

Safety and Soundness

Capital
Adequacy
(C)

Asset
Quality
(A)

**Management
(M)**

Earnings
(E)

Liquidity
(L)

Sensitivity to
Market Risk
(S)

Other
Activities
(O)

Insider Activities

November 2013

RESCINDED

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Introduction

The Office of the Comptroller of the Currency’s (OCC) *Comptroller’s Handbook* booklet, “Insider Activities,” provides guidance for bank examiners and bankers on how national banks and federal savings associations may legally and prudently engage in transactions with insiders and implement risk management processes that provide for the appropriate control and monitoring of insider activities. This booklet also includes guidance on how examiners review and assess insider activities during the supervisory process. Transactions with affiliates are not addressed in this booklet but are covered in detail in the “Related Organizations” booklet of the *Comptroller’s Handbook*. Throughout this booklet, national banks and federal savings associations are referred to collectively as banks, except when it is necessary to distinguish between the two.

Overview

A bank may engage in safe and sound business and personal transactions with its insiders, consistent with law and regulation. Transactions between a bank and its insiders can address legitimate banking needs and serve the interests of both parties. The challenge is to separate legitimate insider financial relationships from those that are, or could become, abusive, imprudent, or preferential. Studies of bank failures have found that insider abuse—such as poor-quality loans made and unjustified fees paid to directors and officers—often contributes to the failures. Because of the significant risks that insider activities can pose, such activities are subject to strict laws and ethical guidelines.

While most risks can be measured and quantified, insider abuse can damage a bank’s reputation beyond the dollar amount of any credit loss. Improper insider activities can undermine public confidence in a bank. Market perception of the integrity of a bank’s insiders is fundamental to the bank’s financial health and ongoing viability. To maintain this public confidence, a bank must have a reputation for honesty, integrity, and high ethical standards in all of its activities, especially in its transactions with insiders.

A bank’s corporate governance processes should comprehensively address insider activities. The board of directors must demonstrate leadership by ensuring a culture that does not tolerate unethical behavior or circumvention of regulations, and by adopting and administering strong written policies that closely govern the relationship between a bank and all insiders. The board must also ensure that bank management implements a process to monitor and validate compliance with these policies. Banks may broadly define insiders to include all bank employees. Certain legal provisions discussed in this booklet may differ, however, in the way they define insider and limit the definition to include, for example, executive officer, director, or principal shareholder and all “related interests” of these persons. Therefore, it is important to determine who qualifies as an insider for purposes of the legal provision or policy being considered.

When the word *management* is used in this booklet, it refers to persons who are appointed by the board of directors and charged with the daily responsibilities of operating a bank. When the term *the board and management* is used in this booklet, it refers collectively to the members of the board of directors and management.

Risks Associated With Insider Activities

From a supervisory perspective, risk is the potential that events, expected or unexpected, will have an adverse effect on a bank's earnings, capital, or franchise or enterprise value. The OCC has defined eight categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. These categories are not mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. Examiners should be aware of this interdependence and assess the effect in a consistent and inclusive manner. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of banking risks and their definitions.

The risks most often associated with insider activities are reputation, credit, compliance, operational, and liquidity.

Reputation Risk

The bank's board, management, and employees must always maintain a high level of honesty and integrity to protect the bank's reputation. Real or perceived insider abuse can severely affect the bank's ability to operate in a safe and sound manner. When the bank is closely associated with an insider or a company owned by an insider (even if the bank and insider do not transact business together), the bank may suffer reputation risk or other harm if the insider or the insider's business experiences financial difficulties or receives adverse publicity. Any damage to the bank's reputation, or any implication of insider abuse or fraud, may adversely affect the confidence of the bank's shareholders, customers, suppliers, and financial partners. In turn, the bank's customer base could erode, materially affecting the bank's earnings, capital, or franchise/enterprise value.

Credit Risk

With certain restrictions, bank insiders are permitted by banking laws and regulations to borrow from the bank. The bank, however, must ensure that loans to insiders are at arm's length, meaning that the loan is on terms and conditions no less stringent than those prevailing at the time for comparable loans the bank offers to non-insiders. Loans to insiders could create added credit risk to the bank when inadequate or lax enforcement of insider policies leads to special treatment of insiders who might not otherwise qualify for credit. In addition, pressure from insiders to relax credit standards for their related interests can cause credit problems and potential losses. Lending to non-creditworthy insiders, offering inappropriate terms to insiders, or otherwise allowing an environment conducive to insider abuse increase the possibility of loss and violations of law and regulation.

Compliance Risk

The bank's board and management are responsible for ensuring that the bank complies with laws, regulations, prescribed practices, and ethical standards. Noncompliance with these requirements or safety and soundness standards can expose the bank and its insiders to serious consequences, including enforcement action. An insider who, knowingly or unknowingly, violates any banking law or regulation, engages in an unsafe or unsound banking practice, or breaches a fiduciary duty may be subject to civil money penalties and a prohibition of that insider from participating in the affairs of any insured depository institution, and may be required to pay restitution, reimbursement, indemnification, or provide a guarantee against loss.

Operational Risk

The lack of controls to identify potential conflicts of interest and insider fraud and abuse is a type of operational risk. A bank's board and management must ensure that appropriate procedures and controls are in place to prevent an insider from circumventing board-established policies regarding conflicts of interest, usurpation of corporate opportunities, and violations of laws and regulations governing insider activities. Weaknesses in systems and controls can increase the potential for operational risk due to insider abuse and fraud.

Liquidity Risk

Any speculation questioning the honesty or integrity of the bank or its insiders, however unfounded, can affect the bank's ability to attract funds from the public, institutional suppliers, and correspondent banks. Even the appearance of insider impropriety could lead to a loss of funding sources and deposit withdrawals and force the bank to prematurely dispose of assets at unacceptable losses to maintain liquidity.

Risk Management

The OCC expects each bank to identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for its size and the complexity of its operations. When examiners assess the effectiveness of a bank's risk management system, they consider the bank's policies, processes, personnel, and control systems. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of risk management.

Duties of the Board and Management

The board must adopt and enforce strong written insider policies governing the bank's relationship to insiders and their related interests. The board and management must ensure that their business and personal relationships with the bank are always at arm's length, do not bias decisions or otherwise harm the bank, and do not improperly take business opportunities away from the bank. In addition, the board and management must take reasonable action to

prevent other employees from abusing their positions within the bank. In this regard, the board and management have a number of duties relating to insider activities:

- Establishing appropriate insider policies, including a code of ethics and required disclosures of actual and potential conflicts of interest.
- Establishing and applying sound, independent processes to monitor and ensure compliance with insider policies, laws, and regulations, e.g., providing for effective internal controls and adequate audit and compliance coverage.
- Fulfilling fiduciary obligations, including the duty of care and the duty of loyalty.
- Complying with insider-related laws and regulations.
- Ensuring that hiring practices require disclosure of and address potential conflicts of interest and insider transactions.
- Ensure adequate training of board, management, and staff regarding insider policies and laws.
- Setting appropriate compensation and fees paid to insiders.
- Following prudent dividend policies.
- Implementing sound management information systems that transparently and comprehensively report on insider risk activities and exposures.
- Submitting accurate financial reports and other disclosures.

Fulfilling these duties should enable the bank to conduct its insider activities in a safe and sound manner.

Policies

Corporate scandals and failures exemplify the need for comprehensive insider policies, including a code of ethics and sound business practices. A corporate culture of ethical and honest behavior, as well as effective board oversight and management supervision, is the bank's primary defense against insider abuse and fraud. Comprehensive insider policies help establish this culture by setting a standard of behavior for all insiders. The bank's board and management must take the lead in demonstrating ethical behavior of the highest order and protecting the bank from conflicts of interest. Such a "tone at the top" emphasizes personal integrity and accountability while acknowledging the importance of an effective control environment. Board members and other insiders should conduct business with the bank according to an established governance structure that observes all of the requirements set forth in the bank's insider policies. Adherence to these policies should facilitate compliance with all legal and internal requirements for insider relationships.

Insider policies should focus on the activities of insiders and their related interests as well as employees at all levels of the bank where appropriate. Once policies are developed and approved by the board, the board and management should ensure that the policies are communicated throughout the bank. The bank should also have effective internal controls and an internal audit process to monitor compliance with those policies and to address identified problems.

The insider policies should

- include a code of ethics that requires the disclosure of actual or potential conflicts of interest.¹
- identify all insider “related interests,” as that term is defined in Regulation O.
- require periodic background checks and identification of material interests that insiders have in the business of any borrower, applicant, other bank customer, vendor, or supplier.
- include guidelines for insider lending and other transactions involving insiders, including fees or commissions received by insiders from the bank.
- require that transactions with insiders be at arm’s length and prohibit self-dealing.
- require the prompt reporting of insider securities transactions.²
- prohibit the use of insider information in securities transactions.
- specify the circumstances and conditions under which the bank makes its facilities, real or personal property (e.g., airplanes, cars), or personnel available for insiders’ use.
- specify restrictions on the acceptance of gifts, bequests, or other items of value (e.g., an exchange of “favors,” payment for services) from customers or other persons doing or seeking to do business with the bank.
- require bank employees to report improper or unethical behavior to appropriate parties (bank management, board, auditors, etc.) and to report suspicious activity in accordance with the bank’s suspicious activity report policy.
- specify the consequences of breaches of fiduciary duty and unethical conduct.
- include guidelines for reporting all insider and insider-related transactions to the board of directors or a committee thereof.
- include record-keeping requirements established by federal or state law.

The amount of detail in the written insider policies should correspond to the volume and nature of the insider activities that the board is willing to accept and to any applicable legal requirements. The written policies should be sufficiently detailed to enable all affected individuals to fully understand the nature and extent of their responsibilities under the policies. For example, if the bank’s policy prohibits all loans to, and any transactions with, insiders, the written policy needs to clearly state that prohibition. If the policy permits loans to, or other transactions with, insiders, the written policy should identify the types of loans and transactions authorized, the dollar or other limits (e.g., percent of capital), and the approval and reporting processes to be followed. Regulatory restrictions and limits, as well as other board imposed limits, should be clearly specified.

¹ Public companies that are obligated to file reports with the U.S. Securities and Exchange Commission (SEC) under section 13 or 15(d) of the Securities Exchange Act of 1934 are required to disclose whether they have adopted a code of ethics that applies to the company’s principal executive officer, principal financial officer, principal accounting officer or controller, or any person performing similar functions. If the company has not adopted a code of ethics, it must disclose why it has not done so.

² Companies whose securities are listed with the SEC are also required to make real-time electronic disclosures relating to insider changes in ownership.

Management should provide all insiders with copies of the bank's written policies and any subsequent changes to these policies. Each insider should sign an acknowledgment that he or she has received and reviewed the written policies and code of ethics, as well as any subsequent change to the policies, and agrees to comply with the policies. Management should maintain a current file of signed acknowledgements.

To foster compliance with laws, regulations, and insider policies, the bank should develop training and awareness programs covering insider issues. The bank should establish communication channels outside the normal chain of command (e.g., an ethics officer) through which insiders and employees in general can seek advice on questions about the insider policies, conflicts of interest, or similar concerns. If such support is readily available, insiders and employees are more likely to seek guidance. Management should monitor questions and responses to ensure that answers and interpretations are consistent and conform to bank policy and applicable legal requirements. In addition, the board and management should ensure a mechanism or process for employees to communicate, without reprisal, legitimate concerns about suspected illegal or unethical practices. The existence of a confidential reporting system (or "whistle-blower" system) indicates the board and management's commitment to the importance of employee responsibility for ethical behavior and the reporting of suspected wrongdoing.

Duty of Care and Duty of Loyalty

In addition to the specific laws and regulation discussed in this booklet, insider activities are governed by fiduciary duties, which include the duty of care and the duty of loyalty. Under the duty of care, the board and management must diligently and honestly administer the bank's affairs in a manner measured against what a reasonable and prudent person would do in similar circumstances. Under the duty of loyalty, the board and management must place the corporate interests of the bank above their personal interests. Many banks, as a matter of policy, have expanded the application of these duties to all employees. The OCC may take enforcement actions against individuals who fail to observe either the duty of care or the duty of loyalty.³

Under the duty of care, directors and management are responsible for knowing what a reasonable and prudent director would have known. Director and officer conduct is evaluated based on that knowledge. When a director's or officer's conduct is evaluated to determine whether that director or officer has fulfilled the duty of care, the conduct is measured against the applicable standard established by law.

The duty of loyalty requires directors and management to act in the best interests of the bank and to ensure that insiders do not abuse their positions by benefiting personally at the bank's expense. Under the duty of loyalty, insiders should avoid placing themselves in a position that creates a conflict of interest or the appearance of a conflict of interest. A director or

³ In addition, national bank directors are required to take an oath pursuant to 12 USC 73. The oath states that they will, so far as the duty devolves on them, diligently and honestly administer the affairs of their banks and will not knowingly violate or willingly permit to be violated any provisions of banking law.

officer has a conflicting interest in a transaction if he or she appears on both sides of the transaction or derives any personal benefit from it in the sense of self-dealing. A conflict of interest also can exist if a director or officer has a significant interest outside of the bank that reasonably affects his or her judgment with respect to the bank's business. Such a conflict of interest may arise from personal business interests or in connection with transactions that benefit friends, relatives, or business associates. A director or officer who has a conflict of interest would breach his or her fiduciary duties if he or she fails to disclose to the board of directors the existence, nature, and extent of his or her conflicting interest, fails to disclose all material nonprivileged information relevant to the board's decision on the matter, participates in any way in the matter, or votes on it. In addition, the "usurpation of corporate opportunity" doctrine, which is also a part of the duty of loyalty, prevents management and directors from improperly taking business opportunities away from the bank.

A bank's relationship with its board and management officials must at all times be prudent, at arm's length, and in compliance with all applicable laws and regulations. Directors and management must fully disclose any personal interest that they have in matters affecting the bank and must ensure that their business and personal relationships with the bank are always at arm's length. Only disinterested directors should approve transactions involving the interests of other directors or their related interests. Directors must abstain from voting and deliberating on any matter involving their own interests. Abstentions should be documented in the board minutes. Banks should note that, with respect to loans that are subject to Regulation O's "prior board approval" requirement (12 CFR 215.4(b)), a majority of the entire board must approve the loan.

Independence and unbiased decision making are important aspects of the duty of loyalty. Therefore, national stock exchanges and national securities associations require a majority of directors of public companies to be independent of management. The Securities and Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) generally requires all members of the audit committee,⁴ and compensation committees of companies with shares listed on national securities exchanges and national securities associations, to be independent directors. Rules of these exchanges and associations include certain enhanced independence requirements for members of issuers' nominating committees. Federal securities laws require all public companies, including those that do not have listed securities, to make public disclosures relating to the independence of directors.

These duties and obligations are described in more detail in the OCC's *The Director's Book*. For additional information on audit committee requirements, refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook*.

A director who violates any banking law or regulation, engages in an unsafe or unsound banking practice, or breaches a fiduciary duty (or permits another person to do so) may be

⁴ The Federal Deposit Insurance Corporation established a similar requirement for the audit committees of insured depository institutions with total assets of \$1 billion or more. See 12 CFR 363.5.

subject to civil money penalties, administrative actions, or other sanctions. The director may be held responsible either alone or jointly with other board members.

Holding Companies and Other Affiliates

The board and management of a bank often include many of the same people who are on the board and management team of the bank's parent company. The board and management of a bank subsidiary of a one-bank holding company may be the same as that of the holding company, particularly in community bank situations. Similarly, the directors and officers of a multi-bank holding company with centralized operations (or the directors and officers of the lead bank) often head each of the holding company's bank subsidiaries. The holding company or lead bank usually controls such activities as investment portfolio management, budgeting, tax planning, personnel management, correspondent banking, loan participations, and asset-liability management. While such structures can benefit the bank, persons who serve in dual capacities can develop conflicting loyalties.

Corporate governance policies should recognize this potential for divided loyalties and should provide guidance for preventing and resolving such conflicts of interest. The overriding principle must be that the bank subsidiary is not disadvantaged by a transaction with its holding company, any other affiliate, or any insider. Certain transactions with affiliates are subject to additional legal limitations. See the "Related Organizations" booklet of the *Comptroller's Handbook* for further discussion of this issue.

Compliance With Insider Laws and Regulations

Various state and federal laws and regulations govern insider activities. Unlike the broad standards of fiduciary duties, these laws and regulations are specific about how insiders are to conduct themselves. Since the statutory and regulatory restrictions on insider transactions do not apply uniformly to all insiders, the board and management must become familiar with each restriction and must pay careful attention to the scope and requirements of each. This booklet provides an overview of the primary federal laws and regulations that govern insider activities.

Regulation O—Extensions of Credit to Insiders (12 CFR 215 and 12 USC 375a and 12 USC 375b)

The Federal Reserve Board's Regulation O implements many of the laws pertaining to extensions of credit by banks to their insiders, including 12 USC 375a and 12 USC 375b (which apply to federal savings associations pursuant to 12 USC 1468(b)). Regulation O is the most comprehensive banking regulation relating to extensions of credit to insiders. The regulation limits the amount and type of credit that may be extended and includes reporting and record-keeping requirements. 12 CFR 31 and 12 CFR 215.12 apply Regulation O to national banks and federal savings associations, respectively.

The term *insider* has a special definition for the purposes of Regulation O. A Regulation O insider is a principal shareholder,⁵ an executive officer,⁶ a director, or a related interest of any of these persons. A related interest of a person is (1) a company controlled by that person, or (2) a political or campaign committee controlled by that person or the funds or services of which benefit that person. These terms are further defined by 12 CFR 215.2. (See appendix A of this booklet.) These definitions, however, do not apply to all provisions of Regulation O, and not all sections of Regulation O apply to all insiders, so banks must be careful in determining the persons or entities subject to a particular Regulation O provision.

The term *extension of credit* is also specifically and broadly defined by Regulation O (12 CFR 215.3) and includes loan renewals, extensions of credit made via credit card advances, and other transactions.⁷ Certain terms used in Regulation O, such as extension of credit, also appear in the OCC's lending limits regulation (12 CFR 32). There can be differences in what these terms mean for the purposes of these regulations.

Regulation O's main provisions include

- a prohibition on extensions of credit to insiders unless a loan is (1) nonpreferential and (2) does not present a higher than normal risk of repayment or other unfavorable features.⁸
- a requirement that prior board approval be obtained for loans to insiders greater than a certain amount.
- a dollar limit on lending to individual insiders and to insiders in aggregate.
- additional restrictions on loans to executive officers.
- a requirement that insiders report and disclose certain financial information.

When determining compliance with the quantitative limits of Regulation O, examiners and bankers must make sure they use the definition of unimpaired capital and unimpaired surplus in Regulation O.⁹

⁵ For purposes of determining whether a person is a principal shareholder (i.e., a person who controls, directly or indirectly, individually or in concert with others, more than 10 percent of any class of the bank's voting securities) any shares controlled by a member of that person's immediate family are considered to be held by that person. See 12 CFR 215.2(m)(1).

⁶ Regardless of his or her title, an executive officer includes anyone other than a director who participates or has authority to participate in major policy making functions of the bank.

⁷ See 12 CFR 215.3. Dodd–Frank amends 12 USC 375b to provide that a bank also extends credit to a person by having credit exposure to the person arising from a derivative transaction (as defined in 12 USC 84(b)), repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the member bank and the person.

⁸ See also OCC Interpretive Letter 1024. A loan to an insider that has become troubled may not be renewed unless the lending bank obtains additional protection to safeguard it and offset the unfavorable features the loan would otherwise present. Depending on the facts, a bank could require additional collateral, a guarantee, or other credit enhancement.

Limits on Extensions of Credit to Insiders (12 USC 375b and 12 CFR 215.4)

12 USC 375b and 12 CFR 215.4 apply limits and prohibitions to extensions of credit made by a bank to all insiders—executive officers, directors, and principal shareholders, and the related interests of these persons—including insiders of affiliates. A bank is prohibited from extending credit to insiders unless the extension of credit is made on substantially the same terms (including interest rates and collateral) as, and following underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons who are not insiders for the purposes of Regulation O and are not employed by the bank. A bank is also prohibited from making an extension of credit to an insider that involves more than a normal risk of repayment or presents other unfavorable features. Exceptions are provided for certain extensions of credit made pursuant to a benefit or compensation program that is widely available to employees. In addition, with certain exceptions, a bank is prohibited from paying an overdraft of an executive officer or director. Regulation O requires prior board approval for extensions of credit that exceed certain amounts set forth in 12 CFR 215.4(b). The statute and regulation also limit aggregate loans to individual insiders and to all insiders as a group as follows.

Individual Insiders

Aggregate loans and extensions of credit to each executive officer, director, or principal shareholder and his or her related interests are limited to the single borrower limit in 12 USC 84. This limit includes any higher amounts permitted by 12 USC 84 for specified types of loans. A bank's loans to related interests of an insider are attributed to that insider and are combined with any other loans to that insider outstanding from the bank regardless of whether such loans are combinable under the legal lending limit combination rule of 12 CFR 32.5. Federal savings associations should note that the additional exceptions contained in 12 USC 1464(u) to the requirements of 12 USC 84 are not available to compute individual lending limits for extensions of credit to federal savings association insiders and related interests under Regulation O.

All Insiders

Total extensions of credit to all insiders and their related interests are limited to the amount of the bank's unimpaired capital and unimpaired surplus. Banks with deposits of less than \$100 million are subject to a higher limit if they meet certain qualifications. That limit is equal to a total of two times the bank's unimpaired capital and unimpaired surplus, subject to

⁹ Regulation O defines unimpaired capital and unimpaired surplus for member banks as the sum of tier 1 and tier 2 capital included in the bank's risk-based capital, based on the bank's most recent call report, and the balance of the bank's allowance for loan and lease losses not included in tier 2 capital for risk-based capital purposes, based on the bank's most recent call report. See 12 CFR 215.2(i). This definition also applies to federal savings associations, see 12 CFR 215.12, 12 CFR 32.2(c). "Capital and surplus" in 12 CFR 32.2(c) is equivalent to "unimpaired capital and unimpaired surplus" in 12 CFR 215.2(i).

restrictions specified in 12 CFR 215.4(d). Exceptions to the limit on aggregate loans to insiders as a group are made for extensions of credit

- secured by a perfected security interest in U.S. Treasury obligations or in other obligations fully guaranteed by the United States.
- to or secured by qualified commitments or guarantees of a department or agency of the United States.
- secured by a perfected security interest in a segregated deposit account with the lending bank.
- arising from the discount of installment consumer paper acquired from an insider with recourse, subject to certain conditions.

Extensions of Credit to Executive Officers (12 USC 375a and 12 CFR 215.5)

12 USC 375a and 12 CFR 215.5 impose additional limits on extensions of credit to executive officers (but not to their related interests and not to executive officers of affiliates). A bank may extend credit to an executive officer in any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of an executive officer if the loan is secured by a first lien on the residence that the executive officer owns (or expects to own after the extension of credit). **An executive officer may have only one such loan from the bank outstanding at a time.** Extensions of credit to finance the education of an executive officer's children are permitted without limit. Certain secured loans may be permitted (12 CFR 215.5(c)(3)) or other loans subject to a spending limit set by 12 CFR 215.5(c)(4). It is important to note that, although mortgage and educational loans are not subject to limitation under 12 USC 375a and 12 CFR 215.5, aggregate loans to an individual executive officer (including mortgage and education loans) collectively are limited by 12 USC 375b and 12 CFR 215.4.

Other Insider Laws and Regulations

While Regulation O is the most comprehensive set of rules governing insider transactions, the following highlights other federal laws and regulations pertaining to insiders. Regardless of whether a law or regulation governs a specific transaction, insiders must observe their fiduciary duties in all insider transactions.

12 USC 376—Preferential Interest Payments

This law prohibits the payment of preferential interest on deposits to any director, officer, attorney, or employee of a national bank.¹⁰

¹⁰ While federal savings associations are not subject to this same statutory prohibition, they should avoid paying preferential interest on deposit accounts of insiders and employees as a matter of prudent banking practice. Depending on circumstances, the payment of preferential interest to a director or officer could be an unsafe or unsound practice or a breach of fiduciary duty.

12 USC 1972(2)—Insider Loans With Correspondent Banks

This law prohibits a bank and its correspondent bank from making preferential loans or loans that involve more than the normal risk of repayment or that present other unfavorable terms to an insider of the other bank. The law also prohibits a bank from opening a correspondent account at another bank where either bank has a preferential loan outstanding, or a loan that involves more than the normal risk of repayment or presents other unfavorable features, to an insider of the other.

12 USC 1828(z)—Asset Purchases and Sales

This law prohibits an insured depository institution (which includes both national banks and federal savings associations) from purchasing an asset from, or selling an asset to, an executive officer, director, or principal shareholder or any related interest of such person unless the transaction is on market terms and, if the transaction represents more than 10 percent of the capital stock and surplus of the institution, the transaction has been approved by a majority of the members of the board who do not have an interest in the transaction.

12 USC 1831i and 12 CFR 5.51 and 12 CFR 163, Subpart H—Proposed Changes in Directors and Senior Executive Officers

These laws and regulations require insured depository institutions (including national banks and federal savings associations), and depository institution holding companies, that are not in compliance with minimum capital requirements or are designated as being in “troubled condition” to provide advance notice to the appropriate federal banking agency of the proposed addition of any individual to the board of directors or the employment of any individual as a senior executive officer. The appropriate federal banking agency may issue a notice of disapproval if the competence, experience, character, or integrity of the individual with respect to whom the advance notice is submitted indicates that it would not be in the best interests of the depositors of the depository institution or in the best interest of the public to permit the individual to be employed by, or associated with, the depository institution.

12 USC 3202 Through 12 USC 3203 and 12 CFR 26 and 12 CFR 196—Management Interlocks

With a goal of fostering competition, these laws and regulations generally prohibit depository institutions that compete in the same geographic market from sharing management officials if the institutions are not affiliated with each other. In addition, a management official of a bank with total assets exceeding \$2.5 billion may not serve at the same time as a management official of an unaffiliated depository organization with total assets exceeding \$1.5 billion, regardless of the locations of the two depository organizations. The OCC has the authority to exempt an otherwise prohibited interlock if it finds that the interlock will not produce a monopoly or a substantial lessening of competition (see 12 CFR 26.6 and 196.6 and OCC *Licensing Manual* booklet “Management Interlocks” for additional information).

12 CFR 160.130—Prohibition on Loan Procurement Fees

This regulation prohibits directors, officers, or other persons having the power to direct the management or policies of a federal savings association from receiving, directly or indirectly, any commission, fee, or other compensation in connection with the procurement of any loan made by the savings association or a subsidiary of the savings association.¹¹

12 CFR 163.200—Conflicts of Interest

Directors, officers, employees of federal savings associations, or persons having the power to direct the savings association's management or policies or otherwise owe a fiduciary duty to the association must not advance their own personal or business interests, or those of others with whom they have a personal or business relationship, at the expense of the savings association. They also must, if they have an interest in a matter or transaction before the board of directors, disclose certain information and refrain from participating in board discussions on the matter or from voting on the matter.¹²

12 CFR 163.201—Usurpation of Corporate Opportunity

Directors, officers, or persons having the power to direct a federal savings association's management or policies or otherwise owe a fiduciary duty to a federal savings association must not take advantage of corporate opportunities belonging to the association.¹³

Internal Controls and Audit

Internal or external audits should complement a bank's internal controls and information systems. Such functions should be sufficient to detect actual or potential conflicts of interest and insider fraud or abuse. The board should ensure that management has implemented a process to monitor compliance with applicable insider laws, regulations, and bank policy.

A system of strong internal controls is critical to ensuring compliance with bank policies and with laws and regulations concerning insider transactions. A sound internal-control system minimizes the possibility of significant errors and irregularities and ensures timely detection

¹¹ While this rule does not apply directly to national banks, loan procurement fees should be addressed in the bank's insiders' policies, as such payments could be considered a conflict of interest. The Real Estate Settlement Procedures Act also addresses the payment of compensation for loan referrals.

¹² Although national bank directors and officers are not subject to a similar regulation regarding conflicts of interest, they do owe a fiduciary duty of loyalty to the bank. The duty of loyalty requires directors and management to act in the best interest of the bank and to ensure that insiders do not abuse their positions by benefiting personally at the bank's expense. (See the "Duty of Care and Duty of Loyalty" section of this booklet.)

¹³ Although national bank directors and officers are not subject to a similar regulation regarding usurpation of corporate opportunity, they do owe a fiduciary duty of loyalty to the bank (see the "Duty of Care and Duty of Loyalty" section of this booklet). The "usurpation of corporate opportunity" doctrine, a part of the duty of loyalty, prevents insiders from improperly taking business opportunities away from the bank.

of those that do occur. The board, through its oversight role, should ensure that the bank's system of internal controls and audit alerts the bank to the following practices or conditions:

- Transactions resulting in a conflict of interest or the appearance of such a conflict.
- The payment of excessive compensation, unjustified fees, or compensation that encourages inappropriate risk-taking that could lead to material financial loss.
- Failure to comply with applicable insider laws, regulations, or bank-imposed restrictions.
- Other red flags for possible insider fraud.

If any of these practices or conditions is discovered, the board should determine the cause, instruct management to take appropriate corrective action, and oversee necessary revisions to policies or internal controls.

For additional guidance and requirements regarding board and management responsibilities for establishing and maintaining an effective internal-control structure and complying with safety and soundness laws concerning transactions with insiders, refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook*; 12 CFR 363, "Annual Independent Audits and Reporting Requirements"; and section 404 of the Sarbanes–Oxley Act.¹⁴

For additional information and guidance regarding potential insider loan abuse, banks and examiners may refer to a Federal Financial Institution Examination Council (FFIEC) publication titled "The Detection, Investigation and Prevention of Insider Loan Fraud: A White Paper," published in May 2008.¹⁵

Compensation and Benefits Paid to Insiders

Compensation and fees paid to insiders must serve the legitimate needs of the bank, be justified by the services rendered, and be reasonable in amount. In assessing this area, all forms of remuneration, including salary, fees, benefits, stock options, and the receipt of other goods and services, should be considered. Compensation packages may include non-cash benefits. One such permissible non-cash benefit is a bank's purchase of directors and officers liability insurance. This insurance protects against the expense of defending lawsuits alleging director or officer misconduct and paying related damages. Some of this insurance reimburses the bank for payments made to directors and officers under indemnification agreements, and the rest reimburses the directors and officers for expenses that the bank is unable to indemnify. This insurance does not cover criminal or dishonest acts, events from which the insider obtained personal gain, or circumstances in which a conflict of interest was apparent. Indemnification agreement requirements are covered by 12 CFR 7.2014, 12 CFR 145.121, and 12 CFR 359.

¹⁴ Under section 301 of Sarbanes–Oxley, the audit committees of public companies are required to establish procedures for (1) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and for (2) the issuer's employees to submit information about questionable accounting or auditing matters in a confidential, anonymous manner.

¹⁵ Available at www.ffiec.gov/exam/whitepapers.htm.

An advance of salary or other unearned compensation to an insider for a period in excess of 30 days constitutes an extension of credit for the purposes of Regulation O (12 CFR 215.3(a)(6)).

12 CFR 30, Appendix A, and 12 CFR 170, Appendix A: Interagency Guidelines Establishing Standards for Safety and Soundness

As set forth in section III of the interagency guidelines, a bank 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 bank. An insider's compensation is considered excessive, and is therefore prohibited as an unsafe and unsound practice, if it is unreasonable or disproportionate to the services actually performed. The following factors should be considered in determining whether compensation is excessive:

- The combined value of all cash and non-cash benefits provided to the individual.
- The compensation history of the individual and other individuals with comparable expertise at the institution.
- The financial condition of the institution.
- Compensation practices at comparable institutions, based on such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets.
- For post-employment benefits, the projected total cost and benefit to the institution.
- 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.
- Any other relevant factors.

Federal savings associations must also ensure that employment contracts with its officers (and other employees) are entered into in accordance with the requirements of 12 CFR 163.39. This rule requires that all employment contracts be in writing and approved by the board, and that they contain certain required provisions specified in the rule. A federal savings association may not enter into a contract with its officers (or other employees) if such contract would constitute an unsafe and unsound practice (e.g., the contract could lead to material financial loss or damage to the association or could interfere materially with the exercise by the members of the board of directors of their duty or discretion provided by law, charter, bylaw, or regulation as to the employment or termination of employment of an officer or employee of the association).¹⁶ Under 12 CFR 163.161(b), compensation to officers, directors, and employees of a federal savings association, or its service corporation, must be reasonable in amount and commensurate with the duties and responsibilities of that individual.

¹⁶ While national banks are not subject to a similar explicit regulatory requirement, a national bank may not enter into an unsafe or unsound employment contract.

Interagency Guidance on Sound Incentive Compensation Policies

Many banks rely on incentive pay to attract, motivate, and retain insiders. If improperly structured, however, incentive-based compensation arrangements can lead bank employees to take imprudent risks. Banks are expected to maintain incentive compensation practices that are consistent with safety and soundness.¹⁷ In 2010, the OCC published OCC Bulletin 2010-24, “Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies”—in conjunction with other federal banking regulatory agencies—to protect the safety and soundness of banking organizations and to promote the improvement of incentive compensation practices. The guidance is based on three key principles that state that incentive compensation arrangements at a bank should

- be supported by strong corporate governance, including active and effective oversight by the board.
- be compatible with effective controls and risk management.
- provide employees with incentives that appropriately balance risk and reward.

The board is responsible for reviewing and closely monitoring all insider incentive compensation arrangements to ensure that they do not result in any unreasonable risk-taking to the bank and to ensure compliance with regulations and guidance.

Banks whose securities are listed on the national exchanges have additional requirements regarding the adoption and disclosure of compensation guidelines. In addition, banks that are subject to the Prompt Corrective Action requirements may be subject to legal restrictions on the payment of compensation to senior executive officers (12 USC 1831o(f)(4), 12 USC 1831o(i)(2)).

Golden Parachute Payments

Federal Deposit Insurance Corporation regulation 12 CFR 359, “Golden Parachute and Indemnification Payments,” implements 12 USC 1828(k) and limits or prohibits, in certain circumstances, troubled insured institutions from making golden parachute payments. 12 CFR 359 also covers indemnification agreements. It defines a golden parachute payment generally to be any payment, or agreement to make any payment, that meets all of the following criteria:

- The institution makes, or agrees to make, a payment in the nature of compensation to or for the benefit of an institution-affiliated party.
- The payment is contingent on or payable on or after the termination of this person’s employment or affiliation with the institution.

¹⁷ Section 956 of Dodd–Frank, 12 USC 5641, requires the banking agencies, along with the National Credit Union Administration, SEC, and Federal Housing Finance Agency, to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at covered financial institutions (institutions with total consolidated assets of \$1 billion or more). The agencies issued a proposed rule on April 14, 2011 (76 Fed. Reg. 21170). As of the date of this publication, a final rule has not yet been issued.

- The payment is received on or after, or made in contemplation of, insolvency (or similar event); the appointment of a conservator or receiver; termination of deposit insurance; or a determination that the institution is in troubled condition.

For purposes of this rule, “institution-affiliated party” includes any director, officer, controlling shareholder, employee of, or agent for an insured depository institution or depository institution holding company. See 12 CFR 359 for further details.

Management and Other Fees

Fees paid to insiders for services rendered to, or on behalf of, a bank must be for services that meet the legitimate needs of the bank, must be justified, and must be reasonable in amount. The OCC considers fees reasonable if they are based on fair market cost or fair market cost plus a fair profit. Reasonable costs may include overhead expenses to the extent they are a legitimate and integral part of the services provided. Debt service requirements of a parent company or other shareholders do not represent a legitimate overhead expense that may be imposed upon or allocated to a bank.

A bank that pays management or other fees to insiders should retain well-documented records that demonstrate the fair value of the goods and services received, their benefit to the bank, and the appropriateness of the fees paid. The board and internal audit should review these records as part of their ongoing oversight of the bank’s affairs.

If excessive management or other fees are paid to insiders, the board is responsible for taking corrective action, possibly to include seeking restitution from the insider.

Under Prompt Corrective Action provisions, the payment of management fees to controlling shareholders is prohibited if it would cause the bank to become undercapitalized (12 USC 1831o(d)(2)). In addition, prepayment of fees to a related interest of an insider for services not yet received may constitute an extension of credit under Regulation O, and also section 23A of the Federal Reserve Act (12 USC 371c), if the related interest is an affiliate of the bank. In that case, it may also be a violation of section 23B of the Federal Reserve Act (12 USC 371c-1), as a transaction with an affiliate that is not on an arm’s length basis. Additionally, as stated above, an advance of salary or other unearned compensation to an insider for a period in excess of 30 days constitutes an extension of credit for purposes of Regulation O.

Audit Committee Member Fees

Audit committee members of public banks or depository institution holding companies¹⁸ are barred from accepting any consulting, advisory, or other compensatory fee, other than director and board committee fees from the bank.¹⁹

Credit Life/Accident and Health Insurance Fees

12 CFR 2 states that it is an unsafe and unsound practice for any director, officer, employee, or principal shareholder of a national bank (including any entity in which this person owns an interest of more than 10 percent) who is involved in the sale of credit life, accident, or health insurance to take advantage of that business opportunity for personal profit.²⁰ 12 CFR 2 also prohibits, with certain exceptions, such persons from retaining commissions or other income from the sale of such insurance to loan customers. In addition, it provides guidance for bonus and incentive plans based on the sale of credit life insurance.

Other Commissions or Fees Paid to Insiders

The payment to insiders of commissions or fees derived from services they or their related interests provide to bank customers could create a conflict of interest if the insiders are either directly or indirectly involved in the approval of a loan or other transaction at the bank for which they are receiving the commissions or fees. Services may include the sale of title insurance, the sale of hazard insurance relating to bank collateral, and legal or appraisal services. Insiders who receive commissions or fees directly or indirectly related to a loan or other bank transaction in which they have an interest must ensure the permissibility of the fee, fully disclose their interest, and abstain from participating in the approval of that transaction. For directors, officers, and employees of federal savings associations, a failure to do so may result in a violation of 12 CFR 163.200. Also, pursuant to 12 CFR 160.130, a federal savings association is prohibited from paying such fees in connection with the procurement of a loan.

¹⁸ Public banks and bank holding companies are defined as those that have securities registered with the OCC or the SEC.

¹⁹ Based on the specific circumstances, however, audit committee members may or may not be prohibited from engaging in other business with the bank. See section 301 of the Sarbanes–Oxley Act for additional discussion of this issue.

²⁰ While this rule does not apply directly to federal savings associations, they are subject to similar prohibitions under 12 CFR 163.201 “Usurpation of Corporate Opportunity.”

Dividends

The board should ensure that any proposed dividend is consistent with applicable legal requirements and the bank's capital and strategic plans and does not adversely affect capital adequacy. Dividend policies of a bank must be consistent with its capacity to pay and should not be based in any way on the needs of insiders or shareholders.²¹ Dividend policies based solely on insiders' or their related interests' need for income are considered unsafe and unsound.

Management Information Systems and Financial Reporting

Banks should have sound information systems that produce the information necessary to assess compliance with insider laws, regulations, and policies. The information gathered through these systems should fully support regulatory and board reporting. In addition, the systems should aggregate extensions of credit to insiders and their related interests to help maintain compliance with statutory limitations.

Proper record keeping is essential for the board and management to effectively monitor insider relationships and lending and to file accurate call reports. Schedule RC-M of the FFIEC Consolidated Reports of Condition and Income (call report) requires banks to report the aggregate amount and number of extensions of credit to executive officers, directors, principal shareholders, and their related interests.

National banks and federal savings associations registered with the OCC and national bank and federal savings association holding companies registered with the SEC are subject to reporting of insider securities transactions. Generally, to prevent the unfair use of information, section 19 of the Securities Exchange Act of 1934 requires disclosure by directors, executive officers, and direct or indirect beneficial owners of more than 10 percent of any class of stock of a registered national bank or federal savings association. After filing initial reports, a beneficial owner may be required to file annual reports. Beneficial owners and other insiders must file reports with the OCC²² (or the SEC for holding companies). This includes the filing of reports within two business days after the date on which an insider transaction in stock was executed. Subject to exceptions, the issuer of the securities may recover realized profits from the insider's purchase or sale of the stock within a period of less than six months. Banks with Internet sites are required to disclose these reports on their sites.

Transactions between an insider and a public company are subject to disclosure and additional oversight by the board of directors. Generally, SEC rules require disclosure of a

²¹ Those dividend policies must comply with 12 USC 56 and 60(b) and 12 CFR 5.64. The dividend policies of a federal savings association must comply with 12 USC 1467a(f) and 12 CFR 163, subpart E. Pursuant to 12 USC 1831o(d)(1)(A), which is implemented by 12 CFR 6 and 12 CFR 165, a bank may not declare or pay any dividend if, after the dividend, the bank would be undercapitalized.

²² See SEC Rule 16a-3. See also 12 CFR 11 (national banks); 12 CFR 194 (federal savings associations).

transaction or proposed transactions exceeding \$120,000 between a public company and a director, officer, nominee for director, or beneficial owner of more than 5 percent of any class of the company's voting securities.²³ Rules of a national securities exchange or national securities association may require the audit committee or another independent body of the board of directors of any company with securities listed on the exchange to exercise enhanced scrutiny of these transactions.

RESCINDED

²³ See Item 404 of Regulation S-K.

Examination Procedures

This booklet contains expanded procedures for examining specialized activities or specific products or services that warrant extra attention beyond the core assessment contained in the “Community Bank Supervision,” “Large Bank Supervision,” and “Federal Branches and Agencies Supervision” booklets of the *Comptroller’s Handbook*. Examiners determine which expanded procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment.

Scope

These procedures are designed to help examiners tailor the examination to each bank and determine the scope of the insider activities examination. This determination should consider work performed by internal and external auditors and other independent risk control functions and by other examiners on related areas. Examiners need to perform only those objectives and steps that are relevant to the scope of the examination as determined by the following objective. Not all will every objective or step of the expanded procedures be necessary.

Objective: To determine the scope of the examination of insider activities and identify examination objectives and activities necessary for the review of insider activities.

1. Obtain and review the following information and note any previously identified problems or changes related to insider activities that require follow-up:
 - The examination scope memorandum.
 - The most recent examination reports, including any reports issued by other regulators, as available.
 - Written insider policies, including a code of ethics and whistle-blower procedures for confidential reporting of suspected fraud and insider abuse.
 - Internal and external audit reports and work papers.
 - Internal bank reports used to track and supervise compliance with insider laws and policies.
 - Bank management’s responses to previous reports of examination or audit reports.
 - Confidential employee complaints regarding suspected fraud or insider abuse.

2. Determine any material changes since the previous examination. Examples include
 - new executive officers.
 - new directors.
 - new affiliations or related interests by directors or management.
 - ownership changes.
 - material changes in policies, procedures, or reports governing insider activities.

3. Review, as appropriate, OCC databases, the previous examination report, examination reports of other regulators, internal and external audit reports, internal bank reports, and any asset management examination report for information about conflicts of interest or insider abuse.
4. Based on the performance of the previous steps and discussions with the bank examiner-in-charge and other appropriate supervisors, determine the scope and set the objectives for this examination.

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Quantity of Risk

Conclusion: The quantity of each associated risk is (low, moderate, or high).

Objective: To determine the level of reputation, credit, compliance, operational, and liquidity risk associated with insider activities.

1. Obtain the following documents or, if appropriate, review the information with the examiner assigned to the relevant area:
 - Board of directors' minutes containing insider transaction information, including any potential or existing conflicts of interest.
 - A list of executive officers, including
 - name.
 - title.
 - date the person became an executive officer.
 - related interests.
 - A list of directors, including
 - name.
 - date the director was elected to the board.
 - related interests.
 - A list of shareholders, who together with members of their immediate families, have more than 10 percent ownership (principal shareholders), including
 - shareholder name.
 - date the person became a principal shareholder.
 - number of shares owned (by shareholder and immediate family members).
 - related interests.
 - A list of extensions of credit (including commitments) to directors, executive officers, principal shareholders, and their related interests, describing
 - the nature of the credit (see 12 CFR 215.3 for a detailed list of what qualifies as an extension of credit for purposes of Regulation O). Note that under an amendment to 12 USC 375b effective July 21, 2012 (not yet reflected in Regulation O), extensions of credit include credit exposures arising from a derivative transaction, a repurchase agreement, a reverse repurchase agreement, or a securities lending or securities borrowing transaction between a bank and an insider.
 - complete name of obligor, co-maker, endorser, and guarantor.
 - type of entity (individual, sole proprietorship, general partnership, limited partnership, limited liability company, or corporation).
 - name of director, officer, or principal shareholder related to the obligor.
 - nature of obligation (signer on note, guarantor, general partner, etc.).
 - original date, amount, and purpose of the loan or commitment.
 - current balance.
 - terms, including interest rate, maturity date, and any collateral.

- status (delinquent, restructured, renegotiated, or considered a problem loan by management).
 - date reported to, or approved by, the board of directors, if applicable.
 - Any bank-generated overdraft report to ensure compliance with 12 CFR 215.4(e)(1).
 - A list of deposit accounts and other vehicles not technically deposits (e.g., repurchase agreements) of directors, officers, and all other employees to ensure that they are not receiving preferential interest rates (12 USC 376).²⁴
 - For each extension of credit to an insider, a list of comparable prior transactions with non-insiders.
 - A report of fees or other payments made as well as any reimbursements of personal expenses (e.g., consulting or other professional services) paid to insiders and their related interests.
 - A list of management officials (as defined in 12 USC 3201) of the bank or savings association, its holding company, and holding company affiliates who are management officials of other depository institutions.
 - A list of purchases or sales of assets to an insider.
 - A description of any insider's use of bank property.
 - A list of loans to third parties of which the proceeds were either directly or indirectly transferred to a bank insider or used for the tangible economic benefit of a bank insider.
2. From the gathered materials, select a representative sample of insider borrowings. Review terms of extensions of credit (including renewals and credit cards), such as interest rates, fees charged, and collateral. Assess compliance with laws and regulations for loans to insiders by determining whether these extensions of credit and loan renewals
- are made on substantially the same terms and adhere to credit underwriting practices that are no less stringent than those available in prior comparable transactions with non-insiders (12 USC 375a(1) and 375b(2) and 12 CFR 215.4(a)(1)).
 - are made pursuant to an employee benefit or compensation plan that is widely available to employees (12 CFR 215.4(a)(2)).
 - carry no more than a normal risk of failure to repay (12 USC 375b(2) and 12 CFR 215.4(a)(1)).²⁵
 - have no other unfavorable features (12 USC 375b(2) and 12 CFR 215.4(a)(1)).

²⁴ Pursuant to 12 USC 376, national banks are prohibited from paying preferential interest on deposit accounts of any director, officer, attorney, or employee. While federal savings associations are not subject to this same statutory prohibition, they should avoid paying preferential interest on deposit accounts of insiders and employees as a matter of prudent banking practice. Depending on circumstances, the payment of preferential interest to a director or officer could be an unsafe or unsound practice or a breach of fiduciary duty.

²⁵ A loan to an insider that has become troubled may not be renewed unless the lending bank obtains additional protection to safeguard it and offset the unfavorable features the loan would otherwise present. Depending on the facts, a bank could require additional collateral, a guarantee, or other credit enhancement.

- do not exceed the greater of \$25,000 or 5 percent of the bank's unimpaired capital and unimpaired surplus (12 USC 375b(3) and 12 CFR 215.4(b)). If extensions of credit exceed these limits, determine whether
 - the extension of credit was approved in advance by a disinterested majority of the entire board of directors (12 USC 375b(3)(A) and 12 USC 215.4(b)(1)(i)).
 - the interested party abstained from participating directly or indirectly in the deliberations and voting (12 USC 375b(3)(B), 12 CFR 215.4(b)(1)(ii), and 12 CFR 215.4(b)(4)).
 - the abstention was noted in the board of directors' minutes. (Although this is not required by regulation, the OCC expects this as a matter of a prudent banking practice.)
 - there was prior approval for any aggregate extension of credit to the insider and all related interests of the insider exceeding \$500,000 (12 USC 375b(3) and 12 CFR 215.4(b)(2) and (3)).
3. Using bank reports and other materials gathered, determine whether aggregate extensions of credit to any insider and related interests exceed the limit on loans to a single borrower established by 12 USC 84 (12 USC 375b(4) and 12 CFR 215.4(c)).
 4. Using bank reports and other materials, determine whether aggregate extensions of credit to executive officers, directors, and principal shareholders and their related interests do not exceed the bank's unimpaired capital and unimpaired surplus (see 12 CFR 215.2(i) for the definition of unimpaired capital and unimpaired surplus). If loans exceed that limit, determine whether the bank has total deposits of less than \$100 million (12 USC 375b(5)(C) and 12 CFR 215.4(d)(2)). If the bank has total deposits of less than \$100 million, determine whether
 - total extensions to insiders do not exceed two times the bank's unimpaired capital and unimpaired surplus (12 CFR 215.4(d)(2)).
 - the board determined that the higher limit is consistent with safe and sound banking practices and is necessary to attract or retain directors or prevent restricting credit availability in small communities (12 USC 375b(5)(C) and 12 CFR 215.4(d)(2)(i)(A)).
 - the board's annual resolution sets forth the facts and reasoning of the resolution, including the amount of the bank's lending to its insiders as a percentage of the bank's unimpaired capital and unimpaired surplus as of the date of the resolution (12 CFR 215.4(d)(2)(i)(B)).
 - the bank meets or exceeds all applicable capital requirements (12 CFR 3, 12 CFR 167, and 12 CFR 215.4(d)(2)(i)(C)).
 - the bank received at least a satisfactory composite rating on its most recent examination (12 CFR 215.4(d)(2)(i)(D)).
 - if the bank subsequently failed to qualify for the higher limit, it did not extend additional credit that would maintain insider lending in excess of 100 percent of unimpaired capital and surplus (12 CFR 215.4(d)(2)(ii)).
 - any exceptions are consistent with the requirements in 12 CFR 215.4(d)(3).

5. Determine whether the proceeds of any loans to third parties were transferred to, or used for the benefit of, any insider and, if so, whether such transfer or benefit qualifies for an exception to the “tangible, economic benefit” rule (12 CFR 215.3(f)).
6. With respect to principal shareholders, determine whether any loans (including credit card advances) were made to members of a shareholder’s “immediate family,” as that term is defined in 12 CFR 215.2(g).
7. Determine whether any executive officer, director, or principal shareholder knowingly received or knowingly permitted any of that person’s related interests to receive from any member bank, directly or indirectly, an extension of credit (as defined in 12 CFR 215.3) not authorized by 12 USC 375a or 375b or Regulation O (12 CFR 215.6).
8. Determine whether a mortgage or a home equity loan to an executive officer
 - is to finance or finance the purchase, construction, maintenance, or improvement of a residence of the executive officer (12 USC 375a(2)(A) and 12 CFR 215.5(c)(2)).
 - is secured by a first lien on the residence that the executive officer owns or expects to own after the extension of credit (12 USC 375a(2)(A) and 12 CFR 215.5(c)(2)(i)).
 - is a refinancing and, if so, whether the amount used to repay the original extension of credit, together with closing costs and any other additional amount used, reflects permissible purposes (12 CFR 215.5(c)(2)(ii)).
 - is the only such loan outstanding (12 USC 375a(2)(B)).
9. Determine whether the aggregate amount of extensions of credit to any executive officer at any one time for purposes other than first-lien mortgages or children’s education exceed the higher of \$25,000 or 2.5 percent of the bank’s unimpaired capital and unimpaired surplus (but in no case may that aggregate amount exceed \$100,000) (12 USC 375a(4) and 12 USC 215.5(c)(4)).
10. Determine whether extensions of credit made pursuant to the exceptions to the limit outlined in 12 CFR 215.4(d)(3) are secured, as prescribed by 12 CFR 215.4(d)(3).
11. Determine whether extensions of credit to executive officers are
 - promptly reported to the board of directors (12 USC 375a(1) and 12 CFR 215.5(d)(1)).
 - made on substantially the same terms as, and adhere to credit underwriting practices that are no less stringent than, those prevailing at the time for comparable transactions with non-insiders (12 USC 375a(1)(B) and 12 CFR 215.4(a) and 12 CFR 215.5(d)(2)).
 - preceded by the submission of a detailed current financial statement of the executive officer (12 USC 375a(1)(C) and 12 CFR 215.5(d)(3)).

- made under the written condition that the extension of credit shall become due and payable on demand at any time that the officer is indebted to any other bank(s) in an aggregate amount greater than the amount specified for a category of credit in 12 CFR 215.5(c) (12 USC 375a(1)(D), and 12 CFR 215.5(d)(4)).

12. Determine whether bank records on insider borrowings satisfy the record-keeping requirements of 12 CFR 215.8, including

- identifying all insiders of the bank and their related interests, annually (12 CFR 215.8(b)(1)).
- specifying the amount and terms of each extension of credit to insiders of the bank (12 CFR 215.8(b)(2)).
- maintaining records of extensions of credit to insiders of the bank's affiliates using one of the methods specified in 12 CFR 215.8(c).
- employing a record-keeping method that the OCC determines is effective (12 CFR 215.8(c)(3)).

13. Determine whether, upon written request from the public, the bank makes available the names of executive officers, principal shareholders, and their related interests to whom the bank has extended credit and other required information if required to do so by 12 CFR 215.9(b).

14. Determine whether each executive officer and director of a bank that is not publicly traded annually reports to the board of directors the outstanding amount of any credit extended to him or her based on the security of shares of the bank (12 CFR 215.10).

15. Using bank reports and other materials, determine whether all loans by the bank to insiders of its correspondent banks

- are on terms no more favorable than those available at the same time to non-insiders for comparable transactions (12 USC 1972(2)).
- carry no more than the normal risk of failure to repay (12 USC 1972(2)).
- have no other unfavorable features (12 USC 1972(2)).

16. Review purchases and sales of assets to or from executive officers, directors, or principal shareholders, or any related interests, to determine whether such transactions are on market terms and, if the transaction represents more than 10 percent of the bank's capital stock and surplus, have been approved by a majority of the disinterested members of the board (12 USC 1828(z)).

17. Review fees paid to insiders and determine whether they have a direct relationship to, and are based solely on, the fair value of goods and services received and compensate the insider only for providing goods and services that meet the legitimate needs of the bank (and do not place the insider in a conflict of interest relative to his or her duties at the bank).

18. Review a sample of deposit accounts of employees, executive officers, directors, principal shareholders, and their related interests and identify any

- exceptions to standard policies on service charges and interest paid.
- preferential treatment for directors, officers, attorneys, or employees of national banks (a greater rate of interest on deposits than that paid to other depositors) (12 USC 376).
- cash items being held by the bank to prevent an overdraft by officers or directors (12 USC 375b(6) and 12 CFR 215.3(b)(2)).
- overdrafts being paid for executive officers or directors on an account at the bank (12 USC 375b(6) and 12 CFR 215.4(e)). For any such overdrafts, determine whether the overdraft
 - was in accordance with a written, pre-authorized interest-bearing extension-of-credit plan that specifies a method of repayment (12 USC 375b(6)(B)(i) and 12 CFR 215.4(e)(1)(i)); or
 - was in accordance with a written, pre-authorized transfer of funds from another account of the account holder at the bank (12 USC 375b(6)(B)(ii) and 12 CFR 215.4(e)(1)(ii)); or
 - was inadvertent and aggregated \$1,000 or less (12 CFR 215.4(e)(2)). If overdrafts were inadvertent, determine whether the overdraft status continued no more than five business days and the executive officer or director paid the same fee charged any other customer of the bank in similar circumstances (12 CFR 215.4(e)(2)(i) and 12 CFR 215.4(e)(2)(ii)).

Note: In steps 2 through 18, any violation of Regulation O (12 CFR 215) also is a violation of 12 CFR 31.2(a), “Extensions of Credit to Insiders and Transactions with Affiliates.”

19. Determine, through discussion with the examiner assigned, whether any concerns were noted with director’s and officer’s liability insurance.

20. If the bank sells credit life, accident, or health insurance, prepare a description of the program(s), including

- a list of insiders who are licensed insurance agents.
- any bonus or incentive compensation programs.
- the disposition of commission payments.

21. For national banks that sell credit life, accident, or health insurance (collectively, credit life insurance), test for compliance with 12 CFR 2 by determining whether

- the bank has not structured its bonus or incentive plan in a manner that could create incentives for persons selling credit life insurance to make inappropriate recommendations or sales of credit life insurance to bank customers (12 CFR 2.3(b)).

- if bank employees or officers participate in a bonus or incentive plan under which payments are based on credit life insurance sales, the payments
 - are in amounts that do not exceed 5 percent of the recipient’s annual salary (12 CFR 2.4(a)); or
 - to any one individual during a year do not exceed 5 percent of the average salary of all loan officers participating in the plan (12 CFR 2.4(b)).
- income is not being improperly retained by an employee, officer, director, or principal shareholder, or by an entity in which such persons have more than a 10 percent interest (12 CFR 2.3(c)).
- when an affiliate receives credit life insurance income, the bank receives reimbursement consistent with the use of its premises, personnel, and goodwill and that reimbursement is equal to at least 20 percent of the affiliate’s net income attributable to the bank’s credit life insurance sales (12 CFR 2.5(b)).

Note: Directors, officers, and other persons having the power to direct the management or policies of a federal savings association are prohibited from receiving, directly or indirectly, any commission, fee, or other compensation in connection with the procurement of any loan made by the savings association or its subsidiary (12 CFR 160.130).

22. If insiders receive payment of commissions or fees from the bank derived from services they or their related interests provide to bank customers, determine whether
- the insiders are directly or indirectly involved in the approval of a loan or other transaction at the bank for which they are receiving commissions or fees.
 - insiders who receive payment of commissions or fees directly or indirectly related to a loan or other bank transaction in which they have an interest have fully disclosed their interest and abstained from participating in the approval of that transaction.

Note: Directors, officers, and other persons having the power to direct the management or policies of a federal savings association are prohibited from receiving, directly or indirectly, any commission, fee, or other compensation in connection with the procurement of any loan made by the savings association or its subsidiary (12 CFR 160.130).

23. Determine whether any management official of the bank or its holding company or affiliates of the holding company is also a management official of an unaffiliated depository institution or depository institution holding company and evaluate whether the relationship complies with the Depository Institution Management Interlocks Act (12 USC 3201 and 12 CFR 26 and 196).
24. Determine whether the purchase or sale of assets to insiders and their related interests was in compliance with 12 USC 1828(z) and was reported to the board, and the bank obtained an independent appraisal of the asset.

25. Determine whether the use of bank property by insiders and their related interests was reported to the board, a determination was made as to reasonableness of such use, tax implications were evaluated, the bank's tax accountant was consulted with regard to the use of the property, and it is in compliance with bank policy.
26. Determine whether any payments to insiders have been reported to the board and an independent assessment of the value of services has been performed in relation to the bank's need for them.
27. Determine whether reimbursement of personal expenses to insiders is of a legitimate nature, is legal, is reasonable, and, when necessary, is reported to the board. Examiners should consider testing vouchers and reimbursable/payable transactions if controls are weak, and should consider tracing loan funds if suspicious loans or activities are identified.
28. For federal savings associations, determine whether employment contracts with association officers (and other employees) have been approved by the board and are entered into in accordance with the requirements of 12 CFR 163.39.

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Quality of Risk Management

Conclusion: The quality of risk management is
(strong, satisfactory, or weak).

The conclusion on risk management considers all risks associated with insider activities.

Policies

Policies are statements of actions adopted by a bank to pursue certain objectives. Policies often set standards (on risk tolerances, for example) and should be consistent with the bank's underlying mission, values, and principles. A policy review should always be triggered when the bank's objectives or standards change.

Objective: To determine whether the bank's insider policies adequately address both the existence and appearance of conflicts of interest, breaches of fiduciary duty and potential violations of law, and arm's-length transactions regarding insider activities.

1. Review the insider policies for standards governing
 - the definition of "insider" for regulatory and other purposes (for certain transactions and activities, insider may be broadly defined to include all employees).
 - disclosure to the board of actual or potential conflicts of interest.
 - abstention by insiders from the deliberations of and approval process on any transaction in which the insider may benefit directly or indirectly from the decision.
 - officers who may enter into insider transactions on the bank's behalf.
 - self-dealing and corporate opportunity.
 - use of company assets.
2. Determine whether the policies appropriately address disclosures by insiders
 - of any interest in the business of a borrower or other bank customer.
 - of any interest in the companies that are supplying goods or services to the bank or doing business on behalf of the bank.
 - of transactions with the bank, including payment to or receipt from the bank of fees or commissions.
 - of related interests as required in 12 CFR 215.8.

3. Determine whether the policies clearly communicate the circumstances and conditions under which
 - the bank may enter into transactions with insiders or their related interests.
 - the bank makes the use of its facilities, real or personal property, or personnel available to insiders.
4. Assess whether the policies adequately address prohibitions that preclude insiders from
 - soliciting anything of value from anyone in return for any business service or confidential information of the bank.
 - accepting anything of value other than their bona fide salary, wages, fees, or other compensation paid in the usual course of business by their employer, from anyone in connection with the business of the bank, either before or after a transaction is discussed or consummated.
 - accepting gifts, bequests, or other items of value from bank customers or other persons with business dealings with the bank.
 - using insider information in securities transactions.
5. Review policy requirements for arm's-length transactions
 - with insiders or their related interests.
 - with businesses with which the bank deals if the business is one in which an insider has an interest.
6. Determine whether the policies adequately address the consequences of breaches of fiduciary duty, unethical conduct, violations of law, or suspected criminal activity and contain effective internal reporting mechanisms as well as suspicious activity report filing processes.
7. Review policy requirements for documentation of insider transactions.
8. Ensure the bank periodically reviews its insider policies to reflect any changes in laws or regulations. Determine whether
 - insiders have copies of the document and have signed an acknowledgement form.
 - insiders are advised of their responsibilities.
 - the bank provides training updates.

Processes

Processes are the procedures, programs, and practices that impose order on a bank's pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are consistent with the underlying policies and are governed by appropriate checks and balances (such as internal controls).

Objective: To determine that the bank’s operating procedures are adequate to ensure compliance with laws and regulations and board-established policies regarding insider activities.

1. Review bank management information systems and determine whether they
 - can provide accurate data on insiders and their related interests.
 - can provide accurate data on extensions of credit to insiders.
 - can ensure proper monitoring of, and compliance with, restrictions on extensions of credit to insiders (see 12 CFR 215.8 for record-keeping requirements and 12 CFR 215.4 and 12 CFR 215.5 for restrictions).
 - require that records of publicly requested disclosures of information be retained for two years from the date of the request (12 CFR 215.9(c)).
2. Determine whether the bank has established communication channels outside the normal chain of command through which employees can seek advice on ethics or compliance questions or report instances of suspected insider abuse.
3. Determine whether the bank’s employment practices include performing periodic background checks on insiders.
4. Determine whether insider-related reports are being reviewed by the board and management.

Personnel

Personnel are the bank staff and managers who execute or oversee processes. Personnel should be qualified and competent and should perform appropriately. They should understand the bank’s mission, values, principles, policies, and processes. Banks should design compensation programs to attract, develop, and retain qualified personnel. In addition, compensation programs should be structured in a manner that encourages strong risk management practices.

Objective: To ensure that bank personnel are aware of the requirements of laws and regulations as well as the importance of avoiding even the appearance of impropriety regarding insider activities.

1. Determine through discussion with compliance and audit personnel their knowledge with regard to laws and regulations addressing insider activities. Review
 - scope of the compliance or audit review program.
 - compliance or audit review findings.

2. Determine whether management ensures personnel are aware of regulatory requirements regarding insider activities.

- Has the bank notified each of its insiders of the record-keeping requirements of 12 CFR 215.8?
- Has the bank established an ongoing program to educate and raise the awareness of all bank insiders and employees regarding its insider policies?
- Has the bank established a confidential process by which personnel may bring potential conflicts of interest or improper situations to the attention of the board and management?
- Has management provided training to personnel regarding regulatory and bank-established policy requirements, including training for regulatory and policy changes and updates, at least annually?
- Do the bank's written insider policies require affected personnel to acknowledge reading the policy including updates, and abiding by their terms?

Control Systems

Control systems are the functions (such as internal and external audits, risk review, and quality assurance) and information systems that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes. Control functions should have clear reporting lines, adequate resources, and appropriate authority. Management information systems should provide timely, accurate, and relevant feedback.

Objective: To ensure that the board has established effective control systems that enable management to comply with laws, regulations, and policies as well as safe and sound banking practices regarding insider activities. These controls should be set up in such a manner as to also be effective in preventing anyone from overruling them.

1. Consult with examiners reviewing the bank's internal and external audit, compliance, or internal loan review functions, and review audit findings or work papers as they relate to existing and proposed insider transactions. Determine whether
 - the function is adequate in terms of
 - independence.
 - scope (e.g., testing for compliance with laws and regulations).
 - coverage (e.g., includes review of income received from and fees paid to insiders and their related interests).
 - frequency of review.
 - procedures.
 - bank management and the board of directors take timely corrective action to address deficiencies noted by the audit, compliance, or internal loan review functions.

2. Determine whether the bank, through the audit department or other independent source, reviews and reports to the board of directors or committee
 - existing transactions between insiders for compliance with the bank's conflicts of interest policy.
 - proposed transactions, or modifications of existing relationships, between the bank and any of its insiders and their interests.
 - insider transactions for compliance with laws, rules, and regulations including breaches of fiduciary duty or unethical conduct.
 - testing performed to ensure the completeness and accuracy of insider reporting.
 - whether the bank accurately calculates unimpaired capital and unimpaired surplus for Regulation O purposes. (This should be done in conjunction with the examiner reviewing capital.)
3. Determine whether a process has been implemented to prevent anyone from overriding the control systems, the systems are checked periodically to ensure that they have not been compromised by anyone, and the systems have been tested.

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Conclusions

Conclusion: The aggregate level of each associated risk is
(low, moderate, or high).

The direction of each associated risk is
(increasing, stable, or decreasing).

Objective: To determine, document, and communicate overall findings and conclusions regarding the examination of insider activities.

1. Discuss preliminary examination findings and conclusions with the examiner-in-charge, including
 - quantity of associated risks (reputation, credit, compliance, operational, and liquidity).
 - aggregate level and direction of associated risks.
 - quality of risk management and potential impact on “M” rating.
 - overall risk of insider activities.
 - violations and other concerns.

| Summary of Risks Associated With Insider Activities | | | | |
|---|---|--|--|---|
| Risk category | Quantity of risk (Low, moderate, high) | Quality of risk management (Weak, satisfactory, strong) | Aggregate level of risk (Low, moderate, high) | Direction of risk (Increasing, stable, decreasing) |
| Credit | | | | |
| Liquidity | | | | |
| Operational | | | | |
| Compliance | | | | |
| Reputation | | | | |

2. If safety and soundness concerns remain unresolved, and such concerns may have a material adverse effect on the bank, further expand the scope of the examination by completing verification procedures.
3. Discuss examination findings with bank management and, as appropriate, the board of directors, including violations, recommendations, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.
4. Compose conclusion comments, highlighting any issues that should be included in the report of examination. If necessary, compose a Matters Requiring Attention comment.

5. Advise appropriate OCC offices of any borrowings in this bank by insiders of another bank (12 USC 1972(2)). Also advise the OCC district office of similar situations that may affect state banks.
6. Update the OCC's information system and any applicable report of examination schedules or tables.
7. Prepare a memorandum with any recommendations regarding what the OCC should do in the future to effectively supervise insider activities at banks.
8. Update, organize, and reference work papers in accordance with OCC policy.
9. Ensure any paper or electronic media that contain sensitive bank or customer information are appropriately disposed of or secured.

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Verification Procedures

Verification procedures are used to verify the existence of assets and liabilities, or test the reliability of financial records. Examiners generally do not perform verification procedures as part of a typical examination. Rather, verification procedures are performed when substantive safety and soundness concerns are identified that are not mitigated by the bank's risk management systems and internal controls.

1. Review the integrity of controls over software used to generate insider activity reports.
2. Using appropriate sampling techniques, select a sample of extensions of credit (as defined in 12 CFR 215.3, including loans, commitments, overdrafts, securities repurchase agreements, advances of unearned salary) to directors, executive officers, principal shareholders, and their related interests.
 - a. Determine if such extensions of credit are properly coded and reflected on the reports.
 - b. Determine that each loan file contains documentation supporting the loan's terms and conditions and compliance with 12 CFR 215.
 - c. Prepare confirmation forms to insiders. Confirmations should include
 - the nature of the extension of credit.
 - complete name and legal form (individual, sole proprietorship, general partnership, limited partnership, limited liability company, or corporation) of obligor, co-maker, endorser, and guarantor as applicable.
 - name of director, officer, or principal shareholder related to the obligor.
 - nature of obligation (signer on note, guarantor, general partner, etc.).
 - original date, amount, and purpose of the loan or commitment or other extension of credit.
 - current balance.
 - terms, including interest rate, maturity date, and any collateral.
 - d. After a reasonable period of time, mail second requests, if necessary.
 - e. Follow up on any "no replies" or exceptions.
 - f. Review payment history and compare with the terms of the extension of credit, investigating any differences.
 - g. Test interest rate and accrual calculations and compare with the general ledger.
 - h. Look for any extensions of time or renewals and determine if they are consistent with loan policy and are reported to the board.

- i. Determine that required board approvals and signatures of approving officer(s) were obtained.
 - j. Determine whether the extension of credit is supported by a promissory note that is signed and appears to be genuine.
 - k. For collateralized extensions of credit,
 - determine if collateral held is consistent with the collateral register and loan terms.
 - list and investigate all collateral exceptions.
 - determine if any collateral held by outside custodians is consistent with loan terms and conditions.
 - confirm any collateral held outside of the bank.
3. Test vouchers and reimbursable/payable transactions for payment of personal expenses for insiders to ensure the expenses are legitimate and in conformance with insider policies.

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Appendixes

Appendix A: Regulation O Record-Keeping and Reporting Requirements

The following is an aid to understanding the various record-keeping and reporting requirements for insider transactions. This is only a guide and is not a substitute for reading and studying 12 USC 375a, 375b and Regulation O (12 CFR 215).

Definitions

An **“executive officer”** is a person who participates (other than in the capacity of a director) or who has the authority to participate in major policymaking functions whether or not the person has an official title (12 CFR 215.2(e)(1)). Persons holding certain titles are presumed to be executive officers unless properly excluded by a bank’s board of directors in accordance with Regulation O’s specified procedures and they do not actually engage in major policymaking functions of the bank. In addition, for all purposes in Regulation O except 12 CFR 215.5, “executive officer” includes an executive officer of an affiliate (a company or any subsidiary of a company of which the member bank is a subsidiary). Regulation O permits an exemption for officers of affiliates if certain procedural and substantive requirements are met (12 CFR 215.2(e)(2)). Officers of bank subsidiaries are generally not considered executive officers of their parent bank for purposes of Regulation O unless they actually engage in major policymaking functions of the bank.

A **“principal shareholder”** is a person (not a company of which the bank is a subsidiary) who directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities. Shares owned or controlled by a member of an individual’s immediate family are considered as being held by the individual (12 CFR 215.2(m)).

A **“related interest”** of a person is (1) a company controlled by that person, or (2) a political or campaign committee that is controlled by that person or the funds or services of which will benefit that person (12 CFR 215.2(n)).

A **“director”** is any person designated as a director regardless of compensation, but does not include advisory directors who provide only general policy advice to the board, are not authorized to vote on matters before the board, and are not elected by shareholders. Regulation O permits an exemption for directors of affiliates if certain procedural and substantive requirements are met (12 CFR 215.2(d)(2)).

Summary of Requirements

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|----------------|--------------------|
| Section | Requirement |
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|--------------|--------------------------------|
| 215.8 | Records of Member Banks |
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A bank must maintain records of all extensions of credit to insiders of the bank and of the bank's affiliates, including the amount and terms of such extensions of credit. The bank must identify, through an annual survey, all insiders of the bank and of the bank's affiliates. Alternative methods are permitted for identifying insiders of the bank's affiliates.

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| 215.9 | Disclosure of Credit From Member Banks to Executive Officers and Principal Shareholders |
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Upon written request from the public, a bank shall make available the names of its executive officers and principal shareholders to whom, or to whose related interests, the bank has outstanding as of the last quarter-end an extension of credit that, when aggregated with all other extensions of credit to that person and the related interests of that person, equals or exceeds 5 percent of unimpaired capital and unimpaired surplus, or \$500,000, whichever is less. No disclosure is required if the total of all extensions of credit to an executive officer or principal shareholder does not exceed \$25,000. Specific amounts of individual extensions of credit are not required to be disclosed. Records of such requests must be maintained for two years.

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| 215.10 | Reporting Requirement for Credit Secured by Certain Bank Stock |
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Executive officers or directors of a bank whose shares are not publicly traded must annually report to the board the outstanding amount of any credit extended to them that is secured by shares of the bank.

Appendix B: Acceptance of Items of Value

Under certain circumstances, a bank insider may accept something of value from someone doing or seeking to do business with the bank. The bank's written policies should establish guidelines regarding the acceptance of gifts and only authorize an insider to accept an item if it meets certain conditions, such as

- it is offered based on a family or personal relationship, independent of any bank business.
- it is available to the general public on the same conditions.
- it would be paid for by the bank as a reasonable business expense if not paid for by another party.

Under these circumstances, there is generally no risk to the bank. Common examples of these types of items include a business lunch or holiday season gift. The bank's written policies may also permit acceptance of the following:

- **Meals, gratuities, amenities, or favors based on obvious family or personal relationships.** The circumstances should make it clear that the relationship, rather than the business of the bank, is the motivating factor.
- **Meals, refreshments, travel arrangements, accommodations, or entertainment of reasonable value in the course of a meeting or other occasion.** In this case, the occasion must be for a bona fide business discussion or part of an effort to foster better business relations, and the expense should be one the bank would pay as a reasonable business expense if not being paid by another party. The bank may wish to establish a dollar limit on arrangements accepted under this exception.
- **Advertising or promotional material of reasonable value, including pens, pencils, notepads, key chains, calendars, and similar items.**
- **Discounts or rebates on merchandise or services that are available to other customers under similar circumstances.**
- **Gifts of reasonable value related to commonly recognized events or occasions such as a promotion, new job, wedding, retirement, Christmas, or bar or bat mitzvah.** The bank may wish to establish a dollar limit on the value of such gifts.
- **Civic, charitable, educational, or religious organization awards for recognition of service and accomplishment.** The bank may wish to establish a dollar limit on such awards.

- **Loans from other banks or financial institutions, when made on customary terms for the purpose of financing proper and usual activities of bank insiders.** Insiders must ensure that financial arrangements are not contingent on the bank either accepting or offering any other service. Insiders must also ensure that they do not receive preferential loans from correspondent banks (and banks must ensure that they do not make preferential loans to insiders of correspondent banks).
- **Other benefits or items of value, when approved in writing, case by case.** Approvals should be based on a full, written disclosure of all relevant facts and should be consistent with the bank bribery statute (18 USC 215).

The OCC has not set a dollar limit on the value of items that may be accepted by insiders. Reasonable standards for one part of the country might appear lavish elsewhere. Each bank should establish dollar limits on the benefits that insiders are allowed to accept. In setting those limits, a bank should observe the highest ethical standards.

A bank's insider policies should require an insider who is offered, or who receives, something of greater value than is authorized to disclose that fact to an appropriately designated official of the bank. The bank should maintain written reports of such disclosures, in whatever format the bank deems appropriate.

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References

Auditing Requirements

| | |
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| Regulations | 12 CFR 363, “Annual Independent Audit and Reporting Requirements” |
| Comptroller’s Handbook | “Community Bank Supervision” (<i>Examination Process</i> series) “Internal and External Audits” (<i>Safety and Soundness</i> series, “Management” category) |
| OCC Issuances | “Large Bank Supervision” (<i>Examination Process</i> series) OCC Bulletin 2003-12, “Interagency Policy Statement on Internal Audit and Internal Audit Outsourcing,” revised guidance (March 17, 2003) OCC Bulletin 1999-37, “Interagency Policy Statement on External Auditing Programs” (October 7, 1999) |

Compensation of Insiders

| | |
|----------------------|---|
| Laws | 12 USC 1831p-1, “Safety and Soundness Standards” 12 USC 1841, “Enhanced Compensation Structure Reporting” |
| Regulations | 12 CFR 30 and 170, “Safety and Soundness Standards” 12 CFR 163.39, “Employment Contracts” 12 CFR 163.151(b), “Management and Financial Policies” |
| OCC Issuances | OCC Bulletin 2010-24, “Interagency Guidance on Sound Incentive Compensation Policies” (June 30, 2010) OCC Bulletin 2004-56, “Interagency Statement on the Purchase and Risk Management of Life Insurance” (December 7, 2004) |

Conflicts of Interest

| | |
|--------------------|---|
| Regulations | 12 CFR 163.200, “Conflicts of Interest” |
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Correspondent Banks

| | |
|-------------|---|
| Laws | 12 USC 1972(2), “Certain Tying Arrangements Prohibited; Correspondent Accounts” |
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Credit Life Insurance

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| Regulations | 12 CFR 2, “Sale of Credit Life Insurance” |
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Employment Contracts

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|--------------------|---------------------------------------|
| Regulations | 12 CFR 163.39, “Employment Contracts” |
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Extensions of Credit to Executive Officers, Directors, and Principal Shareholders

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| Laws | 12 USC 1468(b), “Extensions of Credit to Executive Officers, Directors, and Principal Shareholders” 12 USC 375a, “Loans to Executive Officers of Bank” 12 USC 375b, “Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Member Banks” |
| Regulations | 12 CFR 31, “Extensions of Credit to Insiders and Transactions With Affiliates” 12 CFR 163.43, “Loans by Savings Associations to Their Executive Officers, Directors and Principal Shareholders” 12 CFR 215, “Regulation O” |
| Comptroller’s Handbook | “Related Organizations” (<i>Safety and Soundness</i> series, “Management” category) |
| OCC Issuances | Interpretive Letter 1024 (March 21, 2005) |

Golden Parachute and Indemnification Payments

| | |
|--------------------|--|
| Laws | 12 USC 1828(k), “Authority to Regulate or Prohibit Certain Forms of Benefits to Institution-Affiliated Parties” |
| Regulations | 12 CFR 350, “Golden Parachute and Indemnification Payments” 12 CFR 7.201, “Indemnification of Institution-Affiliated Parties” 12 CFR 145.121, “Indemnification of Directors, Officers and Employees” |

Interest Paid to Directors and Others

| | |
|-------------|--|
| Laws | 12 USC 376, “Rate of Interest Paid to Directors, etc.” |
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Liability of Directors and Officers of Member Banks

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| Laws | 12 USC 503, “Liability of Directors and Officers of Member Banks” 12 USC 93, “Violation of Provisions; Forfeiture of Franchise; Personal Liability of Directors; Civil Money Penalty” 12 USC 1818 |
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Management Interlocks

| | |
|--------------------|--|
| Laws | 12 UCS 3202-3203, “Depository Institution Management Interlocks” |
| Regulations | 12 CFR 26 and 12 CFR 196, “Management Official Interlocks” |

Purchases from and Sales to Insiders

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|-------------|--|
| Laws | 12 USC 1828(z), “General Prohibition on Asset Sales” |
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Prompt Corrective Action

| | |
|--------------------|--|
| Laws | 12 USC 1831o, “Prompt Corrective Action” |
| Regulations | 12 CFR 6, “Prompt Corrective Action” |
| | 12 CFR 165, “Prompt Corrective Action” |

Receipt of Fees for Procuring Loans

| | |
|--------------------|---|
| Laws | 18 USC 215, “Receipt of Commissions or Gifts for Procuring Loans” |
| Regulations | 12 CFR 160.180, “Prohibition on Loan Procurement Fees” |

Role of a National Bank Director

| | |
|----------------------|---|
| OCC Issuances | <i>The Director’s Book</i> , October 2010 |
|----------------------|---|

Self-Dealing (Fiduciary Accounts)

| | |
|-------------------------------|---|
| Regulations | 12 CFR 9.12, “Self-dealing and Conflicts of Interest” |
| | 12 CFR 150.350, “Restrictions on Self-Dealing” |
| Comptroller’s Handbook | “Conflicts of Interest” (<i>Asset Management</i> series) |

Suspicious Activity Reporting

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|--------------------|---|
| Regulations | 12 CFR 21.11, “Suspicious Activity Report” |
| | 12 CFR 163.180, “Suspicious Activity Reports” |

Usurpation of Corporate Opportunity

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|--------------------|---|
| Regulations | 12 CFR 163.201, “Corporate Opportunity” |
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