



**Reg O & Reg W
Not to Be Overlooked!**



**Presented by
Susan A. Rich**
EVP/Chief Compliance Officer



DISCLOSURE

The views and opinions expressed in this presentation are those of the presenter and do not reflect the position of any company or organization.



Have a great
compliance filled day!!!

INFO ON PRESENTER




- 50 years of great compliance filled days
- Former Commissioned National Bank Examiner
- In Florida since 1988
- Passionate about Compliance






- Introduction / Overview
- Regulation O
- Regulation W
- Q&A





OVERVIEW




Reg O governs credit to insiders, their holding companies, and insiders. Reg W covers transactions between a bank and its affiliates.

Reg O passed in 1997 allegedly due to Bert Lance's insider deals at Georgia banks.

Reg W passed in 2002 to implement Sections 23A and 23B of the Federal Reserve Act intended to protect banks from suffering losses in transactions with their own affiliates.



OVERVIEW



Reg O was designed to ensure insiders are not given preferential treatment and to safeguard against insider abuse. Reg W limits a bank's risk exposure from affiliate transactions and is a safety and soundness rule intended to protect the bank and FDIC against loss caused by transactions between the insured bank and its affiliates.

Reg W is an extension of the protections against insider abuse found in Reg O.

Rules are very technical.



REGULATION O



Insider abuse regulation that draws significant regulatory scrutiny

Governs lending to insiders, their holding companies, and affiliates

Detects and prevents abusive insider dealings

Limits the amount and terms of credit extended to insiders, individually and as a group

FOUR CATEGORIES OF INSIDERS



1 - Director

Directors of the bank or its holding company whether or not they receive compensation

Directors of a bank subsidiary are *not* insiders unless they participate in major policymaking

Advisory directors are *not* considered insiders if they just give general advice, and are *not* elected by shareholders; and are *not* authorized to vote on Board matters

FOUR CATEGORIES OF INSIDERS



2 – Executive Officer

Unless specifically excluded by Board bylaws or resolution, these titles are presumed to be executive officers: Chairman, President, Vice President, Cashier, Secretary, and Treasurer

Regulators will consider a person who sets major policies as an executive officer no matter their actual title.

Best Practice for the Board to officially name the executive officers.

FOUR CATEGORIES OF INSIDERS



3 – Related Interest:

Any company controlled by an insider

Includes political campaign committees for an insider's benefit – excludes banks and Federal & state government entities

Control means the insider

- (a) owns or controls >25% of voting stock;
- (b) owns more than 10% of voting stock and serves as director/executive officer of the related interest;
- (c) controls the election of most (majority) of the directors of the related interest; OR
- (d) influences management practices or policies of the related interest.

FOUR CATEGORIES OF INSIDERS



4 – Shareholder

- Principal shareholders own, control, or have the power to vote more than 10% of a bank's voting stock
- The 10% applies whether the shareholders act directly or indirectly, or independently or with others to reach the 10% threshold
- Shares owned or controlled by a member of an insider's immediate family are considered held by the insider. Immediate family includes spouse, minor children, and children living in the insider's home (including adults)

EXTENSIONS OF CREDIT



An extension of credit is broadly defined in Regulation O as any transaction by which a person becomes obligated to pay a bank money.

- Examples include new, renewed or increased loan or line of credit; standby letters of credit; cash advances or advances to pay ODs; any advance of unearned salary or other compensation extended for over 30 days; any debt acquired if insider is liable as maker, drawer, endorser, guarantor, or surety; and a purchase made under a repurchase agreement of securities, other assets, or obligations

EXTENSIONS OF CREDIT



The following are NOT considered to be extensions of credit.

Examples include advances on accrued salary or other compensation; travel or other expense advances for expenses incurred for the bank; credit card when the amount is \$15,000 or less, if made on same terms as extended to the public; debts assumed through a consolidation or merger; or debts assumed through foreclosure (so long as bank does not hold debt for over three years)



PROHIBITIONS



The terms and conditions for loans to insiders must be made on the same terms and conditions as loans made to the public. Not preferential!

- *Interest rates must NOT be lower than rates offered to the bank's best clients.*
- *Underwriting criteria must be prudent; collateral & repayment terms not more favorable; normal risk*
- *On any credit that would benefit an insider, they must abstain from voting at committee or board meetings*



EXCEPTIONS



When a bank has an employee benefit program such as discounted-rate loan programs, insiders can participate.

- For example, if Best Bank provides all bank employees with a 1% discount on HELOCs, then insiders can receive the same 1% discount. However, insiders cannot receive a larger discount when all other employees are granted loans with only a 1% discount.

LENDING LIMITATIONS



Reg O sets limits on the total amount a bank can lend to its insiders to protect the bank's financial stability.

There are both individual and aggregate lending limitations.

Loans extended to an insider of the bank or one of its affiliates + all that person's related interests are added together to determine if the threshold is reached.

LENDING LIMITATIONS



Individual Limits = 15% of bank's unimpaired capital & surplus for loans not fully secured by readily marketable collateral and 25% of unimpaired capital & surplus for loans fully secured by readily marketable collateral.

Aggregate Limits = combined total of credit to all insiders added together CANNOT exceed the bank's unimpaired capital & surplus

LENDING LIMITATIONS



Before a loan is granted to an insider, approval **MUST** be obtained from the Board for loans over \$25,000 or 5% of the bank's unimpaired capital & surplus.

Any board member with an interest in the loan must abstain from the voting.

Board approval must be obtained for all subsequent loans when the total outstanding amount made to the insider & related interests exceed \$500,000.

For additional advances under lines of credit up to the amount originally approved, prior board approval is not required if the advance is made within 14 months from the original approval date.



BEST PRACTICES

When underwriting an insider loan, provide 3 examples of similar credit with terms and conditions to document that preferential terms for the credit are not being granted.

Insider should leave the room when their loan is discussed, and it should be documented in the minutes when they leave and return.

Florida State law requires all directors be invited to join the meeting to discuss and vote on insider loans; conference calls are acceptable; email notification and vote without group meeting is not acceptable.

The Board should designate executive officers.

LOANS TO EXECUTIVE OFFICERS



More safeguards are needed to avoid the appearance or impropriety or abusive practices.

Additional rules exist for loans to executive officers because these insiders could impact the bank's lending decisions and financial performance.

In a situation where there are loans to related interests of executive officers such as being a partner with a majority interest, then loans to that partnership are considered the same as if they were made directly to the executive officer.

LOANS TO EXECUTIVE OFFICERS



Loans made to executive officers MUST be:

Preceded by submission of a current and detailed financial statement

Made on terms NOT more favorable than loans to the public

Payable on demand if officer borrows from other banks in an amount greater than officer is legally allowed to borrow from own bank – *best practice to include due on demand clause*

Promptly report to the board – *best practice at next regular meeting*

LOANS TO EXECUTIVE OFFICERS



Maximum amount a bank can lend to any executive officer is \$25,000 OR 2.5% of bank's unimpaired capital & surplus; overall limit is \$100,000.

Loans exempt from this maximum limit include credit fully secured by a deposit account at the bank OR loans fully secured by US government or any government agency guaranteed obligations

EXCEPTIONS FOR LOANS TO EXECUTIVE OFFICERS



Exceptions apply for certain types of credit extended to executive officers. *Note: these exceptions do NOT apply to directors or principal shareholders.*

- Loans secured by a segregated deposit account at the bank OR fully secured by obligations guaranteed by the US government
- Credit for purpose of purchasing, building, improving, or maintaining their residence (must be secured by a first lien on the home)
- Loans for financing the education of the children of the executive officer

SMALL BANK EXCEPTION FOR LOANS TO EXECUTIVE OFFICERS



The aggregate lending to insiders of banks with total deposits under \$100 million is increased to 200% of capital and unimpaired surplus.

This exception only allowed if the bank:

- Has a total CAMELS rating of 1 or 2
- Meets capital standards
- Has a board resolution stating the higher aggregate lending level is safe, sound and needed to ensure the availability of credit to smaller communities and to attract qualified directors.



LENDING LIMITATIONS FOR OVERDRAFTS



Do's

Inadvertent overdrafts of \$1,000 or less can be paid if the account is not overdrawn for over 5 days, AND the insider is charged the same fee as any other client would be charge in similar circumstances

Don'ts

Overdrafts for directors and executive officers of the bank or its affiliates cannot be paid unless the insider has a written overdraft protection interest-bearing line of credit agreement in place.



RECORDKEEPING REQUIREMENTS



Regulation O requires:

Maintaining records that identify all insiders of the bank and

Keeping a list of credit to insiders that includes the amount and terms of each extension.

Note: This information is requested at Safety & Soundness Exams.



LIABILITY FOR NONCOMPLIANCE

Reg O violations result in severe CMPs and increase in proportion to the amount of loss to the bank or gain to the person charged.

Continuing violations can result in CMPs that exceed \$2 million per day.

CMPs may be imposed on the bank, the board of directors, and participating insiders.

Persons involved may be suspended or permanently barred from the banking industry.





REGULATION W



Implements Section 23A and Section 23B of the Federal Reserve Act

Primary purpose is to limit risks from transactions with affiliates and limit ability of a bank to transfer risk to affiliates by:

- Limits size of transactions to % of bank's capital
- Prohibits transactions of low-quality assets
- Requires terms be safe & sound and on market terms & conditions
- Requires adequate marketable collateral for credit to affiliates or guarantees on their behalf



AFFILIATES



Any company under the common control with the bank such as an insurance company owned by parent co.

Any company that owns or controls 25% or more of the bank such as a parent company

Any company where most of its directors consists of most of persons holding any office with a bank or any company that controls the bank

Any company that's a subsidiary of the bank engaged in activities not permissible for bank directly

Any registered investment company that the bank or its affiliates serve as investment advisor



NOT AFFILIATES



Any company for the purpose of holding bank premises

Any company solely engaged in safe deposit business

A bank subsidiary that engages in activities allowed for the bank directly such as a consumer loan finance company

Any company for the purpose of holding debt of the United States (U.S.) or its agencies or obligations fully guaranteed by the U.S. or its agencies

Any company when control results from exercise of rights from an authentic debt previously contracted (limited to a period of 2 years from the date of the exercise of such rights)



COVERED TRANSACTIONS



1) Any transaction resulting in an affiliate being obligated to pay money or its equivalent to a bank

Examples:

- Sale of federal funds to an affiliate
- An extension of credit to an affiliate
- Increasing the amount, extending the maturity, or changing interest rate or other term of an extension of credit to an affiliate
- A lease that is the equivalent of an extension of credit to an affiliate



COVERED TRANSACTIONS



2) Any transaction when the bank is exposed to an affiliate's credit or investment risk

Examples:

- Bank's purchase of, or investment in, a security issued by an affiliate, including an asset subject to recourse or repurchase agreement
- Bank's purchase of an asset from an affiliate, including an asset subject to repurchase or recourse
- Bank's acceptance of a security issued by an affiliate as collateral for an extension of credit to any company or person



EXEMPTIONS



- *Dividends paid to a parent holding company*
- *Purchase of loans on a non-recourse basis*
- *Transactions secured by U.S. government securities and cash*
- *Transactions between sister FDIC-insured banks. When 2 banks are 80% or more owned by a parent company or one bank owns 80% or more of the other banks shares, the banks are considered sister banks*



REQUIREMENTS



Terms and conditions are required to be consistent with safe & sound banking practices for all covered transactions between a bank and its affiliates

A bank is prohibited from purchasing low-quality assets from affiliates unless the bank committed itself to purchase the asset before the asset was acquired by the affiliate

Note: a low-quality asset includes (1) assets classified by examiners or internally as specially mentioned, substandard, doubtful, or loss; (2) assets on nonaccrual status; (3) a renegotiated asset due to declining financial condition; (4) principal or interest payments are more than 30 days delinquent



REQUIREMENTS



Terms and conditions for transactions between a bank and its affiliates must be at fair market value and on an arm's length basis to prevent preferential treatment that could result in unsafe or unsound practices

In addition to covered transactions with an affiliate, other transactions that are subject to fair market terms include any transaction where an affiliate is an agent, broker, or is paid a fee for services to the bank; the sale of a security or other asset to an affiliate; any transaction if an affiliate has a financial interest in a nonaffiliate or participant in the transaction or series of transactions.

Note: A bank transaction with any person is deemed to be with an affiliate if any proceeds are used for the benefit of the affiliate



MARKET TERM EXEMPTIONS

- *Sister FDIC-insured bank transactions*
- *Correspondent deposits*
- *Purchasing securities of a servicing affiliate*
- *Loan purchases from an affiliated deposit institution*
- *Purchasing certain liquid assets*
- *Asset purchases by a newly formed bank or that are approved under the Bank Merger Act*
- *Transactions with a deposit institution if bank controls 80% or more of voting securities or the deposit institution controls 80% or more of voting securities of the bank*
- *Credit for uncollected items*
- *Transactions secured by cash or US government securities*
- *Purchasing a loan subject to a repurchasing agreement*



COLLATERAL REQUIREMENTS



Credit a bank extends to an affiliate or guarantee on behalf of the affiliate must be secured by a perfected first security interest with a minimum market value of:

100% of loan amount when collateral consists of U.S. government obligations or government guaranteed obligations, or notes, drafts, bills of exchange, or banker's acceptances eligible for rediscount or purchase by a Federal Reserve Bank, or a special, designated account at bank for the specific purpose of securing the credit between bank and its affiliate



COLLATERAL REQUIREMENTS



Remember the credit a bank extends to an affiliate or guarantee on behalf of the affiliate must be secured by a perfected first security interest with a minimum market value of:

110% of loan amount required if collateral consists of obligations of a State or subdivision of a State such as a county or city

120% of credit total required if collateral is debt instruments, including loans & other receivables

130% of loan amount required if collateral is stock, leases, or other real or personal property



LIMITATIONS



A bank's Reg W covered transactions with any one affiliate is limited to no more than 10% of a bank's capital & surplus

The combined transactions with all affiliates is limited to no more than 20% of a bank's capital stock & surplus

Note definition: capital stock & surplus is equal to Tier 1 and Tier 2 capital, plus any allowance for losses from loans and leases that are not included in Tier 2 capital.



Develop Organization Chart with a complete list of legal entities

Make a list of all “covered” bank transactions with affiliates

Document compliance

- Be sure limits are not exceeded
- Make sure collateral is properly secured & meets fair market value requirements
- Be sure all terms meet the “market terms” requirements



LIABILITY FOR NONCOMPLIANCE

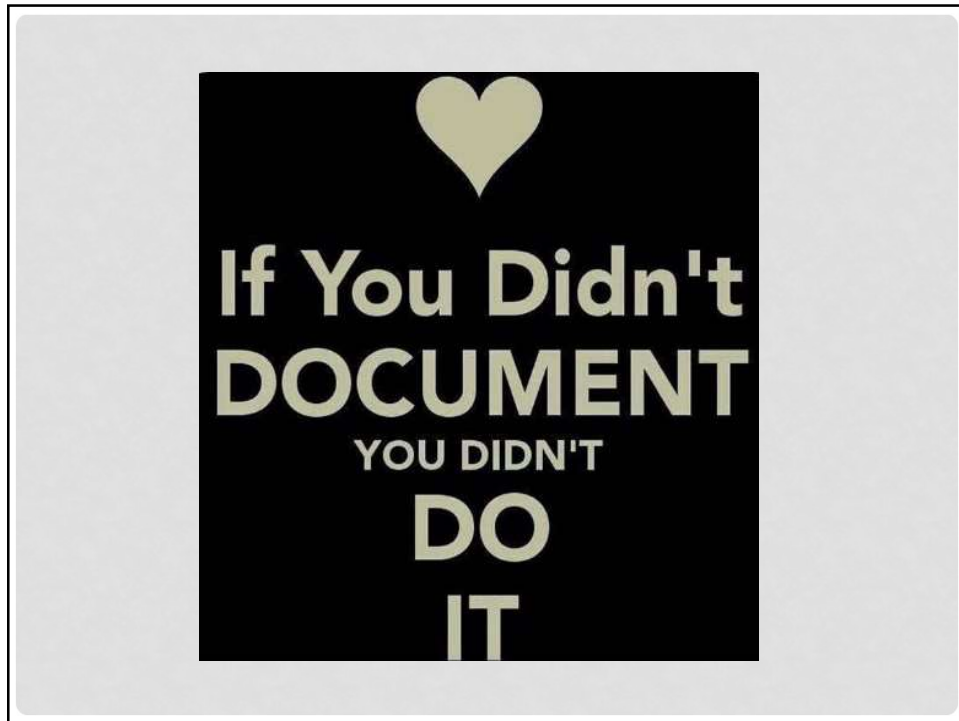
Penalties for Reg W violations can result in substantial Civil Money Penalties.

Depending on the severity of the violation CMPs may exceed \$2 million or 1% of total assets per day (whichever is less).



EXAMS ARE STRESSFUL





EXPECTATIONS

The complex block contains two images side-by-side. The left image shows two yellow directional signs on a black post against a blue sky with white clouds. The top sign points left and has the word "PROACTIVE" written on it. The bottom sign points right and has the word "REACTIVE" written on it. The right image has a green background. It features a white clipboard with a green checkmark on it. To the right of the clipboard, the words "Proactive Compliance" are written in white. A dotted line connects the clipboard to the text.

It takes less time
to do things right
than to explain why
you did it wrong.

~ Henry Wadsworth Longfellow





Resources for Compliance Officers

- BankersOnline (BOL) – free daily briefing
- Ballard Spahr – update emails and free webinars
- BID Daily Newsletter from PCBB – free daily briefing
- American Banker, Financial Brand, Ncontracts, Thomson Reuters, Compliance Week, CBANC, ABA, FBA, Temenos, Bankers Compliance Consulting, Compliance Cohort, ACFCS, BAI, Contact Center Compliance (DNC.com), Verafin, Abrigo, ACAMS, Law360, Community Bankers Association (CBA)



More Resources for Compliance Officers

- Crowe, Deloitte, Withum, Protiviti, Kroll and Wipfli –webinars & emails
- K&L Gates, Buckley, Garris Horn, Mayer Brown and Skadden – free webinars & emails
- CRA Today, findCRA, Kadince, Wolters Kluwer, CRA Hub, EVERFI
- Radical Compliance, OCEG, Green Check Verified, Chainalysis, NYDIG, ActiveComply, Compliance Next, NAVEX Global, GreenBiz, Insider Inc., eOSCAR, Safe Systems, Mitratech, ePay, Gartner
- Alerts from FDIC, OCC, FRB, FinCEN, CFPB, FFIEC, OFAC, FTC, DOJ, Census Bureau, FHLB Atlanta & other government agencies (sign up on their website)

QUESTIONS





THANKS FOR YOUR TIME AND ATTENTION



Susan A. Rich, GRCP, GRCA

Executive Vice President

Chief Compliance Officer/CRA Officer/Audit Liaison



745 Primera Blvd Suite 1011

Lake Mary, FL 32746

Mobile 407.921.3037

www.onefloridabank.com

Member FDIC

*HAVE A GREAT
COMPLIANCE FILLED DAY!!!*

Contact Information

Susan A. Rich

Cell: 407.921.3037

Office: 407.693.0525
srich@onefloridabank.com

LUNCH IS NEXT

