



### Application of Regulation O to Credit Unions

Staff of the Indiana Department of Financial Institutions has developed the following frequently asked questions (FAQs) to assist credit unions in their compliance with Regulation O. These FAQs are staff interpretations and have not been approved by the Members Board. Staff may supplement or revise these FAQs as necessary or appropriate.

Although the language contained in Regulation O uses the term “member banks”, or institutions that are a member of the Federal Reserve system, it is made applicable to Indiana chartered credit unions<sup>1</sup> by I.C. § 28-7-1-17.2.

Regulation O is used throughout this document and is intended to reference 12 C.F.R § 215. Indiana Code § 28-7-1-17.2 is the portion of Indiana law that makes Regulation O applicable to Indiana chartered credit unions.

### Frequently Asked Regulation O Questions

1. **Q:** What provisions of Regulation O apply to Indiana state-chartered credit unions?

**A:** In 2020 the Indiana General Assembly amended I.C. § 28-7-1-17.2, a portion of Indiana’s Credit Union Act, to expressly apply all portions of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215, to Indiana chartered credit unions. Regulation O had always been applicable, but the amendment made it abundantly clear. Restrictions on extensions of credit to supervisory committee members, and to the immediate family members or related interests of supervisory committee members, are required to be treated consistently with restrictions on extensions of credit to directors as imposed by Regulation O.

2. **Q:** What is Regulation O and what constitutes an extension of credit?

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<sup>1</sup> The term financial institution is used throughout this document and is intended to be any Indiana chartered financial institution. If the term credit union is used it is intended to be specifically a credit union and not another financial institution.

**A:** Regulation O<sup>2</sup> is a regulation that places limits and stipulation on the credit extensions a financial institution can offer to insiders<sup>3</sup>. Regulation O defines an “extension of credit” in the broadest terms to prevent circumvention of the intent of the law. 12 C.F.R § 215.3 defines “extension of credit” as making or renewal of any loan, a granting of a line of credit, or an extending of credit in any manner whatsoever, and includes:

1. A purchase under repurchase agreement of securities, other assets, or obligations;
  2. An advance by means of an overdraft, cash item, or otherwise;
  3. Issuance of a standby letter of credit (or other similar arrangement regardless of name or description) or an ineligible acceptance;
  4. An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which an insider may be liable as maker, drawer, endorser, guarantor, or surety;
  5. An increase of an existing indebtedness, but not if the additional funds are advanced by the [financial institution] for its own protection for accrued interest or taxes, insurance, or other expenses incidental to the existing indebtedness;
  6. An advance of unearned salary or other unearned compensation for a period in excess of 30 days;
  7. Any other similar transaction as a result of which a person becomes obligated to pay money (or its equivalent) to a [financial institution], whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.
3. **Q:** What is the difference between an executive officer and an Insider for purposes of Regulation O?

**A:** 12 C.F.R. § 215.2(e)(1) defines executive officer as a person who participates or has authority to participate (other than in the capacity of a director) in major policy making functions of the company or credit union, whether or not: the officer has an official title; the title designates the officer as an assistant; or the officer is serving without salary or other compensation. The chairman of the board, the president, every vice president, the cashier, the secretary, and the treasurer of a company or bank are considered executive

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<sup>2</sup> Regulation O is used throughout this document and is intended to reference 12 C.F.R. § 215. I.C. § 28-7-1-17.2 is the portion of Indiana law that makes Regulation O applicable to Indiana chartered credit union.

<sup>3</sup> Executive officer and insider are used throughout this document and intended to reference an individual of which Regulation O applies. Additionally, note that while all executive officers are insiders, not all insiders are officers.

officers, unless the officer is excluded, by resolution of the board of directors or by the bylaws of the credit union or company, from participating (other than in the capacity of a director) in major policymaking function of the credit union or company, and the officer does not actually participate therein.

An Insider is defined as “an executive officer, director, or principal shareholder, and includes any related interests of such a person.”

All executive officers are Insiders, but not all Insiders are executive officers.

**4. Q:** What are exceptions to the definition of extension of credit for purposes of Regulation O?

**A:** Pursuant to 12 C.F.R. § 215.3(b), an extension of credit does not include the following:

1. An advance against accrued salary or other accrued compensation, or an advance for the payment of authorized travel or other expenses incurred or to be incurred on behalf of the financial institution;
2. A receipt by a financial institution of a check deposited in or delivered to the financial institution in the usual course of business unless it results in the carrying of a cash item for or the granting of an overdraft (other than an inadvertent overdraft in a limited amount that is promptly repaid);
3. An acquisition of a note, draft, bill of exchange, or other evidence of indebtedness through:
  - a. A merger or consolidation of a financial institution or a similar transaction by which a financial institution acquires assets and assumes liabilities of another financial institution or similar organization
  - b. Foreclosure on collateral or similar proceeding for the protection of the financial institution, provided that such indebtedness is not held for a period of more than three years from the date of the acquisition, subject to extension by the appropriate federal banking agency for good cause
4. An endorsement or guarantee for the protection of a financial institution of any loan or other asset previously acquired by the financial institution in good faith or any indebtedness to a financial institution for the purpose of protecting the financial institution against loss or of giving financial assistance to it;
5. Indebtedness of \$15,000 or less arising from a financial institution credit card plan, check credit plan, or similar open-end credit plan, provided:
  - a. The indebtedness does not involve prior individual clearance or approval by the financial institution other than for the purposes of determining

authority to participate in the arrangement and compliance with any dollar limit under the arrangement; and

- b. The indebtedness is incurred under terms that are not more favorable than those offered to the general public
6. Indebtedness of \$5,000 or less arising by reason of an interest-bearing overdraft credit plan;
  7. A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper without recourse (such as financing purchases of goods from a business owned by a director); or
  8. Except for purposes of § 215.5, a loan;
    - a. in which the participation by the Small Business Administration on a deferred basis is 100 percent pursuant to section 1102(a)(1) of Public Law 116—136 (to be codified at 15 U.S.C. § 636(a)(2)(F)) (also known as the Paycheck Protection Program);
    - b. that is made during the period beginning on February 15, 2020, and ending on August 8, 2020; and
    - c. that would not be prohibited by 13 C.F.R. § 120.110(o) or rules or interpretations thereof issued by the Small Business Administration.

Additionally, pursuant to 12 C.F.R. § 215.3(c) non-interest-bearing deposits to the credit of a financial institution are not considered loans, advances, or extensions of credit to the bank of deposit; nor is the giving of immediate credit to a bank upon uncollected items received in the ordinary course of business considered to be a loan, advance or extension of credit to the depositing financial institution.

5. **Q:** A portion of Regulation O requires credit unions to promptly report extensions of credit to its board of directors. How is “promptly” interpreted? Is a loan required to be reported at the next board meeting, or is it sufficient if the loan is included in the next Quarterly Report of Loans to Officials?

**A:** I.C. § 28-7-1-17.3 requires credit unions to report new Regulation O applicable loans in the next quarterly report. For the purposes of Regulation O, as long as the credit union has followed the pre-approval requirements found in 12 C.F.R. § 215.4(b), reporting the loan on the quarterly report will be considered as reporting the loan promptly. Additionally, see question 6 for more information regarding name reporting requirements.

6. **Q:** Are financial institutions required to include insider’s names on the insider indebtedness quarterly report to the board of directors?

**A:** 12 C.F.R. § 215.8(b)(1)-(2) requires financial institutions to identify, through an annual survey, all insiders of the financial institution and to maintain records of all extensions of credit to insiders of the financial institution, including the amount and terms of each such extension of credit. Additionally, prior to extending credit to any insider, 12 C.F.R. § 215.4(b)(1) requires financial institutions to obtain approval by a majority of the board of directors, when the amount of credit, aggregated with the amount of all other extensions of credit to that person and to all related interests of that person, exceed the higher of \$25,000 or 5% of the credit union's unimpaired surplus.

In regards the quarterly report required by I.C. § 28-7-1-17.3, it is the Department's position that the insider's names are not required to be included, as long as the names with the following details have been provided to a supervisory committee, and the report to the board of directors includes: (1) the amount of each indebtedness; and (2) a description of the terms and conditions of each loan, including: (A) the interest rate; (B) the original amount and date of the loan; (C) the maturity date; (D) payment terms; (E) security, if any; and (F) any unusual term or condition of a particular extension of credit. The credit union is also required to comply with all Regulation O record keeping requirements.

7. **Q:** Does I.C. § 28-7-1-17.2(3) also apply to loans made to an insider's immediate family and related interests or does it apply only to loans made to the insider themselves? For example, a financial institution's CEO's adult son lives with the CEO. The son obtains an auto loan that is not signed, co-signed, or guaranteed by the CEO. Is this loan considered to be a loan within the parameters of Regulation O and I.C. § 28-7-1-17.2?

**A:** I.C. § 28-7-1-17.2(a) permits a financial institution to extend credit to an insider's immediate family member in accordance with the definitions, restrictions, and provisions of Regulation O. 12 C.F.R. § 215.3(f) directs that when determining whether a loan should be considered a loan to the insider, the tangible economic benefit rule applies. 12 C.F.R. § 215.3(f)(1) states that "an extension of credit is considered made to an insider to the extent that the proceeds are transferred to the insider or are used for the tangible economic benefit of the insider." Pursuant to 12 C.F.R. § 215.3(f)(2), the exception to the tangible benefit rule is that an extension of credit is not considered made to an insider if:

- (i) The credit is extended on terms that would satisfy the standard set forth in § 215.4(a) of this part for extensions of credit to insiders; and
- (ii) The proceeds of the extension of credit are used in a bona fide transaction to acquire property, goods, or services from the insider.

Therefore, the tangible economic benefit rule must be applied to determine whether the loan is attributable to the insider. Answering individual situations will be fact specific. If the credit is extended on terms that satisfy the requirements of 12 C.F.R. § 215.4 (terms and creditworthiness), and the proceeds are used in a bona fide transaction to acquire property, goods, or services from the insider, then the extension fits within the

exception and should not be assessed to the insider. However, if the extension does not fit within the exception and the insider will benefit from the proceeds, then the extension should be attributed to the insider directly. The same analysis applies regardless of where the son resides.

- 8. Q:** I.C. § 28-7-1-0.5(14) defines the term executive officer, which includes the chairman of the board of directors, the president, vice president, cashier, secretary, and treasurer. However, I.C. § 28-7-1-17.2, Indiana's Regulation O statute, does not use the term executive officer, but rather uses the term officer when discussing to whom Regulation O applies. Under Indiana law, is the chairman of the board considered an executive officer for the purposes of Regulation O?

**A:** Yes, 12 C.F.R. § 215.2(e)(1) includes the chairman of the board in its definition of executive officer, which is made applicable to Indiana's credit unions through I.C. § 28-7-1-17.2. So while Indiana's statute may use a different term, Regulation O includes the chairman of the board in its definition and therefore is considered an executive officer for the purposes of Regulation O.

- 9. Q:** If an insider obtains a mortgage that is exempt under Regulation O, does the specific mortgage hold the exemption for the duration of the loan? For example, an insider has a first lien mortgage that is considered exempt on a residence. The mortgage is paid down enough that it and all other debts are below the \$100,000 limit. The insider desires to purchase a vacation home that in aggregate will exceed the \$100,000 limit. Can the mortgage on the vacation property be designated as the exempt loan instead of the mortgage on the primary property?

**A:** The financial institution may swap the designation of the Regulation O loan to accommodate the example. It is permissible to designate the balance of the vacation home as the residence for Regulation O, and aggregate the smaller loan balance, with the insider's other loans to determine if the total non-exempt loans are below the \$100,000 limit.

- 10. Q:** Does the residence exception for executive officers apply to multiple loans secured by a residence, or only to a single loan secured by a residence?"

**A:** The exception only applies to one loan secured by a residence; you cannot have multiple mortgage loans under that exemption.

- 11. Q:** How does a financial institution cure a Regulation O violation if the total extension of credit to an insider exceeds the permissible dollar limit?

**A:** 12 C.F.R. § 215.6 states in part that "no executive officer, director, or principal shareholder of a member bank or any of its affiliates shall knowingly receive (or knowingly permit any of that person's related interests to receive) from a member bank, directly or indirectly, any extension of credit not authorized under this part." Accordingly, receiving anything above the permissible limit is a violation of Regulation O. The loan must be paid-off to consider the violation cured. Paying down the loan to be within the permissible dollar threshold does not cure the violation because the insider

knowingly received an extension of credit above the permissible limits, which is a violation.

**12. Q:** Must the residence be an executive officer's primary residence to qualify for the mortgage exemption?

**A:** No, the residence is not required to be the executive officer's primary residence to qualify for an exemption. The "housing" exception found in 12 C.F.R. § 215.5(c)(2) is available for only one property of an executive officer and the property must be used as a residence of the executive officer. The property must be a house, condominium, cooperative, mobile home, house trailer, houseboat, or other similar property that has sleeping, cooking, and toilet facilities. The regulation does not restrict the exception to primary residences; the exception may be used for a property that is not a primary residence so long as the executive officer uses the property as a residence and does not use this exception for any other property. See 12 CFR § 215.5(c)(2).

**13. Q:** Can the financial institution establish a special employee designated lending program that provides a different rate or incentive than non-employee loans?

**A:** Financial institutions may establish special employee designated lending programs that provide a different rate or incentive than it does to non-employee loans. Generally, the restrictions in place are devised to ensure that insiders are not given more advantageous or generous credit extensions than non-insiders. It may however provide compensation and benefit packages to all its employees, including non-insiders. For example, a financial institution has a policy of waiving certain mortgage application fees for non-insider employees. Those same fees may be waived for the financial institution insiders. However, the financial institution must still provide proper TILA disclosures, which may include but are not limited to, variable rate disclosures. Another example is a financial institution that provides all employees a 1/8 basis point rate reduction on mortgage loans. Executive officers may also receive the basis point reduction if it is on the same terms as the other employees.

**14. Q:** Is it a Regulation O violation if a financial institution extends a line of credit to an insider that if fully utilized exceeds the statutory limits, however the line of credit is not fully drawn upon?

**A:** Yes, because it is an extension of credit above the permissible limits. In extending a line of credit, the financial institution is approving the insider to utilize the entire line and constitutes an extension of credit. 12 C.F.R. § 215.6 precludes an executive officer, director, or principal shareholder of a member bank or any of its affiliates from knowingly receiving (or knowingly permitting any of that person's related interests from receiving), directly or indirectly, any extension of credit that is not in compliance with Regulation O.

**15. Q:** Should Regulation O be retroactively applied if a financial institution extends credit to an individual who is not considered to an insider at the time, but later, after the extension of credit, becomes an insider?

**A:** No. Regulation O is considered at the time of the extension. Any subsequent control changes are not taken into consideration unless the loan is renewed, new money is advanced, or another modification to the extension of credit is made.

**16. Q:** Does a financial institution need to seek board approval to extend credit in excess of \$500,000 to a company that is owned by an individual who is also a member of the credit union's board?

**A:** Yes, 12 C.F.R. § 215.4(b)(2) of Regulation O states that in no event may a financial institution extend credit to any insider of the financial institution or "insider of its affiliates in an amount that, when aggregated with all other extensions of credit to that person, and all related interest of that person, exceeds \$500,000, except by complying with the requirements of this paragraph (b)." Paragraph (b) requires prior board approval when granting an extension of credit to any insider or an affiliate, when aggregated with the amount of all other extensions of credit to that person and to all related interests of that person, exceeds the higher of \$25,000 or 5 percent of the financial institution's unimpaired capital and unimpaired surplus. Accordingly, the institution must obtain board approval prior to issuing the extension of credit to the board member.

**17. Q:** Is it a Regulation O violation if a financial institution's CEO refinances a mortgage at a different financial institution, of which he/she is not considered an insider, on a primary residence and as part of the refinance receives cash out, and then a year later refinances the residence again, at his/her financial institution but does not receive cash out in the second refinance?

**A:** It is not a Regulation O violation because the CEO is not considered an insider of the financial institution that provided the cash out on the mortgage refinance. The financial institution of which the CEO is considered an insider did not provide cash out on the refinance.

**18. Q:** Are loans made to financial institution employees prior to becoming an executive officer a violation of Regulation O if they exceed the permissible extension of credit maximums at the time the employee becomes an executive officer? For example, prior to being promoted to executive officer level, which qualifies as an insider, a financial institution employee applied for and received a \$150,000 HELOC. At the time of the promotion the balance on the HELOC is below \$100,000. Six months after being promoted to being an executive officer, the individual applied for and received a \$90,000 first mortgage. Is the HELOC grandfathered, or it is a violation of Regulation O?

**A:** The requirements of Regulation O apply at the time a loan or extension of credit is made. Thus, loans or extensions of credit that were made to an individual before he or she became an executive officer are grandfathered, as long as they were made in good faith and not in contemplation of the individual's becoming an executive officer. If such loans exceed the amount permitted by Regulation O, they will be considered nonconforming rather than a violation of Regulation O. However, no new loans may

be made, and existing loans may not be renewed, except in compliance with Regulation O.

**19. Q:** How are credit cards treated for purposes of Regulation O?

**A:** Corporate credit cards where the insider does not use the card personally and only for business purposes as an authorized signer are not considered an obligation of the officer and do not count towards Regulation O limits, including the credit card exclusion. See 12 C.F.R. § 215.3(b)(5).

Insiders may have personal credit cards from the credit union for up to \$15,000 and the extension of credit does not count towards the Regulation O limit as long as the credit card charges meet the requirements of 12 C.F.R. § 215.3(b)(5). An extension of credit occurs for the purposes of Regulation O if the amount of outstanding personal charges made to the card, when aggregated with all other indebtedness of the insider that qualifies for the credit card exception in 12 C.F.R. § 215.3(b)(5) of Regulation O, exceeds \$15,000. For example, if an officer has a \$20,000 personal credit card from the institution, the first \$15,000 does not count towards the Regulation O extension of credit limit, but the additional \$5,000 does count towards the limit. All other terms of the credit card must also meet the exceptions in 12 C.F.R. § 215.3(b)(5).

**20. Q:** Are overdraft lines of credit of \$5,000 or less considered an extension of credit pursuant to Regulation O?

**A:** No. Overdraft lines of credit that are \$5,000 or less are not considered an extension of credit pursuant to Regulation O. See 12 C.F.R. § 215.3(b)(5).

**21. Q:** Is it a Regulation O violation to refinance a first lien mortgage for an executive officer and to advance an additional sum of money in the refinance that will be used to pay off credit card debt?

**A:** 12 C.F.R. § 215.5(c)(2) states that a financial institution may extend credit to any executive officer of the financial institution in any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, provided:

- (iii) in the case of a refinancing, that only the amount thereof used to repay the original extension of credit, together with the closing costs of the refinancing, and any additional amount thereof used for any of the purposes enumerated in this paragraph (c)(2), are included within this category of credit.

Accordingly, it is a violation of Regulation O to advance additional money that is not used to repay the original extension of credit, together with the closing costs, or for the construction, maintenance, or improvement of the residence if the loan is to be considered as the mortgage exemption. If there is any cash out, debt consolidation, or any other use of the funds, the loan cannot be classified as a mortgage exemption. If

there is additional money issued that is not for one of the permissible purposes outlined in 12 C.F.R. § 215.5(c)(2), the loan will lose its mortgage exemption and be analyzed under the applicable Regulation O loan limits.

**22. Q:** What corrective actions should be taken when a loan made to an insider required, but did not receive board authorization prior to issuing the extension of credit?

**A:** The credit union may approve the extension of credit post initial approval, but it should document the error in the board's minutes and the DFI will cite the violation in its report of examination. If the extension of credit does not meet creditworthiness requirements, violates lending limits, or otherwise violates Regulation O, then the loan should be promptly repaid.

**23. Q:** Do all extensions of credit that are subject to Regulation O require prior board approval?

**A:** No, 12 C.F.R. § 215.4(b) requires prior approval when the extension of credit that is aggregated with the amount of all other extensions of credit to that person and to all related interests of the person exceed the higher of \$25,000 or 5% of the financial institution's unimpaired capital and unimpaired surplus. Regulation O further states in § 215.4(b)(2), that prior approval is required when a financial institution extends credit to any insider of the financial institution or insider of its affiliates in an amount that, when aggregated with all other extension of credit to that person, and all related interests of that person, exceeds \$500,000.

Therefore, anything above the greater of \$25,000 or 5% of capital and surplus must be preapproved. Additionally, anything above \$500,000 must have preapproval.

**24. Q:** Does Regulation O require that loans to executive officers include a demand feature in the note?

**A:** Yes. 12 C.F.R. § 215.5(d)(4) requires that any extension of credit by a financial institution to any of its executive officers (note it states executive officers; it does not use the broader term insider) be "made subject to the condition in writing that the extension of credit will, at the option of the financial institution, become due and payable at any time that the officer is indebted to any other financial institution or financial institutions in an aggregate amount greater than the amount specified for a category of credit in paragraph (c) of this section."

Paragraph (c) sets the limit at 2.5 percent of the financial institution's unimpaired surplus or \$25,000, but in no event more than \$100,000.

**25. Q:** Can a first lien HELOC on an executive officer's residence be used as the exempt mortgage loan to an officer? If so, what are the requirements for documentation?

**A:** Regulation O does not prohibit an executive officer from using a HELOC as the exempt mortgage loan designation. However, the credit union is required to document

each advance and provide evidence showing that the entirety of the funds advanced were used for the purchase, construction, maintenance, improvement, refinance of the residence.

Regulation O may be found on the website for the [Code of Federal Regulations](#). Additionally the Federal Reserve Board has an FAQ that may be found on its [website](#) and includes additional questions that this FAQ may not have addressed. The FRB also posts interpretative letters it publishes, which may also be found on its [website](#).

If you have a Regulation O question that is not addressed by this FAQ, please contact the DFI for assistance.