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Memorandum

Federal Reserve Proposes Long-Awaited Modernization of Regulation O Insider Lending Rules

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On July 31, 2026, the Board of Governors of the Federal Reserve System (the "Board") proposed the most significant updates to insider lending restrictions for banks in more than three decades ("Proposed Rule"). If finalized, the amendments to Regulation O would, among other things, modernize long-outdated dollar thresholds, codify significant staff interpretations and statutory provisions, and provide targeted relief for banks which have passive investment funds as "principal shareholders" (10% or more of a class of voting shares).[1] The Proposed Rule includes additional updates to certain definitions and provisions with the general goal of modernization (*e.g.*, updating the definition of "executive officer") and to make it more understandable and user-friendly. The Proposed Rule takes comprehensive steps to reorganize and restate Regulation O around these collective changes. For banks, the proposal presents welcome compliance relief in many areas, new obligations in others, and an overall need to reassess insider-lending policies, approval processes, and related questionnaires.

Significant Increases to Dollar-Based Thresholds

The most anticipated and desired updates in the Proposed Rule are upward adjustments to the dollar-based thresholds in Regulation O. The dollar-based thresholds in Regulation O have not been updated since 1994 or, in some cases, 1983. The Proposed Rule would increase these thresholds to adjust for economic growth and inflation, approximately quadrupling most amounts. The proposed threshold increases are as follows:

- Credit card exemption from "extension of credit": $15,000 → $60,000.
- Overdraft credit plan exemption from "extension of credit": $5,000 → $20,000.
- Inadvertent overdraft exception: $1,000 → $4,000.
- Executive officer loan other purpose loan exemption: $100,000 → $400,000.
- Board of directors prior approval threshold: $500,000 → $2 million.

[1] Regulation O governs loans by member banks (state or federal) to their executive officers, directors, and principal shareholders (collectively, "insiders") and insiders of their affiliates. Sections 22(g) and 22(h) of the Federal Reserve Act; 12 CFR part 215. Other federal law subjects federally insured state non-member banks and insured savings associations to sections 22(g) and 22(h) in the same manner and to the same extent as if they were member banks. 12 U.S.C. § 1828(j); 12 U.S.C. § 1468(b).

To limit the need for future adjustments through rulemaking, the proposal would adopt a mechanism to automatically adjust the dollar-based thresholds every five years based on cumulative growth in nominal GDP.

These updated numbers reflect an effort to significantly reduce the recordkeeping and compliance burden for all banks without impacting the core intent or restrictions in the statute or rule. Most importantly, the increase in the prior approval threshold from $500,000 to $2 million would substantially reduce the number of insider transactions requiring heightened board review, potentially resulting in significant time and cost savings for most banks. The other updated thresholds would allow banks to extend modestly larger amounts of credit to executive officers and to provide higher credit card limits and overdraft protection to all insiders without triggering additional regulatory requirements.

Relief for Passive Investment Fund Complexes

The Proposed Rule also would codify a 2019 interagency action that carves out certain portfolio companies of large passive investment fund complexes from being treated as "related interests" of a "principal shareholder" of a bank. Due to the increasing popularity of passive investing through index funds, a number of fund complexes have acquired more than 10% of a class of voting securities of a wide range of publicly traded companies, including banks. Without the relief granted in the 2019 action and the Proposed Rule, many of the portfolio companies of these large passive investment funds would qualify as "related interests" (the Proposed Rule suggests as many as 2,047 portfolio companies) and thus be subject to the restrictions in Regulation O.[2]

Under the Proposed Rule, a "qualified fund complex" would not be presumed to "control" a portfolio company for purposes of Regulation O and thus that portfolio company may not be a "related interest" if:

- The fund complex is not (and is not affiliated with) a depository institution or holding company supervised by the Board, FDIC, or OCC;
- No individual investment fund in the fund complex owns or controls more than 10% of any class of voting securities of a depository institution or holding company;
- Non-index funds in the fund complex do not in the aggregate own or control more than 10% of any class of voting securities of a depository institution or holding company; and
- The fund complex does not meet any of the conditions that would give rise to a rebuttable presumption of control under the Board's Regulation Y with respect to a depository institution or holding company.

There are three important things to note about this proposed exemption:

1. <u>Some portfolio companies could continue to be "related interests"</u>: This exemption *only* applies to the presumption of control in Regulation O. A portfolio company of a qualified investment fund would

[2] A portfolio company can be any company in which a fund complex has an ownership stake.

continue to be a "related interest" subject to Regulation O if a qualified fund complex directly, indirectly, or acting in concert with another party: (a) owns or controls, or has the power to vote 25% or more of any class of the portfolio company's voting securities; (b) controls in any manner the election of a majority of the portfolio company's directors; or (c) has the power to exercise a controlling influence over the management or policies of the portfolio company.

2. No influence over lending permitted: If a qualifying fund complex attempts to influence the lending decisions of any bank in its portfolio in favor of its other portfolio companies, the Board could find that the fund complex no longer qualifies for the exemption.

3. Does not apply to private equity or venture capital funds holding 10% or more of any class of voting shares: Non-index fund complexes that individually or in aggregate hold more than 10% of any class of voting shares of a bank and any of their related interests would not qualify for this exemption and would be subject to the restrictions in Regulation O. Note that the definitions of "principal shareholder" and "control" in Regulation O are linked to individual *classes of voting shares*, not a fully diluted ownership interest.

Codification of Staff Interpretations

Decades of accumulated uncodified staff interpretations and guidance on Regulation O have forced banks to piece together a large number of separate (and occasionally outdated or conflicting) interpretations that are not easy to access in an effort to understand agency expectations and develop practical policies and procedures. The Proposed Rule takes steps to fold in a number of the most common interpretations, including clarification that:

- A new extension of credit is created when a previously existing extension is renewed, revised, or extended.
- Dollar-based limits for certain exemptions apply on an aggregate basis (*e.g.*, when determining whether extensions of credit arising from an interest-bearing overdraft credit plan are exempt, a bank must aggregate all outstanding balances owed by an insider).
- Extensions of credit to spouses are generally attributable to an insider as a result of the "tangible economic benefit rule".
- "Grandfathered or transition loans" (extensions of credit made to a person who later becomes an insider) need not conform to Regulation O until renewed, revised, or extended, but must be included in lending limit calculations immediately upon the borrower becoming an insider.
- An executive officer may only take advantage of the "residence" exemption from the current 12 CFR 215.5 for a single mortgage. The Proposed Rule also lays out explicit expectations related to when a property will be considered a "residence" for purposes of Regulation O.
- Extensions of credit to trusts involving insiders and/or where insiders serve as trustees implicate provisions of Regulation O.

Codification of Dodd-Frank and Other Statutory Provisions

The Proposed Rule would codify certain requirements from the Dodd-Frank Act that have not previously been incorporated into Regulation O or any other rulemaking in an effort to help reintroduce regulatory visibility to these statutory requirements.

- Derivatives and Securities Financing Transactions: Section 614 of the Dodd-Frank Act amended the definition of "extension of credit" in Section 22(h) to include credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions. The Proposed Rule would set forth valuation methodologies for these credit exposures, generally allowing banks to use any method authorized under the Federal banking agencies' risk-based capital rules.
- Asset Purchases and Sales: Section 615 of the Dodd-Frank Act (12 U.S.C. 1828(z)) prohibits a depository institution from purchasing or selling an asset from or to an insider unless the transaction is on "market terms" and, if the transaction represents more than 10% of the institution's capital stock and surplus, the transaction has been approved in advance by a majority of the members of the board of directors who do not have an interest in the transaction. The Proposed Rule would interpret "market terms" consistently with Section 23B of the Federal Reserve Act, as opposed to the more restrictive version in Section 22(h) and Regulation O.
- Correspondent Bank Relationships: Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)) restricts extensions of credit to an executive officer, director, or principal shareholder of a bank from a correspondent bank. These restrictions and accompanying definitions were previously codified in Regulation O but were eliminated by rule in 2006 in response to a statutory change.[3]

Practical Implications for Banks

As discussed above, if finalized, the Proposed Rule would have several significant practical implications for insured depository institutions. Additionally, consistent with the recent trend in rulemaking by the federal banking agencies, the Board is seeking feedback on over 100 questions in the Proposed Rule. As a result, there will likely be comments on the details of the proposed changes. The Proposed Rule is open for public comment for 60 days.

[3] Section 601 of the Financial Services Regulatory Relief Act of 2006 (Pub. L. No. 109-351), removed certain statutory reporting and disclosure requirements relating to insider transactions, including those related to 12 U.S.C. § 1972(2). Interestingly, the Board is proposing specific recordkeeping requirements for the correspondent bank restrictions in the Proposed Rule. Given the changes in 2006, which concluded that "a bank may select any reasonably prudent method to ensure compliance with the restrictions", it is not clear why the Board is taking a different approach in the Proposed Rule.

Given the scope and reorganization of the proposed amendments, banks should consider developing a plan to:

- Inventory policies, procedures, and insider-lending controls and recordkeeping affected by threshold changes;
- Update these policies, procedures, and controls;
- Review board approval workflows and update accordingly;
- Update their director and executive officer questionnaires.

Please contact Amanda Allexon, Lee Meyerson, or any of the contacts below if you have any questions regarding this proposed rulemaking or need assistance reviewing your bank's Regulation O compliance program.

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