

March 23, 2000

To All Pennsylvania State-Chartered Banks, Bank and Trust Companies, and Savings Banks:

This letter is to notify you that the Pennsylvania Department of Banking (the Department) interprets section 1414 of the Banking Code of 1965 as permitting Pennsylvania state-chartered banks, bank and trust companies, and savings banks (collectively referred to as Pennsylvania Banking Institutions) to charge interest on loans to their directors to the same extent as permitted under Federal Reserve Regulation O,¹ for member banks, and the corresponding Federal Deposit Insurance Corporation regulation at 12 C.F.R. ' 337.3, for nonmember banks², subject to the conditions and discussion stated herein.

Under the Department's interpretation of section 1414, a Pennsylvania Banking Institution may charge interest on loans to directors consistent with the revisions to Regulation O, which provide that a member bank may not extend credit to any insider of the member bank or insider of its affiliate on favorable terms unless the extension of credit is made pursuant to a formal written benefit or compensation program:

- 1) that is widely available to employees of the member bank and, in the case of extensions of credit to an insider of its affiliates, is widely available to employees of the affiliates at which that person is an insider; and
- 2) that does not give preference to any insider of the member bank over other employees of the member bank and, in the case of extensions of credit to an insider of its affiliates, does not give preference to any insider of its affiliates over other employees of the affiliates at which that person is an insider.³

In consideration of the comments to section 1414 of the Banking Code, it is the position of the Department

¹ 12 C.F.R. Part 215.

² Regulation O is made applicable to Pennsylvania state-chartered non-member banks, bank and trust companies, and savings banks by the Federal Deposit Insurance Corporation regulations which provide that, with the exception of 12 C.F.R. ' 215.5(b), 215.5(c)(3), 215.5(c)(4), and 215.11, insured non-member banks are subject to the restrictions contained in Regulation O to the same extent and in the same manner as though they were member banks. 12 C.F.R. ' 337.3(a).

³ 12 C.F.R. ' 215.4(a).

that a Pennsylvania Banking Institution may extend credit to a director pursuant to a benefit or compensation plan and grant the same favorable rate of interest which is offered to other employees to the extent permissible under Federal Reserve Regulation O, provided that the rate reflects the lower cost of placing and administering the loan to directors than to customers who are not employees.

Please be advised that Pennsylvania Banking Institutions must continue to comply with the provisions of section 1415 of the Banking Code when extending credit to their directors. More specifically, section 1415(a) provides that a loan to a director may not be granted without either (1) the prior affirmative vote, or written consent filed with the secretary of the banking institution, of a majority of all the directors or trustees or members of an executive or other committee, other than a director or member of a committee having a direct or indirect personal interest in the transaction, or (2) the loan being secured by deposits in the banking institution or cash surrender value of life insurance in an amount equal to, or by other collateral with a market value of at least twenty percent more than, the amount of the loan or of the agreement for the payment of money. In the latter case, the Department's position is that the board of directors or trustees or members of an executive or other committee of respective Pennsylvania Banking Institutions in advance of granting any such proposed director loan also should vote or file a written consent to the same extent as in the case of a loan not secured by such type and amount of collateral.

Personal loans to individual directors, not business loans or business-related loans, are permitted pursuant to the Department's interpretation stated herein. For example, (1) a residential mortgage loan secured by a director's primary residence not for rental purposes and (2) a consumer loan not for or related to a business purpose loan are permissible as stated in this letter.

The conclusions stated in this letter regarding section 1414 are notwithstanding any previous Department interpretation of the Banking Code of 1965 to the contrary. In addition, these conclusions are consistent with section 103 of the Banking Code of 1965 in that they reflect a reasonably modern interpretation of law that maintains the competitiveness of the Pennsylvania Banking Institutions with banking and financial organizations existing under the laws of the United States.

Please refer any questions regarding this issue to the Department's Legal Office at (717) 787-1471.

Sincerely,