FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 303, 337, and 362

RIN 3064–AC20

Activities of Insured State Banks and Insured Savings Associations

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice of proposed rulemaking.

SUMMARY: The FDIC is seeking public comment on its proposal to amend its rules and regulations governing activities and investments of insured state banks. The FDIC proposes to add safety and soundness standards to govern insured state nonmember banks that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities through a subsidiary if those activities are permissible for a national bank subsidiary but are not permissible for the national bank itself. In addition, the FDIC proposes to require that insured state nonmember banks file a notice before commencing any activities permissible for subsidiaries of a national bank that are not permissible for the parent national bank itself. The FDIC also proposes to remove and reserve the provisions addressing, ''Securities Activities of Subsidiaries of Insured State Banks: Bank Transactions with Affiliated Securities Companies.'' The proposed effect of these amendments will be to require banks to notify the FDIC prior to conducting securities or other activities through subsidiaries that are not permissible for the bank itself. These amendments also will consolidate all securities activities regulation.

DATES: Comments must be received by February 1, 1999.

ADDRESSES: Send written comments to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. Comments may be hand delivered to the guard station at the rear of the 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (Fax number (202) 898–3838; Internet Address: comments@fdic.gov). Comments may be inspected and photocopied in the FDIC Public Information Center, Room 100, 801 17th Street, N.W. Washington, D.C. 20429, between 9:00 a.m. and 4:30 p.m. on business days.

FOR FURTHER INFORMATION CONTACT: Curtis Vaughn, Examination Specialist, (202/898–6759), Division of Supervision; Linda L. Stamp, Counsel, (202/898–7310) or Jamey Basham, Counsel, (202/898–7265), Legal Division, FDIC, 550 17th Street, N.W., Washington, D.C. 20429.

SUPPLEMENTARY INFORMATION:

I. Background

Recently, the FDIC reassessed part 362 of its rules, ''Activities and Investments of Insured State Banks'' (12 CFR part 362) and § 337.4 of its rules, ''Securities Activities of Subsidiaries of Insured State Banks: Bank Transactions with Affiliated Securities Companies'' (12 CFR 337.4). That reassessment resulted in an amended part 362 that is published as a final rule elsewhere in this issue of the **Federal Register**. Although, in connection with that reassessment, FDIC proposed removing § 337.4, the FDIC decided to leave that rule in place to retain the safety and soundness standards governing securities activities that are not subject to section 24 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1831a) (discussed below) during a further comment period on rules that would govern those activities.

In this proposal, the FDIC seeks comment on proposed safety and soundness standards governing an insured state nonmember bank subsidiary engaging in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities permissible for a subsidiary of a national bank that are not permissible for the parent national bank directly. The proposal also requests comment on a proposed requirement that a notice be filed before an insured state nonmember bank subsidiary engages in any other activity permissible for a subsidiary of a national bank that is not permissible for the parent national bank directly. Under the proposal, the FDIC would remove and reserve § 337.4. The proposal is described in more detail below.

Part 362 of the FDIC's regulations implements the provisions of section 24 of the FDI Act. Section 24 was added to the FDI Act by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) (Pub. L. 102–242). With certain exceptions, section 24 limits the direct equity investments of state chartered insured banks to equity investments of a type permissible for national banks. In addition, with certain exceptions, section 24 prohibits an insured state bank from engaging as principal in any type of activity that is not permissible for a national bank unless the bank meets applicable capital requirements and the FDIC determines that the activity will not pose a significant risk to the appropriate deposit insurance fund. Section 24 also prohibits an insured state bank subsidiary from engaging as principal in any activity or making any equity investment of a type that is not permissible for a national bank subsidiary unless the bank meets applicable capital requirements and the FDIC determines that the activity will not pose a significant risk to the appropriate deposit insurance fund.

Since section 24 was enacted, the Office of the Comptroller of the Currency (OCC) has confirmed—through its rule governing operating subsidiaries—that there may be activities that are not permissible for a national bank itself, but that are permissible for national bank subsidiaries. Effective December 31, 1996, the OCC amended its regulations governing the acquisition and establishment of operating subsidiaries by national banks. 12 CFR part 5. These regulations establish a process through which a national bank may seek approval to conduct activities in an operating subsidiary that are part of or incidental to the business of banking as determined by the OCC pursuant to 12 U.S.C. 24 (Seventh) or other statutory authority but that differ from the activities that are permissible for the national bank itself. The OCC always requires an application from a bank seeking to conduct a bank-impermissible activity in an operating subsidiary. If the activity proposed for the operating subsidiary has not been approved previously by the OCC, the OCC will publish a notice of the application in the **Federal Register** and solicit comment. The OCC may also follow this notice and comment procedure if the activity is one that the OCC has previously approved. 12 CFR 5.34(f).

The framework in the regulation sets up a review process that has two, equally important components. First, the OCC reviews operating subsidiary applications to determine whether the proposed activities are legally permissible for an operating subsidiary. Second, the OCC evaluates the proposal to determine whether it is consistent with safe and sound banking practices and OCC policy and does not endanger the safety or soundness of the particular parent national bank.

The operating subsidiary rule sets out a number of conditions, or firewalls, that the OCC will impose each time it approves the conduct of an activity in an operating subsidiary that the parent

bank could not do directly.[1] In addition, the rule contemplates the imposition of other bank-specific conditions tailored to the facts and circumstances presented by the individual application. To date, the OCC has received and published notice of three applications to conduct activities, through an operating subsidiary, which would not be permissible for a national bank. Two applications were filed by NationsBank, National Association, (Charlotte, North Carolina) to engage in limited real estate development activities in connection with bank premises and to provide real estate lease financing through operating subsidiaries of the bank. The FDIC, in its final rule published elsewhere in today's **Federal Register**, dealt with state nonmember banks which seek to engage in real estate activities permissible for a national bank only through a subsidiary (subpart B of the amended part 362).

Another application was filed by Zions First National Bank, (Salt Lake City, Utah) (Zions) to conduct municipal revenue bond underwriting activities on April 8, 1997. The OCC published notice and requested comment in the **Federal Register** on April 18, 1997. 62 FR 19171. On December 11, 1997, the OCC announced its approval of the Zions' application allowing an operating subsidiary of a national bank to engage in the activities of underwriting, dealing in, and investing in state and municipal revenue bonds, subject to certain safety and soundness requirements.[2]

This OCC approval means that the requirement under section 24 and subpart A of part 362, that an insured state nonmember bank apply to the FDIC for consent to engage in this activity through a subsidiary, no longer applies. However, the FDIC did not remove § 337.4 as proposed, but instead left § 337.4 in place to require that an insured state nonmember bank file a notice and comply with the FDIC's safety and soundness requirements to engage in the distribution or underwriting of stocks, bonds, debentures, notes or other securities through a subsidiary.[3]

Section 337.4 of the FDIC's regulations governs securities activities of subsidiaries of insured state nonmember banks as well as transactions between insured state nonmember banks and their securities subsidiaries and affiliates. The regulation was adopted in 1984 (49 FR 46723) and is designed to promote the safety and soundness of insured state nonmember banks that have subsidiaries which engage in securities activities that are impermissible for banks directly, under section 16 of the Banking Act of 1933 (12 U.S.C. 24 (Seventh)), commonly known as the Glass-Steagall Act. Section 337.4 requires that these subsidiaries qualify as bona fide subsidiaries; establishes transaction restrictions between a bank and its subsidiaries or other affiliates that engage in securities activities that are prohibited for banks under section 16; requires that an insured state nonmember bank give prior notice to the FDIC before establishing or acquiring any securities subsidiary; requires that disclosures be provided to securities customers in certain instances; and requires that a bank's investment in a securities subsidiary engaging in activities that are impermissible for a bank under section 16 be deducted from the bank's capital.

Under the current version of § 337.4, a subsidiary of a state nonmember bank that wanted to underwrite, deal in, and invest in municipal revenue bonds (securities of states and their political subdivisions that do not qualify under the OCC's current definition of general obligation bonds) would have to file a notice under § 337.4 and meet its requirements. To underwrite, deal in, or invest in municipal revenue bonds, the bank and its subsidiary would be required to:

1. File a notice at least 60 days prior to the consummation of the operation of the subsidiary;
2. Meet the ''bona fide subsidiary'' requirements as set forth in definition in § 337.4;
3. Deduct the capital invested in subsidiary from bank's total capital;
4. Underwrite only debt securities of investment grade, unless the subsidiary has been in continuous operation for the five year period preceding the notice.[4]

The applicability of § 337.4 is not impacted by the OCC's approval of the Zions application. The application of § 337.4 is independent of and was adopted prior to section 24 of the FDI Act and part 362. Section 337.4 is invoked based on the securities activities of the bank subsidiary and was adopted pursuant to an analysis of the Glass-Steagall Act undertaken in the early 1980s. In short, the regulation lists securities underwriting and distribution as an activity that will not pose a significant risk to the fund if conducted through a majority-owned subsidiary that operates in accordance with § 337.4. Now, in this rulemaking proceeding, the FDIC proposes to remove and reserve § 337.4 and address

[1] Under these conditions, the § 5.34(f) operating subsidiary generally must: be physically separate from the parent; hold itself out as a separate and distinct entity; use a different name; have adequate capital; maintain separate accounting and corporate records; have independent policies and procedures designed to inform customers of the independence of the subsidiary; negotiate contracts with the parent at arm's length; hold separate board meetings; have at least one-third of the members of the board who are not directors of the bank who have relevant expertise; and have internal controls to manage financial and operational risks. Moreover, if the operating subsidiary will be conducting activities as principal, additional safety and soundness conditions are imposed, including that the bank's equity investment in the subsidiary must be deducted from the bank's capital and assets, and the assets and liabilities of the subsidiary may not be consolidated with those of the bank. In addition, the OCC will apply sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1) to transactions between the parent bank and its operating subsidiary.

[2] Zions applied to the OCC pursuant to 12 CFR 5.34(f) to commence a new activity in an existing operating subsidiary. The subsidiary would underwrite, deal in, and invest in securities of states and their political subdivisions. These securities include the following: (1) Obligations presently defined by the OCC as general obligations of states and political subdivisions (General Obligation Securities); and (2) other obligations of states and their political subdivisions that do not qualify under the OCC's current definitions as general obligations (Revenue Bonds). The OCC determined that the activity was permissible for an operating subsidiary under the authority of 12 U.S.C. 24 (Seventh) that allows a national bank to own operating subsidiaries that conduct activities that are incidental to the business of banking. In this case, the OCC determined that the activity of underwriting revenue bonds is incidental to banking by finding that underwriting revenue bonds is the functional equivalent or a logical outgrowth of activities that are currently conducted by national banks. However, the OCC reiterated that section 20 of the Glass-Steagall Act prohibits the affiliation of member banks with firms that principally engage in underwriting bank-ineligible securities. As a result, the OCC imposed a 25 percent revenue limitation on the Zions' subsidiary to conform to the limitation for section 20 subsidiaries set by Board of Governors of the Federal Reserve System. The OCC imposed the conditions set forth in § 5.34(f), including corporate separateness requirements and the applications of sections 23A and 23B of the Federal Reserve Act to transactions between the bank and its subsidiary. In addition, the OCC imposed other conditions tailored to the Zions' application. For example, it required disclosures to customers, including use of the Interagency Statement on Retail Sales of Nondeposit Investment Products (Interagency Statement), and limited opinions on the bonds by bank directors, officers and employees.

[3] Section 362.4 of the final regulation establishes rules by which subsidiaries of insured state banks may conduct certain securities activities which are not permissible for a national bank subsidiary. Section 362.8(b) established similar rules for securities affiliates of insured state nonmember bank subsidiaries of so-called ''nonbank bank holding companies.'' As is specified in § 337.4(i), the activities of such subsidiaries and affiliates are controlled by part 362, not § 337.4.

[4] According to the information provided in the application, the Zions' subsidiary appears to meet the 5-year operation test that § 337.4 would apply to a state nonmember bank subsidiary. Section 337.4 has no procedure for a bank to file an application to be relieved of the five year operation requirement; however, there is a waiver application procedure in § 337.10. Any such application would be granted at the discretion of the FDIC's Board of Directors.

the FDIC's standards governing bank subsidiary activities through part 362.

II. Description of the Proposal

In this proposal, the FDIC imposes safety and soundness constraints on insured state nonmember bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that may be permissible for a national bank subsidiary but are not permissible for a national bank directly. In this proposal, the FDIC also requires that an insured state nonmember bank file a 30-day advance notice before the bank's subsidiary may engage in other activities not permissible for a national bank directly that may be permissible for a national bank subsidiary. This 30-day advance notice is designed to allow the FDIC to review any such activity and consider whether safety and soundness considerations make it prudent that conditions be placed on FDIC's consent to allow such activities. The FDIC believes it gave sufficient notice in its August 26, 1997, proposal to amend part 362 that the FDIC could adopt a final rule governing the insured state nonmember bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank that are permissible for national bank subsidiaries. However because regulatory text was not provided in its earlier proposal, the FDIC believes that it is appropriate to provide an additional opportunity for public comment before approving a final rule to govern insured state nonmember bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that may be permissible for a national bank subsidiary but are not permissible for a national bank.

A. Requirements for Securities Activities

There are three general reasons the FDIC proposes the imposition of certain standards upon a state nonmember bank seeking to engage in the sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that may be permissible for a national bank subsidiary but are not permissible for a national bank itself: to ensure the bank is independent and operated in a manner consistent with safe and sound banking practices; to protect the insurance fund (the FDIC wants to avoid claims against the bank arising out of the public's misperception as to with whom it is dealing and in what capacity); and to comply with section 21 of the Glass-Steagall Act (12 U.S.C. 378), which prohibits securities companies from taking deposits and banks from engaging in certain securities activities. The FDIC has attempted to meet these goals in a manner that minimizes the burden to insured state nonmember banks without jeopardizing the FDIC's goals.

Thus, the FDIC proposal contains more flexible physical separation standards than exist in the current version of § 337.4. The FDIC views these proposed physical separation standards, coupled with the comprehensive requirements that include affirmative disclosures, investment limits, transaction requirements and capital standards, as adequate to protect bank safety and soundness, maintain the legal separation between the bank and its subsidiary and avoid customer confusion.

The FDIC also proposes to eliminate the different treatment of state nonmember bank subsidiaries depending upon the type of securities underwritten by the subsidiary. Instead, the FDIC is focusing on prudent management policies and practices, and the sufficiency of the subsidiary's capitalization. Additionally, the FDIC proposes to eliminate the tiered approach to the securities activities of the subsidiary, which limited for five years the underwriting by a new subsidiary to investment quality debt securities, investment quality equity securities, mutual funds that invest exclusively in investment quality equity securities and/or investment quality debt securities. Section 337.4 currently does not permit a subsidiary to engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a bank under section 16 of the Glass-Steagall Act, unless the subsidiary meets the bona fide definition and the activities are limited to underwriting of investment quality securities. Later, a subsidiary can engage in additional underwriting if it meets the definition of a bona fide subsidiary and the following additional conditions are met:

(a) The subsidiary is a member in good standing of the National Association of Securities Dealers (NASD);

(b) The subsidiary has been in continuous operation for a five-year period preceding the notice to the FDIC;

(c) No director, officer, general partner, employee or 10 percent shareholder has been convicted within five years of any felony or misdemeanor in connection with the purchase or sale of any security;

(d) Neither the subsidiary nor any of its directors, officers, general partners, employees, or 10 percent shareholders is subject to any state or federal administrative order or court order, judgment or decree arising out of the conduct of the securities business;

(e) None of the subsidiary's directors, officers, general partners, employees or 10 percent shareholders are subject to an order entered within five years issued by the Securities and Exchange Commission (SEC) pursuant to certain provisions of the Securities Exchange Act of 1934 or the Investment Advisors Act of 1940; and

(f) All officers of the subsidiary who have supervisory responsibility for underwriting activities have at least five years experience in similar activities at NASD member securities firms.

Current § 337.4 requires a bona fide subsidiary to be adequately capitalized, and therefore, these subsidiaries are required to meet the capital standards of the NASD and SEC. As a protection to the insurance fund, a bank's investment in these subsidiaries engaged in securities activities that would be prohibited to the bank under section 16 are not counted toward the bank's capital; that is, the investment in the subsidiary is deducted before compliance with capital requirements is measured.

The FDIC views its established separations for banks and securities firms as creating an environment in which the FDIC's responsibility to protect the insurance fund has been met without creating too much overlapping regulation for the securities firms. The FDIC maintains an open dialogue with the NASD and the SEC concerning matters of mutual interest. To that end, the FDIC entered into an agreement in principle with the NASD concerning examination of securities companies affiliated with insured institutions and has begun a dialogue with the SEC concerning the exchange of information which may be pertinent to the mission of the FDIC.

The number of banks which have subsidiaries engaging in securities activities that cannot be conducted by the bank itself is very small. These subsidiaries engage in the underwriting of debt and equity securities and distribution and management of mutual funds.

Since implementation of the FDIC's § 337.4 regulation, the relationships between banks and securities firms have not been a matter of supervisory concern due to the protections FDIC has in place. However, the FDIC realizes that in a time of financial turmoil these protections may not be adequate and a

program of direct examination could be necessary to protect the insurance fund. Thus, the continuation of the FDIC's examination authority in that area is important.

B. Notice Requirement for Other Activities Generally

Under a safety and soundness standard, subpart B of the revised part 362 requires insured state nonmember bank subsidiaries engaging in certain enumerated activities to meet certain standards established by the FDIC, even if the OCC has determined that the activity in question is permissible for a subsidiary of a particular national bank. Under the modifications contained in this proposal, the FDIC would obtain the opportunity to review situations in which a state nonmember bank subsidiary seeks to engage in any activity determined by the OCC to be permissible for a national bank through its subsidiary, rather than through the national bank itself. This review would be analogous to the safety and soundness evaluation undertaken by the OCC with respect to operating subsidiary applications filed under § 5.34(f) of its rules (12 CFR 5.34(f)). It also would provide the FDIC with an opportunity to impose appropriate conditions on the operations of the subsidiary. The FDIC's Board of Directors wants to ensure that the FDIC can make a determination if there are adverse effects on the safety and soundness of the insured state nonmember bank and reserve authority to impose appropriate conditions.

C. Authority

The FDIC's action in proposing this regulation is fully within the agency's authority and is consistent with its stated goal of safeguarding the safety and soundness of insured state nonmember banks. The courts have recognized that defining what constitutes an unsafe or unsound banking practice in a particular fact situation is within the domain of the banking agencies. The United States Court of Appeals for the Fifth Circuit, on two occasions, stated that ''[o]ne of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies.'' *Groos National Bank* v. *Comptroller of the Currency*, 573 F.2d 880, 897 (5th Cir. 1978); *First National Bank of LaMargue* v. *Smith*, 610 F.2d 1258, 1265 (5th Cir. 1980). The United States Court of Appeals for the D.C. Circuit has stated with regard to the OCC's authority under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818)—one of the statutory provisions from which the FDIC derives authority for this rulemaking—that ''the Comptroller is entitled to accomplish his regulatory responsibilities over ''unsafe and unsound'' practices both by cease and desist proceedings and by rules defining and explicating the practices which in his discretion he finds threatening to a stable and effective national banking system.'' *Independent Bankers Association of America* v. *Heimann*, 613 F.2d 1164, 1169 (D.C. Cir. 1979). In his testimony on financial modernization, the FDIC's Chairman recently confirmed the view that barriers between banking and commerce should be lowered cautiously and incrementally with safeguards to protect the insured bank.[5]

Under the proposed regulation, the FDIC is not waiving its right to address on a case-by-case basis practices, conduct, or acts that are not specifically addressed by this regulation which it finds constitute unsafe and unsound practices. The FDIC will continue to monitor bank direct and indirect involvement in securities activities and will take whatever future action is appropriate.

The FDIC requests comments about all aspects of this proposed revision to part 362. In addition, the FDIC is raising specific questions for public comment as set out in connection with the analysis of the proposal below.

III. Section by Section Analysis

A. Majority-owned Subsidiaries Engaging in the Public Sale, Distribution or Underwriting of Stocks, Bonds, Debentures, Notes or Other Securities That Are Not Permissible for a National Bank Under Section 16 of the Banking Act of 1933

1. Description of the Rule

In connection with its recent adoption of restrictions, under subpart A of part 362, for insured state bank subsidiaries seeking to engage in the sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank and its subsidiary, the FDIC has determined that such activities may involve risk. The FDIC consequently requires insured state banks to file a notice to conduct this activity through a majority-owned subsidiary. As long as the FDIC does not object to the notice, the bank may conduct the activity in compliance with the requirements set out in the rule. The fact that prior consent is not required by subpart A does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

In developing the proposed amendments under consideration here, the FDIC did not see a need for differing treatment based on whether the insured state nonmember bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank are engaging in a similar activity that is permissible for a national bank subsidiary. In either instance, the proposal would provide the same comprehensive structure for insured state nonmember bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank.

Thus, the standards being proposed as amendments to subpart B addressing safety and soundness concerns are the same as those that were adopted in subpart A in the final rule. The difference is that the activities addressed in subpart A are not permissible for a national bank subsidiary while the activities addressed in subpart B are those that are permissible for a national bank subsidiary. Thus, the activities addressed in subpart A are addressed primarily under the authority found in section 24 of the FDI Act whereas the activities addressed in subpart B are addressed under the authority found in section 8 of the FDI Act.

The revised language would be located in subpart B of part 362 and would become part of proposed § 362.8(a).

Subpart A of part 362 does not grant authority to conduct activities or make investments; subpart A only gives relief from the prohibitions of section 24 of the FDI Act. In subpart A, the FDIC grouped the exception for insured state bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank together with the real estate exception in the structure of the regulation to promote uniform standards across activities. In a parallel fashion in subpart B, the FDIC proposes to group the exception for insured state nonmember banks that acquire or establish subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are permissible for

[5] *See* ''Testimony on Financial Modernization'' of Andrew C. Hove, Jr., Chairman, Federal Deposit Insurance Corporation, Before the Subcommittee on Finance and Hazardous Materials, Committee on Commerce, United States House of Representatives, July 17, 1997.

a national bank only through a subsidiary together with the real estate exception in the structure of the regulation, to promote uniform standards across activities.

Similarly, the authority, constraints and notice process refers back to subpart A and incorporates the same requirements and limitations as govern securities underwriting activities thereunder. In both instances the proposal would require the insured state nonmember bank and its subsidiary to meet and continue to meet the following standards to engage in the activity after notice to the FDIC, rather than making a full application:

1. The bank must meet the requirements for an ''eligible depository institution;''[6]

2. The bank must be well capitalized after deducting its investment in the subsidiary;

3. The subsidiary must be an ''eligible subsidiary;''[7]

4. The bank and the subsidiary must comply with the investment limits, transaction requirements and collateralization requirements in dealing with each other;

5. The bank must adopt policies and procedures to govern its participation in financing transactions arranged by the subsidiary;

6. The bank may not express an opinion of value or advisability of securities underwritten by the subsidiary unless the customer is notified of the bank's relationship with the subsidiary;

7. The subsidiary must be registered with SEC and agree to notify the regional office of any material actions against the subsidiary by any state authorities or the SEC; and

8. The bank may not buy securities underwritten by the subsidiary as principal or fiduciary unless the bank's board of directors approves.

The proposed requirements are uniform with other part 362 notice procedures for insured state bank subsidiaries to engage in activities not permissible for national banks or their subsidiaries, and would recognize the level of risk present in subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank itself. These requirements are not all presently found in § 337.4 but the FDIC believes that only banks that are well-run and well-managed should be given the opportunity to engage in securities activities that are not permissible for a national bank under the streamlined notice procedures. These criteria are imposed as expedited processing criteria rather than substantive criteria. Banks not meeting these criteria that want to engage in these activities should be subject to the scrutiny of the application process. Although operations not permissible for a national bank are conducted and managed by a separate majority-owned subsidiary, such activities are part of the analysis of the consolidated financial institution. The condition of the institution and the ability of its management are an important component in determining if the risks of the securities activities will have a negative impact on the insured institution.

When the FDIC initially implemented § 337.4 on securities activities of subsidiaries of insured state nonmember banks, the FDIC determined that some risk may be associated with those activities. The FDIC continues to see a need to address that risk. The FDIC requests comment on the application of these safeguards to these activities, including the utility of management and board separations to limit controlling person liability and the inappropriate disclosure of material nonpublic information; the extent that any securities underwriting liability may have been reduced due to the enactment of The Private Securities Litigation Reform Act of 1995, Public Law 104–67; and the efficacy of more limited restrictions on officer and director interlocks to prevent both liability and information sharing and any related issues.[8]

2. Substantive Changes to the Subsidiary Underwriting Activities

Generally, these proposed amendments to subpart B, as compared to the current provisions of § 337.4 governing the state nonmember bank subsidiaries that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a bank under section 16 of Glass-Steagall, have been streamlined to make compliance easier. In addition, state nonmember banks that deem any particular constraint to be burdensome may file an application with the FDIC to have the constraint removed for that bank and its majority-owned subsidiary.

The FDIC has proposed to eliminate those constraints that were deemed to overlap with other requirements or that could be eliminated and still maintain safety and soundness. The FDIC has determined that it can adequately monitor other securities activities through its regular reporting and examination processes. We invite comment on whether the elimination of the other notices now found in § 337.4, such as the notice requirement for any

[6] An ''eligible depository institution'' is a depository institution that: (1) Has been chartered and operating for at least three years or is in an acceptable holding company structure; (2) received an FDIC-assigned composite UFIRS rating of 1 or 2 at its most recent examination; (3) received a rating of 1 or 2 under the ''management'' component of the UFIRS at its most recent examination; (4) received at least a satisfactory CRA rating from its primary federal regulator at its last examination; (5) received a compliance rating of 1 or 2 from its primary federal regulator at its last examination; and (6) is not subject to any corrective or supervisory order or agreement.

[7] An entity is an ''eligible subsidiary'' if it: (1) Meets the capital requirements; (2) is physically separate and distinct in its operations; (3) maintains separate accounting and other records; (4) observes separate business formalities; (5) has a chief executive officer who is not an employee of the bank; (6) has a majority of its board of directors who are neither directors nor officers of the state-chartered depository institution; (7) conducts business pursuant to independent policies and procedures; (8) has only one business purpose; (9) has a current written business plan that is appropriate to the type and scope of business conducted by the subsidiary; (10) has adequate management; and (11) establishes policies and procedures to ensure adequate computer, audit and accounting systems, internal risk management controls, and has the necessary operational and managerial infrastructure to implement the business plan.

[8] Liability of ''controlling persons'' for securities law violations by the persons or entities they ''control'' is found in section 15 of the Securities Act of 1933, 15 U.S.C. 77o and section 20 of the Securities and Exchange Act of 1934, 15 U.S.C. 78t(a). Although the tests of liability under these statutes vary slightly, the FDIC is concerned that liability may be imposed on a parent entity that is a bank under the most stringent of these authorities in the securities underwriting setting. Under the Tenth Circuit's permissive test for controlling person liability, any appearance of an ability to exercise influence, whether directly or indirectly, and even if such influence cannot amount to control, is sufficient to cause a person to be a controlling person within the meaning of section 15 or section 20. Although liability may be avoided by proving no knowledge or good faith, proving no knowledge requires no knowledge of the general operations or actions of the primary violator and good faith requires both good faith and nonparticipation. *See First Interstate Bank of Denver, N.A.* v. *Pring*, 969 F.2d 891 (10th Cir. 1992), rev'd on other grounds, 511 U.S. 164 (1994); *Arena Land & Inv. Co. Inc.* v. *Petty*, 906 F. Supp. 1470 (D. Utah 1994); *San Francisco-Oklahoma Petroleum Exploration Corp.* v. *Carstan Oil Co., Inc.*, 765 F.2d 962 (10th Cir. 1985); *Seattle-First National Bank* v. *Carlstedt*, 978 F. Supp. 1543 (W.D. Okla. 1987). However, to the extent that any securities underwriting liability may have been reduced due to the enactment of The Private Securities Litigation Reform Act of 1995, Pub .L. 104–67, then the FDIC's concerns regarding controlling person liability may be reduced. It is likely that the FDIC will want to await the development of the standards under this new law before taking actions that could risk liability on a parent bank that has a subsidiary that engages in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities that are not permissible for a national bank.

securities activity in § 337.4(d), is appropriate.

The FDIC proposes the removal of the customer disclosures currently contained in § 337.4. Instead, the FDIC will be relying on the Interagency Statement on the Retail Sale of Nondeposit Investment Products (FIL–9–94,[9] February 17, 1994) (or any successor requirement) as applicable guidance to ensure that appropriate disclosures are made when the subsidiary's products are sold on bank premises, are sold by bank employees or are sold when the bank receives a referral fee. While the current regulation requires disclosures, those disclosures are similar but not identical to the disclosures required by the Interagency Statement. This change makes compliance easier. Comments submitted to the FDIC in connection with its recent revisions to subpart A of part 362 support this change and recognize that any retail sale of nondeposit investment products to bank customers under such circumstances are subject to the Interagency Statement. The FDIC requests comment on whether the Interagency Statement provides adequate disclosures for retail sales in a securities subsidiary and whether required compliance with that policy statement needs to be specifically mentioned in the regulatory text. Comment is invited on whether any other disclosures currently in § 337.4 should be retained or if any additional disclosures would be appropriate.

The FDIC proposes to continue to impose many of the safeguards found in section 23A of the Federal Reserve Act (12 U.S.C. 371c) and to impose the safeguards similar to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1). The FDIC requests comment on the restrictions that have been removed, including whether any of these restrictions should be reimposed for securities activities. The FDIC also invites suggestions for further improvements.

The FDIC proposes that the notice period be shortened from the existing 60 days to 30 days and that the required notice and application procedures be located in subpart G of part 303. Previously, specific instructions and guidelines on the form and content of any applications or notices required under § 337.4 were found within that section.

With regard to any insured state nonmember banks that have been engaging in these activities under a notice filed and in compliance with § 337.4, the proposed regulation would allow those activities to continue under the terms of that approval. This result differs from the approach set out in § 362.5(b) (applicable to state banks engaging in securities activities impermissible for a national bank and its subsidiary), which requires that the bank and its majority-owned subsidiaries meet the core eligibility requirements, the investment and transaction limitations, and capital requirements contained in § 362.4(c), (d), and (e). The FDIC did not consider the additional requirements to be necessary in subpart B, because we are not aware of any insured state nonmember banks having subsidiaries that are underwriting only securities that would fall under subpart B. We believe that any subsidiaries that are underwriting the types of securities regulated under subpart B already are required to follow the continuation requirements found in subpart A.

3. Notice for Change in Circumstances

The final rule in subpart A applicable to state banks engaging in securities activities impermissible for a national bank and its subsidiary (§ 362.4(b)(5)) requires the bank to provide written notice to the appropriate Regional Office of the FDIC within 10 business days of a change in circumstances. A change in circumstances is described as a material change in a subsidiary's business plan or management. Under the proposal, subpart B incorporates this requirement by reference. The FDIC believes that it can address a bank's falling out of compliance with any of the other requirements of the regulation through the normal supervision and examination process.

B. Other Activities Permissible for Subsidiaries of a National Bank That Are Not Permissible for a National Bank

In this proposal, the FDIC requires that an insured state nonmember bank file a 30-day advance notice before the bank's subsidiary may engage in other activities not permissible for a national bank that may be permissible for a national bank subsidiary. This 30-day advance notice is designed to allow FDIC to review any such activity and consider whether safety and soundness considerations make it prudent that conditions be placed on FDIC's consent to allow such activities.

Since section 24 was enacted, the OCC has confirmed through its rule governing operating subsidiaries that there may be activities that are permissible for national bank subsidiaries even though the parent national bank may not conduct them directly. The FDIC needs to review the activities and assess their safety and soundness in determining whether the activity is appropriate for an insured state nonmember bank's subsidiary. The FDIC also needs to determine whether any conditions should be placed on the conduct of that activity. The FDIC cannot assess the activities that may be approved in the future and adopt specific standards to govern those activities. This safety and soundness review and, if appropriate, the imposition of conditions should be done on a case-by-case basis. The FDIC has elected to limit its review to a 30-day period to limit the burden from this requirement.

IV. Additional Requests for Comments

The FDIC is specifically requesting comments that address the following:

(1) What criteria should the FDIC use to decide whether an activity that is permissible for a national bank subsidiary but not permissible for the national bank may be conducted in a safe and sound fashion by a subsidiary of an insured state nonmember bank?

(2) Should activities that are permissible for a national bank subsidiary but are not permissible for the national bank be limited to subsidiaries of insured state nonmember banks of a certain asset size, with a certain composite rating, *etc.*?

(3) What are the likely competitive effects of authorizing insured state nonmember banks to engage (through subsidiaries) in activities that are permissible for a national bank subsidiary but are not permissible for the national bank?

(4) Alternately, are there other approaches or methods which would facilitate access without compromising traditional safety and soundness concerns?

Comments addressing these issues and any other aspects of the general subject of permitting subsidiaries of insured state nonmember banks to engage in activities that are permissible for a national bank subsidiary but are not permissible for the national bank will be welcomed.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) the FDIC may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number. The collection of information contained in this proposed rule has been submitted to

[9] Financial institution letters (FILs) are available in the FDIC Public Information Center, room 100, 801 17th Street, N.W., Washington, D.C. 20429.

OMB for review. Comments on the collection of information should be sent to the desk officer for the agencies: Alexander T. Hunt, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503. Copies of comments should also be sent to: Steven F. Hanft, FDIC Clearance Officer, Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429, (202) 898–3907. Comments may be hand-delivered to the guard station at the rear of the 17th Street building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m. [Fax number (202) 898–3838; Internet address: COMMENTS@FDIC.GOV]. For further information on the Paperwork Reduction Act aspect of this rule, contact Steven F. Hanft at the above address.

Comment is solicited on:

(i) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(ii) The accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

(iii) The quality, utility, and clarity of the information to be collected; and

(iv) Ways to minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Title of the collection: The proposed rule will modify an information collection previously approved by OMB titled ''Activities and Investments of Insured State Banks'' under control number 3064–0111.

Summary of the collection: Generally, the collection includes the description of the activity in which an insured state bank or its subsidiary proposes to engage that would be impermissible absent the FDIC's consent or nonobjection, and information about the relationship of the proposed activity to the bank's and /or subsidiary's operation and compliance with applicable laws and regulations.

Need and Use of the information: The FDIC uses the information to determine whether to grant consent or provide a nonobjection for the insured state bank or its subsidiary to engage in the proposed activity that otherwise would be impermissible pursuant to section 8 of the FDI Act and 12 CFR part 362.

Proposed changes to the collection: The proposed rule will modify the collection in two ways. First, by adding, at § 362.8(a)(2), the requirement of a notice to the FDIC before the state nonmember bank through a subsidiary engages in either the public sale, distribution or underwriting of stocks, bonds, debenture, notes or other securities if those activities are permissible for a national bank subsidiary but are not permissible for the national bank itself. Second, by adding, at § 362.8(b), the requirement of a notice to the FDIC before the state nonmember bank through a subsidiary engages in activities that are permissible for a national bank subsidiary but are not permissible for the national bank itself. The contents of both notices are described at § 303.121(b) of the final part 362 rule also published in today's **Federal Register**.

Respondents: Banks or their subsidiaries desiring to engage in activities that would be impermissible absent the FDIC's consent or nonobjection.

Estimated annual burden resulting from this proposed rulemaking:

Frequency of response: Occasional

Number of responses: 1

Average number of hours to prepare a response: 8 hours

Total annual burden: 8 hours

VI. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the FDIC certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. As noted above in connection with the Paperwork Reduction Act, the FDIC estimates that the incidences in which insured state nonmember banks will be required to file a notice under the rule will be infrequent, and will not require significant time to complete. Furthermore, the proposed rule streamlines requirements for insured state nonmember banks. It simplifies the requirements that apply when insured state nonmember banks conduct certain securities activities through majority-owned corporate subsidiaries. Whenever possible, the rule clarifies the expectations of the FDIC when it requires notices or applications to consent to activities by insured state banks. The proposed rule will make it easier for small insured state banks to locate the rules that apply to their investments.

List of Subjects

12 CFR Part 303

Administrative practice and procedure, Authority delegations (Government agencies), Bank deposit insurance, Banks, banking, Bank merger, Branching, Foreign branches, Golden parachute payments, Insured branches, Interstate branching, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 337

Banks, banking, Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 362

Administrative practice and procedure, Authority delegations (Government agencies), Bank deposit insurance, Banks, banking, Insured depository institutions, Investments, Reporting and recordkeeping requirements.

For the reasons set forth above and under the authority of 12 U.S.C. 1819(a) (Tenth), the FDIC Board of Directors hereby proposes to amend 12 CFR chapter III as follows:

PART 303—FILING PROCEDURES AND DELEGATIONS OF AUTHORITY

1. The authority citation for part 303 continues to read as follows:

Authority: 12 U.S.C. 378, 1813, 1815, 1816, 1817, 1818, 1819 (Seventh and Tenth), 1820, 1823, 1828, 1831a, 1831e, 1831o, 1831p–1, 1835a, 3104, 3105, 3108, 3207; 15 U.S.C. 1601–1607.

2. In § 303.122, the first sentence of paragraph (a) and the first sentence of paragraph (b) are revised to read as follows:

§ 303.122 Processing.

(a) *Expedited processing.* A notice filed by an insured state bank seeking to commence or continue an activity under § 362.4(b)(3)(i), § 362.4(b)(5), § 362.8(a)(2), or § 362.8(b) of this chapter will be acknowledged in writing by the FDIC and will receive expedited processing, unless the applicant is notified in writing to the contrary and provided a basis for that decision. * * *

(b) *Standard processing for applications and notices that have been removed from expedited processing.* For an application filed by an insured state bank seeking to commence or continue an activity under § 362.3(a)(iii)(A), § 362.3(b)(2)(i), § 362.3(b)(2)(ii)(C), § 362.4(b)(1), § 362.4(b)(2), § 362.4(b)(4), § 362.5(b)(2), § 362.8(a)(2), or § 362.8(c) of this chapter or for notices which are not processed pursuant to the expedited

processing procedures, the FDIC will provide the insured state bank with written notification of the final action as soon as the decision is rendered. * * *

PART 337—UNSAFE AND UNSOUND BANKING PRACTICES

4. The authority citation for part 337 continues to read as follows:

Authority: 12 U.S.C. 375a(4), 375b, 1816, 1818(a), 1818(b), 1819, 1820(d)(10), 1821(f), 1828(j)(2), 1831f, 1831f–1.

§ 337.4 [Removed and Reserved]

5. § 337.4 is removed and reserved.

PART 362—ACTIVITIES OF INSURED STATE BANKS AND INSURED SAVINGS ASSOCIATIONS

6. The authority citation for part 362 continues to read as follows:

Authority: 12 U.S.C. 1816, 1818, 1819(a) (Tenth), 1828(m), 1831a, 1831e.

Subpart B—Safety and Soundness Rules Governing Insured State Nonmember Banks

7. In § 362.6, remove the third sentence and add two sentences in its place to read as follows:

§ 362.6 Purpose and scope.

* * * The following standards shall apply for insured state nonmember banks to conduct either real estate investment or to engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities through a subsidiary if those activities are permissible for a national bank subsidiary but are not permissible for the national bank itself. The FDIC also requires that notices be filed before insured state nonmember banks conduct any other activities through a subsidiary if those activities are permissible for a national bank subsidiary but are not permissible for a national bank. * * *

8. In § 362.8, revise paragraph (a), redesignate paragraph (b) as paragraph (c) and add new paragraph (b) to read as follows:

§ 362.8 Restrictions on activities of insured state nonmember banks.

(a) *Real estate investment or engaging in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities through a subsidiary if those activities are permissible for a national bank subsidiary but are not permissible for the national bank itself.* The FDIC Board of Directors has found that, depending on the facts and circumstances presented by a particular case, real estate investment or engaging in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities activities may have adverse effects on the safety and soundness of an insured state nonmember bank. Therefore, an insured state nonmember bank may not establish or acquire a subsidiary that engages in such real estate investment or in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities activities unless the insured state nonmember bank:

(1) Has an approval previously granted by the FDIC and continues to meet the conditions and restrictions of the approval; or

(2) Meets the requirements for engaging in real estate investment or securities underwriting activities (as relevant) as set forth in § 362.4(b)(5), and submits a corresponding notice under § 303.121 and § 303.122(a) of this chapter to which no objection is taken by FDIC, or applies for and obtains the FDIC's consent in accordance with the procedures of § 303.121 and § 303.122(b) of this chapter.

(b) *Other activities permissible for subsidiaries of a national bank that are not permissible for a national bank.* The FDIC Board of Directors has found that depending on the facts and circumstances of a particular case, the conduct of an activity in a subsidiary of an insured state nonmember bank that is not permissible for a national bank may have adverse effects on the safety and soundness of the insured state nonmember bank. The FDIC Board of Directors has found that the FDIC cannot make a determination whether there are adverse effects on the safety and soundness of an insured state nonmember bank engaging through a subsidiary in an activity not permissible for a national bank but permissible for a subsidiary of a national bank, unless the FDIC has had an opportunity for prior review of the activities. Therefore, an insured state nonmember bank may not establish or acquire a subsidiary that engages in such an activity unless the insured state nonmember bank obtains the FDIC's consent. Consent will be given only if the FDIC determines the activity poses no adverse effects on the safety and soundness of the insured state nonmember bank. Notices should be filed in compliance with §§ 303.121 and 303.122(a) of this chapter. Approvals granted under § 303.122(a) of this chapter may be made subject to any conditions or restrictions found by the FDIC to be necessary to protect the deposit insurance funds from risk, prevent unsafe or unsound banking practices, and/or ensure that the activity is consistent with the purposes of federal deposit insurance and other applicable law. If the FDIC previously granted an approval to the insured state nonmember bank to engage in the activity, the bank need not file another notice under this section.

* * * * *

By order of the Board of Directors.

Dated at Washington, DC, this 5th day of November 1998.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 98–31151 Filed 11–30–98; 8:45 am]

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