BUREAU OF BANKING
Department of Professional and Financial Regulation
State of Maine
June 14, 1993

BULLETIN #56 LOANS TO BANK OFFICERS WRITTEN ON DEMAND

To the Chief Executive Officer Addressed:

Bureau of Banking Regulation #8, "Loans Secured by a First Mortgage on Residential Real Estate Payable on Demand", was promulgated effective May 16, 1977. This rule, based upon the provisions of Title 9-B MRSA §241(1), found that the practice of writing residential mortgages on demand is unfair and injurious to the public interest and effectively prohibited the use of a demand feature in residential mortgage lending with the following exceptions:

1. construction loans and so-called "bridge loans", normally used to facilitate purchase of a second home pending sale of the present home; and
2. including in residential mortgage loan documents a demand feature designed to accelerate payment in the event of default in meeting the terms of the obligation.

Since Regulation #8 was promulgated, the Federal Reserve System issued Regulation O, "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks" (12 CFR §241). This rule stipulates that any loans made by a member bank to any of its executive officers must be "...made subject to the condition in writing that the extension of credit will, at the option of the member bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the amount specified..." by Regulation O. While it is recognized that first mortgages secured by an individual's primary residence are exempt from the aggregate dollar limitations imposed by Regulation O, such loans mustDecember 11, 2006 executive officer obtain other financing in an aggregate amount that exceeds the limitations of the rule.

Several individuals have contacted the Bureau with this seemingly "Catch 22" situation that, complying with Federal Reserve Regulation O, in effect, places the bank in violation of Bureau of Banking Regulation #8 prohibiting demand mortgages.

The Bureau recognizes that Regulation #8 was promulgated in 1977 to provide a general prohibition for loans secured by first mortgages on residential real estate written on demand. Federal Reserve Regulation O identifies a much smaller class of borrowers and mandates the demand feature in certain circumstances as a means to address potential insider abuses.

As a general exception to the prohibition of the demand feature, Regulation #8 provides for the acceleration of a payment when the borrower is found to be in default of the terms of the contract. This provision essentially parallels that found in Regulation O which mandates the acceleration of loans to executive officers only when that officer becomes indebted to another lending institutions in an aggregate amount which exceeds loan limitations permitted under Regulation O. This is a limited demand feature that is triggered by a specific set of circumstances and is not the same as the broader demand feature that is prohibited by Regulation #8.

In summary, while on the surface there appears to be a conflict between the general prohibition against first mortgages written on demand and the requirement under federal Regulation O, the Bureau has concluded that, given the cross-purposes of these rules, no such conflict exists. Therefore, state-chartered financial institutions should structure indebtedness to executive officers to assure compliance with Regulation O. Should anyone have any questions regarding this Bulletin, you may contact Colette Mooney at the Bureau of Banking.

/s/H. Donald DeMatteis
Superintendent