affiliate as collateral for the loan without the loan being deemed a "covered transaction" under section 23A of the Federal Reserve Act (12 U.S.C. 371c) if:

- a. The borrower provides additional collateral that, taken alone, meets or exceeds the collateral requirements specified in section 23A(c) (12 U.S.C. 371c(c)); and
- b. The loan proceeds:
 1. Are not used to purchase the bank affiliate's securities that serve as collateral; and
 2. Are not otherwise used for the benefit of, or transferred to, any affiliate.

Section 2. Deposits Between Affiliated Banks

a. *General rule.* The OCC considers a deposit made by a bank in an affiliated bank to be a loan or extension of credit to the affiliate under 12 U.S.C. 371c. These deposits must be secured in accordance with 12 U.S.C. 371c(c). However, a national bank may not pledge assets to secure private deposits unless otherwise permitted by law (*see, e.g.*, 12 U.S.C. 90 (permitting collateralization of deposits of public funds); 12 U.S.C. 92a (trust funds); and 25 U.S.C. 156 and 162a (Native American funds)). Thus, unless one of the exceptions to 12 U.S.C. 371c noted in paragraph b. of this interpretation applies or unless another ex-

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ception applies that enables a bank to meet the collateral requirements of 12 U.S.C. 371c(c), a national bank may not:

1. Make a deposit in an affiliated national bank;
 2. Make a deposit in an affiliated State-chartered bank unless the affiliated State-chartered bank can legally offer collateral for the deposit in conformance with applicable State law and 12 U.S.C. 371c; or
 3. Receive deposits from an affiliated bank.
- b. *Exceptions.* The restrictions of 12 U.S.C. 371c (other than 12 U.S.C. 371c(a)(4), which requires affiliate transactions to be consistent with safe and sound banking practices) do not apply to deposits:
1. Made in the ordinary course of respondent business; or
 2. Made in an affiliate that qualifies as a "sister bank" under 12 U.S.C. 371c(d)(1).

[61 FR 54536, Oct. 21, 1996]

APPENDIX B TO PART 31—COMPARISON
OF SELECTED PROVISIONS OF PART 31
AND PART 32 (AS OF OCTOBER 1, 1996)

NOTE: Even though part 31 now simply requires that national banks comply with the insider lending provisions contained in Regulation O (Reg. O) (12 CFR part 215), the chart in this appendix refers to part 31 because Reg. O is a Federal Reserve Board regulation and part 31 is the means by which several provisions of Reg. O are made applicable to national banks and their insiders.

DEFINITION OF "LOAN OR EXTENSION OF CREDIT"

Renewals	In most cases, the two definitions of "loan or extension of credit" will be applied in the same manner. A difference exists, however, in the treatment of renewals. Under Part 31, a renewal of a loan to an "insider" (which, unless noted otherwise, includes a bank's executive officers, directors, principal shareholders, and "related interests" of such persons) is considered to be an extension of credit. Under Part 32, renewals generally are not considered to be an extension of credit if the bank exercises reasonable efforts, consistent with safe and sound banking practices, to bring the loan into conformance with the lending limit. Renewals would be considered an extension of credit under Part 32, however, if new funds are advanced to the borrower, a new borrower replaces the original borrower, or the OCC determines that the renewal was undertaken to evade the lending limits.
Commitments to extend credit: ...	A binding commitment to make a loan is treated as an extension of credit under Part 31. Under Part 32, a commitment to make a loan will not be treated as an extension of credit if the amount of the commitment exceeds the lending limit. Rather, the commitment will be deemed a "non-qualifying commitment" under Part 32 and advances may be made thereunder only if the advance, together with all other outstanding loans to the borrower, will not exceed the bank's lending limit.
Overdrafts	An advance by means of an overdraft (except for an intraday overdraft) generally is considered to be an extension of credit under both Parts 31 and 32. However, indebtedness in amounts up to \$5,000 is excluded from the definition of "extension of credit" under Part 31 if the indebtedness arises pursuant to a written, preauthorized, interest-bearing plan or written, preauthorized transfer of funds from another account. Under Part 31, if an overdraft is not made pursuant to this type of plan or transfer, a bank is prohibited from paying an overdraft of an insider (which, in this case, includes only an executive officer or director of the insider's bank) unless the overdraft is inadvertent, in amounts not exceeding \$1,000, outstanding for not more than 5 business days, and subject to the bank's standard overdraft fee. Part 32 does not contain these exceptions for overdrafts, and simply treats overdrafts (except for intraday overdrafts) as extensions of credit subject to lending limits.
Guarantees	Generally speaking, guarantees are included in the Part 31 definition of "extension of credit" but are not included in the definition of "extension of credit" in Part 32 unless other criteria are satisfied. Part 31 applies to any transaction as a result of which an insider becomes obligated to pay money to a bank, whether the obligation arises (i) directly or indirectly, (ii) because of an endorsement on an obligation or otherwise, or (iii) by any means whatsoever. Accordingly, a loan guaranteed by an insider will be deemed to have been made to that insider. In contrast, Part 32 does not consider a loan on which someone signs as guarantor as having been made to the guarantor unless that person is deemed to be a borrower under the "direct benefit" or "common enterprise" tests (see discussion of these tests in the discussion of the "General Rule" under "Combination/Attribution Rules," below).

EXCLUSIONS TO DEFINITION

Funds advanced for taxes, etc., necessary to preserve collateral or that are incidental to indebtedness.	Both rules exclude funds advanced for items such as taxes, insurance, or other expenses related to existing indebtedness. However, Part 32 includes these advances for the purpose of determining whether subsequent loans meet the lending limit, whereas Part 31 excludes these advances for all purposes. In addition, Part 32 requires that the funds, which are advanced "for the benefit of" a borrower, be advanced by the bank directly to the third party to whom the borrower is indebted. Part 31 contains no such requirement.
Loan participations	Both rules exclude loan participations if the participation is without recourse. However, Part 32 elaborates on this exclusion by requiring that the participation result in a pro rata sharing of credit risk proportionate to the respective interests of the originating and participating lenders. Part 32 also requires the originating bank, if funding the entire loan, to receive funding from the participants before the close of the next business day. Otherwise, the portion funded will be treated as a loan by the originating bank to the underlying borrower, and may be treated as a "non-conforming" loan rather than a violation if (i) the originating bank had an agreement with the participating bank that reduced the loan to an amount within the originating bank's lending limit, (ii) the participating bank reconfirmed its participation and the originating bank had no knowledge of information that would permit the participating bank to withhold its participation, and (iii) the participation was to be funded by close of business of the originating bank's next business day.
Acquisition of debt through merger or foreclosure.	Under Part 31, a note or other evidence of indebtedness acquired through a merger is excluded from the definition of "extension of credit." Under Part 32, the indebtedness is deemed to be a loan or extension of credit. However, if a loan that conformed with Part 32 when originally made exceeds the lending limits following a merger after the loan is aggregated with other extensions of credit to the same borrower, the loan will not be deemed to be a lending limits violation. Rather, the loan will be treated as "nonconforming," and the bank will have to exercise reasonable efforts to bring the loan into compliance unless to do so would be inconsistent with safe and sound banking practices.

An insider may incur up to \$15,000 in debt on a credit card or similar open-end credit plan offered by the insider's bank without the debt counting as an extension of credit under Part 31. The terms of the credit card or other credit plan must be no more favorable than those offered by the bank to the general public. Part 32 does not exclude credit card debt from the lending limits.

COMBINATION/ATTRIBUTION RULES

General rule Under Part 31, a loan will be attributed to an insider if the loan proceeds are "transferred to," or used for the "tangible economic benefit of," the insider or if the loan is made to a "related interest" of the insider. Under Part 32, a loan will be attributed to another person when either (i) the proceeds of the loan are to be used for the direct benefit of the other person or (ii) a common enterprise exists between the borrower and the other person. The "transfer" test and "tangible economic benefit" test of Part 31 are substantially the same as the "direct benefit" test of Part 32. Under each of these tests, a loan will be attributed to another person where the proceeds are transferred to the other person, unless the proceeds are used in a bona fide arm's length transaction to acquire property, goods, or services. However, the "related interest" test of Part 31 and the "common enterprise" test under Part 32 will lead to different results in many instances. Under Part 31, a "related interest" is a company or a political or campaign committee that is "controlled" by an insider. Part 31 defines "control" as meaning, generally speaking, that someone owns or controls at least 25 percent of a class of voting securities of a company, controls the election of a majority of the company's directors or can "exercise a controlling influence" over the company. Part 32 uses the same definition of "control" in the "common enterprise" test, but a mere finding of "control" is not, by itself, a sufficient basis to find that a common enterprise exists. Part 32 will attribute a loan under the "common enterprise" test if the borrowers are under common control (including where one of the persons in question controls the other) and there is "substantial financial interdependence" between the borrowers (i.e., where at least 50 percent of the gross receipts or expenditures of one borrower comes from transactions with the other). If there is not both common control and substantial financial interdependence, the OCC will not attribute a loan under the "common enterprise" test unless (i) the expected source of repayment for a loan is the same for each borrower and neither borrower has another source of income from which the loan may be repaid, (ii) two people borrow to acquire a business of which they will own a majority of the voting securities, or (iii) OCC determines that a common enterprise exists based on facts and circumstances of a particular transaction.

Loans to corporate groups Both Parts 31 and 32 will consider a loan that was made to a corporation to have been made to a third person if the tests identified in the previous discussion of the "General Rule" are satisfied. If these tests are not met, Parts 31 and 32 still may require attribution, but the circumstances when this will occur and the consequences of attribution under these circumstances differ under the two rules. Under Part 31, a loan to a corporation will be deemed to have been made to an insider if the corporation is a "related interest" of the insider (i.e., the insider owns at least 25% percent of a class of voting shares of the company, controls the election of a majority of the company's directors, or has the power to exercise a controlling influence over the company). Under Part 32, a loan to an individual or company will not be considered to have been made to a corporate group until a "person" (which includes individuals and companies) owns more than 50% of the voting shares of a company. If a loan is found to have been made to a related interest of an insider under Part 31, the loan must comply with all of the insider lending restrictions of Part 31. If a loan is found to have been made to a corporate group under Part 32, the loan, when aggregated with all other loans to that corporate group, generally may not exceed 50% of the bank's capital and surplus.