

# Back to Basics: Sections 23A and 23B of the Federal Reserve Act (Regulation W)

## Guest Speaker:

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**Federal Reserve System  
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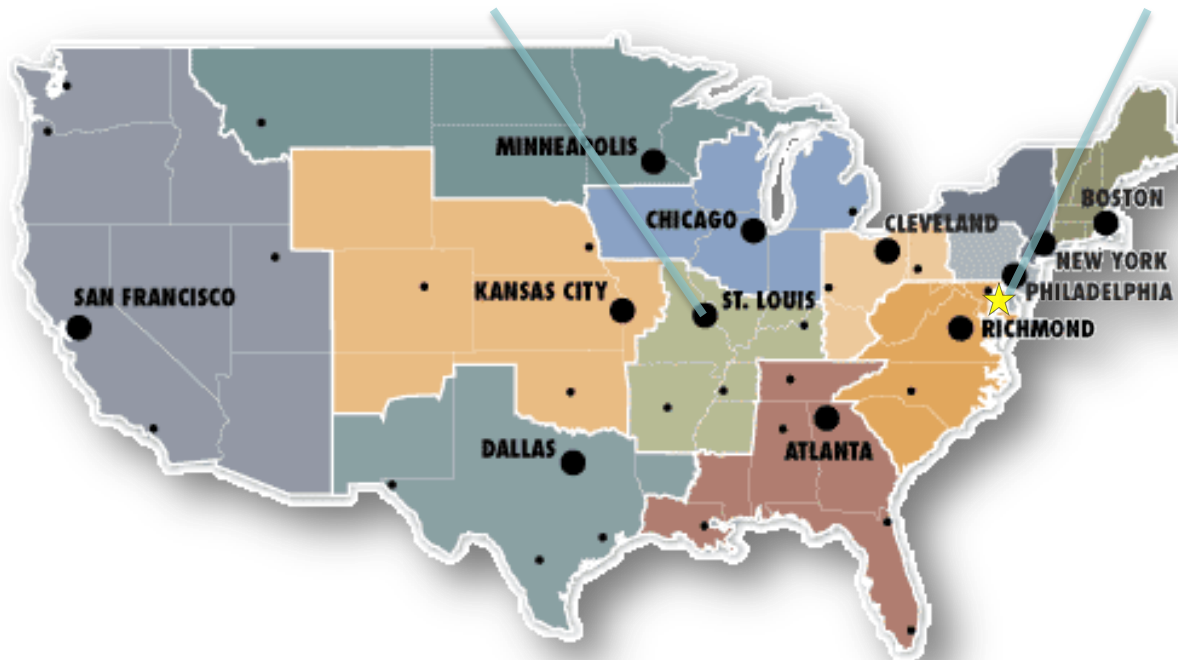
# Our Presenter and Host Today



**Julie Stackhouse**  
Federal Reserve  
Bank of St. Louis



**Pamela G. Nardolilli**  
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## Outline

- **Basics**
- **Collateral**
- **Exemptions**
- **Section 23B**
- **Foreign Banks and Agencies**
- **Savings Associations**
- **Dodd-Frank Changes (as of July 21, 2012)**

## Basics

- **Key: Watch for property, subsidiary, or anything of value going in or out of the bank.**
- **Basics**
  - A member bank and its subsidiaries may engage in a covered transaction with an affiliate only if:
    - In the case of any affiliate, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 10 percent of the capital stock and surplus of the member bank.
    - In the case of all affiliates, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 20 percent of the capital stock and surplus of the member bank.

## Basics (continued)

- **Basics**
  - Critical elements
    - Member bank – actually any insured depository institution
    - Covered transaction
      - A loan or extension of credit to the affiliate
      - A purchase of or an investment in securities issued by the affiliate
      - A purchase of assets from an affiliate
        - » Donation can result in purchase of assets, i.e. assumption of liabilities.
      - The acceptance of securities or other debt obligations issued by the affiliate as collateral
      - The issuance of a guarantee, acceptance, or letter of credit, on behalf of an affiliate
      - The credit exposure resulting from derivative transactions
      - The credit exposure resulting from securities lending and borrowing transactions

## Basics (continued)

- **Basics**
  - Affiliates—companies under common control with bank
    - Affiliate must be a company; people are not affiliates.
      - Look to Regulation O or Loans to One Borrower Rule.
      - Watch Attribution Rule.
    - Bank holding company (BHC) and its subsidiaries
    - Ownership or control by a group
    - Investment fund to which a bank or affiliate is an advisor
    - What is not an affiliate?
      - Subsidiary of bank—operating vs. financial subsidiary
      - Bank premises—BHC Act / 23A definitions differ
  - Capital stock and surplus



## Other

- **Other**
  - The Attribution Rule
    - For the purposes of this section, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.
  - Purchase of low-quality assets (LQA) is prohibited.

## Collateral

- **Collateral**
  - 100% → 130%
  - Never accept LQA as collateral for loan to an affiliate.
  - Never accept any affiliate securities for loans to *any* affiliate.

# Exemptions

- **Exemptions**
  - Sister bank—80 percent owned by same company
  - Certain secured loans—cash/Treasury securities
  - (d)(6) Part 1
    - Purchasing assets having a readily identifiable and publicly available market quotation and purchased at the market quotation
    - Expanded (d)(6) assets + municipal securities
  - (d)(6) Part 2
    - Purchasing loans on a nonrecourse basis from affiliated banks
    - No LQA
  - Corporate reorganization—223.41(d)
    - Step transaction—23.31(d)—good for applications
    - Immediately vs. three months

## Exemptions (continued)

- **Exemptions**
  - Newly formed bank
  - Bank Merger Act
    - Insured Depository Institution (IDI) → IDI
    - IDI → U.S. branch or agency
  - The agencies can grant an exemption—see website
    - Corporate reorganization
    - Building purchase
  - Intraday credit
  - Riskless principal
    - Buy from U.S. securities affiliate

## Section 23B/Foreign Banks

- **Section 23B**
  - A member bank and its subsidiaries may engage in any of the [special] transactions only if transaction is on market terms
  - “Transactions”
    - Just about anything
    - 23A covered transactions plus more
    - Sale of assets
  - Important exemption
    - Banks are not affiliates for 23A
    - But safety and soundness still requires market terms
- **Foreign Banks and Agencies**
  - Securities, merchant banking, insurance

# Savings Associations

- **Savings Associations**
  - Generally, a savings association is treated like a member bank under sections 23A and 23B.
    - Exception: financial subsidiaries
  - Additional Restrictions—more Home Owners’ Loan Act than 23A
    - A savings association may not make a loan or extension of credit to any affiliate unless the affiliate is engaged only in activities that the Board, by regulation, determines to be permissible for BHCs under section 4(c) of the BHC Act.
      - Attribution Rule will not prohibit, but transaction is subject to section 23A.
    - A savings association may not purchase or invest in securities issued by any affiliate other than with respect to shares of a subsidiary.

## Dodd-Frank Changes

- **Dodd-Frank Changes—July 21, 2012**
  - Affiliate
    - Expanded
  - Investment fund advised by investment counselor
  - Covered transactions
    - Reverse repo becomes extension of credit instead of purchase of assets.
  - Derivatives
    - Credit exposure—covered
  - Securities lending and borrowing
    - Credit exposure—covered
  - Exemptions—each agency to do its own with consent of Board and FDIC
  - Implementation

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