For Release Upon Delivery
2:00 p.m., May 12, 1999

TESTIMONY OF

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COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

COMMITTEE ON BANKING AND FINANCIAL SERVICES

of the

U. S. HOUSE OF REPRESENTATIVES

May 12, 1999

Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Madam Chairwoman and members of the Subcommittee, I appreciate this opportunity to discuss continuing efforts to reduce regulatory burdens on the banking industry, and specifically to offer the views of the Office of the Comptroller of the Currency on H.R. 1585, the Depository Institution Regulatory Streamlining Act of 1999. I commend you for your leadership in crafting a bill that builds on prior successful efforts to provide prudent and effective regulatory relief for banks.

Effective bank supervision requires a regulatory infrastructure that maintains the safety and soundness of the industry, ensures that the credit needs of the public are served, and protects the interests of banking customers. The achievement of these goals necessarily results in some degree of regulatory burden on the banking industry. However, those of us in the bank regulatory community share with the Congress the responsibility to identify and eliminate the regulatory and supervisory burdens that are unnecessary and to streamline the requirements that are needed in order for banks to serve their important role in our national economy and our nation's communities. Needless burdens make banking more costly, inhibit banks' ability to serve their customers, and, in the long run, undermine safety and soundness.

The Office of the Comptroller of the Currency (OCC) has a strong, continuing commitment to reduce unnecessary regulatory burdens and improve the efficiency of our supervision. A few weeks ago, I announced that the OCC would undertake a program to address the needs of community banks. As part of that program, we are conducting a community-bank-focused review of our regulations that will enable us to identify and to change rules that are particularly onerous for community banks. I am pleased to report to you that today's edition of the *Federal Register* contains an advance notice of proposed rulemaking (ANPR) soliciting public comment and suggestions for addressing the regulatory burdens that especially impact community national banks. This ANPR is the first step toward revising our rules to lessen community banks' burden consistent with maintaining safety and soundness. We look forward to hearing the suggestions of community banks and others interested in this effort.

Of course, the need for regulatory burden reduction is felt throughout the industry, not only among community banks. The OCC has a consistent record of working hard to ensure that regulation and supervision are efficient for all national banks. Efficient supervision means that the OCC focuses its regulations and its supervisory resources on those bank activities and products that present the greatest risks to safety and soundness or that most directly affect the other aspects of the national banking system's mission. Our recent initiatives include the OCC's Regulation Review Program, completed in 1996, which involved reviewing all of the OCC's rules and eliminating or revising provisions that did not contribute significantly to maintaining the safety and soundness of national banks, facilitating equitable access to banking services for all consumers, or accomplishing the OCC's other statutory responsibilities. Second, we have implemented a supervisory approach, Supervision by Risk, which deploys our examiners as efficiently as possible by focusing their attention on the supervisory issues that have the greatest effect on the nature and extent of the risks in each particular institution. Finally, we have reduced the assessments and charges national banks' pay the OCC to pass along savings in our actual cost of supervision.

The OCC's ability to undertake these initiatives successfully owes much to the leadership that the Congress has shown over the last five years in reducing needless burden on the banking industry without compromising either safety and soundness or the community and customer responsibilities of banks. And there is still opportunity to do more. As you know, regulatory burden on national banks can take many forms. In addition to unnecessary and antiquated statutory requirements, banks face regulatory burden through unwarranted restrictions that impede their ability to compete with other financial services providers. For example, national bank insurance sales activities are subject to a geographic constraint -- the so-called "place of 5,000" restriction -- that limits their ability to conduct this business in a way that is both outdated and anti-competitive. Unfortunately, none of the financial modernization bills currently under consideration removes this burdensome restriction. Whatever the outcome of the financial modernization debate in this Congress, I believe this restriction is no longer warranted and should, consistent with the elimination of needless regulatory burden, be repealed.

I thank you, Madam Chairwoman, the members of the Subcommittee, and your staffs for working with the OCC and the other Federal banking regulators to craft a bill that takes into account many of our concerns and suggestions for appropriate regulatory burden relief. The OCC supports the Subcommittee's efforts to provide regulatory relief and promote economic efficiency in the banking industry.

In the remainder of my statement, I will offer the OCC's comments on several provisions in the bill and recommend additional changes that I believe would provide additional burden relief.[1]

Comments on the Depository Institution Regulatory Streamlining Act of 1999

Removal of Restrictions on Interest Payments

In your invitation letter, you requested that the OCC comment on two of the bill's most significant provisions, which would amend the Federal Reserve Act to lift the prohibition on depository institutions paying interest on business checking accounts and to allow the Federal Reserve Board to pay interest on required and excess reserves.

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[1]Appendix A to this statement contains the OCC's section-by-section comments on the bill. Appendix B lists the OCC's additional suggestions for regulatory burden relief.

Interest on Business Checking Accounts. H.R. 1585 removes the statutory prohibitions that prevent depository institutions from offering interest-bearing negotiable order of withdrawal (NOW) accounts to businesses and paying interest on demand deposits. In a 1996 interagency report[2] the OCC and other Federal banking regulatory agencies concluded that the statutory prohibition against the payment of interest on demand deposits no longer serves a useful public purpose. The OCC continues to believe the prohibition is outdated in the modern financial services environment. While banks might incur a cost from paying interest on demand accounts, the long-term effects of removing this regulatory distortion and encouraging increased competition and efficiency in the banking industry are likely to be beneficial. Further, we do not believe that the repeal of this prohibition would raise any longer-term supervisory concerns. We agree with the sponsors of this legislation, however, that it is appropriate to provide a transition period so that financial institutions can make necessary changes in their funding sources and pricing to accommodate the repeal of the prohibition, especially in light of the unique challenges financial institutions now face in readying themselves for the year 2000. The proposed effective date of October 1, 2004 provides an ample transition period for this purpose.

Interest on Reserves. The question of paying interest on reserves has been under debate for many years. On one side, the prohibition on payment of interest on required reserves has caused banks to create mechanisms to reduce required reserves.[3] The practical result of these measures has been the shrinkage of the reserve base.[4] Recently, the Federal Reserve Board has expressed concern over this shrinkage and the possibility that this could hinder its implementation of monetary policy. On the other side, permitting the payment of interest on required reserves would reduce revenue that the Federal Reserve Board currently turns over to the Treasury.

This provision thus has a budgetary impact. Accordingly, while we have no objection in principle to paying interest on required reserves, without knowing the budgetary ramifications of the changes, and given the range of programs that could be detrimentally

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[2] *Joint Report: Streamlining of Regulatory Requirements*, September 23, 1996, p. I-47.

[3] For example, the development of sweep accounts has proliferated. Under these arrangements, funds in corporate checking accounts are transferred, or "swept", into interest-bearing investment vehicles, usually overnight, to be returned to the demand account the next day. This has had two significant effects from the bank's perspective. First, sweep arrangements reduce the level of transaction deposits, thereby reducing the amount of sterile reserves that a bank must hold and increasing the funds available to lend or invest. Second, sweep accounts enable corporate checking account customers to earn interest on their transaction balances by temporarily placing these funds in interest-bearing accounts. Thus, banks can attract and maintain corporate deposits, funds which could otherwise be placed in nonbank financial institutions that do not face the payment of interest restriction. These deposits, in turn, provide funds that the bank may use to make loans and investments.

[4] According to the February 25, 1998 American Banker article, *Fed Raps Plan to Get Around Ban on Corporate Checking Interest*, the growth in sweep accounts has coincided with a $14 billion drop in reserve balances from December 1994 to November 1997 (p.4).

affected, we are not able to take a position on this provision at this time. The Treasury Department has offered its analysis and comment on this proposal and we defer to those views for a more detailed reaction.

The Bank Examination Report Privilege Act (BERPA)

Your invitation letter also specifically requested that we comment on the Bank Examination Report Privilege Act (BERPA), contained in sections 501 and 502 of the bill, which would establish a bank supervisory privilege to protect confidential supervisory information, such as depository institution examination reports and other documents relating to the examination. The OCC supports BERPA. Codifying and strengthening the examination privilege will help preserve the cooperative exchange of information by supervised institutions with their examiners and the candid internal analysis of examiners that is so critical to maintaining an institution's safety and soundness. These sections will buttress existing, uniform procedures for handling and accessing supervisory information by requiring third-party litigants to seek supervisory information directly from the supervisory agencies rather than indirectly from the supervised institution. They also will address the supervised institutions' concerns that their privileges will be waived if they voluntarily permit the supervisory agencies to have access to privileged information that can be valuable to an examiner's assessment of safety and soundness. These sections favorably resolve many of the unsettled issues regarding the handling of access to supervisory information, while preserving a fair process, including judicial review, by which third parties may seek access to supervisory information.

Limited Purpose Banks

You also requested our comments on sections 222 and 223, which contain amendments relating to limited purpose banks, otherwise known as "nonbank banks." Among other things, these sections would exempt well-capitalized and well-managed nonbank banks from the activities restrictions contained in the Competitive Equality Banking Act of 1987, although leaving in place the prohibition on nonbank banks accepting both demand deposits and making commercial loans. The OCC has no objections to these changes.

Corporate Governance Provisions

The bill contains important, burden-reducing provisions that would streamline and modernize aspects of the corporate governance of national banks. The OCC supports all of these provisions and, as described in the Section III of my statement, we have some suggestions for additional amendments that would complement those already included in the bill.

Expedited Procedures for Corporate Reorganization. Section 203 expedites the procedure by which a national bank may reorganize to become a subsidiary of a holding company. Currently, a national bank that wishes to reorganize into a subsidiary of a bank holding company must go through a cumbersome multi-step process because there are no provisions in current law that permit the bank to accomplish this type of reorganization in a single, direct transaction. The OCC supports this provision because it would make it easier for banks to create a holding company, if they choose that structural form of organization, in a manner that reduces unnecessary burdens and costs.

Authority to Allow Additional Directors. Section 201 would permit the OCC to allow a national bank to have more than the current limit of 25 directors. Permitting this increase would provide the bank with more flexibility to determine the composition of its board of directors in a manner that best suits its particular needs. For example, a larger board of directors may be more appropriate for banks resulting from a merger or consolidation and would permit better local representation on the board of directors of interstate banks.

Waiver of Citizenship Requirement. Section 603 reinstates the Comptroller's authority to waive the citizenship requirement for up to a minority of directors of national banks that are subsidiaries or affiliates of foreign banks. Congress inadvertently repealed this longstanding authority when it adopted the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The OCC supports the correction of this technical error. However, we prefer the provision adopted by the Senate Banking Committee in S. 576, which expands this amendment to give the OCC the flexibility to waive the citizenship requirements for up to a minority of the directors for any national bank, whether or not affiliated with a foreign bank.

Ownership of a Depository Institution's Own Stock. Section 202 permits any depository institution to own or hold its own stock. Under current law, a national bank is prohibited from owning or holding its own stock unless the stock is acquired to prevent loss on a debt previously contracted (DPC) and sold or disposed of within six months. The OCC has concluded that, in light of other provisions in national banking law, a national bank may acquire its own stock for certain legitimate corporate purposes. This amendment is important, however, because it will eliminate any confusion about the authority of a national bank to purchase its own shares for legitimate corporate purposes, *e.g.*, offering stock in connection with an officer or employee stock option or bonus plan; selling stock to a potential director in circumstances where a director is required to own qualifying shares; reorganizing as a Subchapter S corporation; or reducing capital when market conditions or internal operations indicate that doing so is in the best interest of the bank and is consistent with safety and soundness.

Provisions Affecting the Banking Agencies' Supervisory Authorities

H.R. 1585 contains a number of provisions that affect various supervisory authorities of the Federal banking agencies. Here, I would like to highlight a few specific suggestions with respect to certain of these amendments for the Subcommittee's consideration.

Purchased Mortgage Servicing Rights. Section 303 amends the Federal Deposit Insurance Act to allow the Federal banking agencies to jointly adjust or eliminate the 10 percent "haircut" on the valuation of purchased mortgage servicing rights and originated mortgage servicing rights, if they find that such valuation would not have an adverse effect on the deposit insurance funds or the safety and soundness of the depository institution. The OCC prefers this provision, which we jointly suggested with the other Federal banking agencies, over any proposal that would repeal this "haircut" altogether.

Insider Lending Limits. The OCC believes that the Subcommittee should proceed cautiously with the relaxation of insider lending limits proposed in section 310. As a whole, these insider lending limits provide important safeguards including protections against valuation issues arising with collateral provided in transactions by bank insiders. Over time there has been a series of reductions in these limits and we urge the Subcommittee to examine the cumulative effect of earlier liberalization in this area.

Additional Regulatory Relief Items

The OCC also asks that the Subcommittee consider additional amendments that would further reduce burden for national banks, streamline corporate governance procedures, and clarify existing laws. A few of these suggestions are described here.

Corporate Governance Provisions

Facilitating Subchapter S Status. Amendments to the Internal Revenue Code enacted in the 104th Congress now permit banks to organize as subchapter S corporations. With subchapter S status, corporations pay no corporate income taxes and pass profits (and losses) directly to shareholders, who are individually taxed. However, under existing banking laws, banks, especially small, community institutions, often have trouble qualifying for this corporate status. Specifically, because subchapter S corporations may only have 75 shareholders or less, the requirement that a bank's directors own shares in the bank or the bank's holding company may limit the ability of some banks to obtain subchapter S status. In addition, there is no express authority in the national banking laws for banks to conduct reverse stock splits, which can be a useful mechanism for a bank to reduce its number of shareholders for Subchapter S status. Therefore, in order to permit more national banks to take advantage of subchapter S status, we urge that provisions be added to H.R. 1585 to permit the Comptroller to waive the directors' stock purchase requirement, in whole or in part, in the case of national banks that elect to be subchapter S corporations, and to clarify the authority of a national bank to engage in reverse stock splits, upon the approval of the Comptroller and with protections for dissenting shareholders. These two amendments would work together with section 202, which repeals the prohibition on a national bank's purchasing or holding its own shares, to make it easier for community banks to qualify as Subchapter S corporations.

Elections of National Bank Directors. As indicated by my earlier comments, the OCC supports the proposal included in the bill that would permit the OCC to allow a national bank to have more than 25 directors. We also believe it would be appropriate to allow national banks to elect their directors for terms of up to three years in length and to permit these directors to be elected on a staggered basis, so that only one third of the board of directors is elected each year. Currently, national bank directors may hold office for only one year and must be elected annually. Conducting an election for an entire board every year can be disruptive of regular business operations and there are, in addition, sound public policy reasons for allowing banks to choose a staggered election process. Staggered elections can help ensure that a board will always include experienced members, a factor that tends to enhance safety and soundness. This change would be consistent with the Model Business Corporation Act and with many State corporate codes, including Delaware's General Corporation Law. Moreover, it would promote stability on bank boards of directors and enhance a bank's flexibility to determine the membership of the board to reflect its lines of business and the markets in which it operates.

Further Streamlining National Bank Corporate Reorganizations. The OCC also suggests permitting national banks to merge or consolidate with nonbank subsidiaries or affiliates that are engaged in activities that are permissible for the bank to conduct directly. The National Bank Consolidation and Merger Act authorizes and establishes the procedures for the merger or consolidation of national banks with other national banks or with State banks. However, there is no express authority under Federal law for national banks to merge with nonbank subsidiaries or affiliates. As a result, in order to accomplish a corporate reorganization involving a combination of an uninsured subsidiary or affiliate with the bank, the bank must use a more burdensome form of corporate transaction -- a purchase of assets and assumption of liabilities of the subsidiary or affiliate. The substance of the transaction is the same as a merger in that the bank acquires the other entity, but the purchase and assumption transaction can require extensive documentation of transfers of individual assets and can entail issues of corporate succession that do not arise in a merger. Permitting national banks to merge with their nonbank subsidiaries and affiliates would enhance the ability of banks to organize activities and assets within their banking organizations in the way that makes the best business sense and does not impose unnecessary burdens.

Community Involvement and Banking Access Amendments

Clarifying National Bank Authority to Branch on Indian Reservations. The national bank branching statute provides that the OCC may authorize branches "within the city, town or village" or, alternatively, "at any point within the State" in which the bank "is situated" to the same extent permitted to State banks. However, because Indian land is sovereign territory it is unclear whether an Indian reservation is located “within” a State. In addition, the fact that State banking laws generally do not apply on Indian reservations also makes it unclear whether the Federal statute, which incorporates State branching laws, permits national banks to branch on Indian reservations. Finally, it is also unclear how the Federal branching statute applies in situations where an Indian reservation spans more than one State. In order to enhance the ability of national banks to serve the financial needs of Native American communities, we suggest that this section be clarified to specifically permit a national bank to establish and operate branches on Indian reservations, provided tribal law permits such branching. This approach would treat Indian reservations and other lands comprising Indian country similarly to States by permitting tribal governments to control branching laws in their local jurisdiction.

National Bank Participation in Certain Community Activities. Current law generally prohibits national banks from announcing, advertising, or publicizing lotteries or any lottery winners or participants. The legislative history of this prohibition indicates that Congress clearly intended to prohibit banks from being used for State lottery activities. However, because this section broadly defines the term lottery to include any arrangement in which the participants advance money or credit to another in exchange for the possibility or expectation of winning an amount more than they advanced, this provision could be interpreted to prohibit types of community-related fundraising activities that were not intended to be covered by the statute, such as raffles sponsored by community or non-profit organizations. We propose that the Comptroller be allowed to permit activities that include the use of national bank premises for charitable fundraising that does not involve cash awards. This change would enhance the ability of national banks to participate in and support community-based fundraising activities.

Conclusion

The OCC remains committed to the reduction of unnecessary regulatory and supervisory burden. But we must do so without compromising either the safety and soundness or the community and consumer responsibilities of insured depository institutions. We applaud you, Madam Chairwoman, and the Subcommittee for your efforts to reduce unnecessary regulatory burden, consistent with these goals.

APPENDIX A

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

H.R. 1585, THE DEPOSITORY INSTITUTION REGULATORY STREAMLINING ACT OF 1999
as introduced on April 27, 1999

SUMMARY AND COMMENTS
of the
OFFICE OF THE COMPTROLLER OF THE CURRENCY

TITLE I--IMPROVING MONETARY POLICY

Sec. 101. Payment of Interest on Reserves at Federal Reserve Banks

Summary: In general, section 19(b) of the Federal Reserve Act (FRA) requires depository institutions to maintain reserves against their transaction accounts and nonpersonal time deposits ("sterile reserves"). This section amends section 19(b) to permit the Federal Reserve Board (Fed) to pay interest on all reserve balances, both required and excess, on at least a quarterly basis at a rate not to exceed the general level of short term interest rates. The Fed would have authority to issue regulations regarding the payment, distribution, and crediting of interest pursuant to this section. In addition, this section permits depository institutions to place their reserves in either Federal Reserve Banks or banks that maintain reserves in a Federal Reserve Bank.

OCC Comment: This provision thus has a budgetary impact. Accordingly, while we have no objection in principle to paying interest on required reserves, without knowing the budgetary ramifications of the changes, and given the range of programs that could be detrimentally affected, we are not able to take a position on this provision at this time. The Treasury Department has offered its analysis and comment on this proposal and we defer to those views for a more detailed reaction.

Sec. 102. Amendments Relating to Savings and Demand Deposit Accounts at Depository Institutions

Summary: Section 1832 of Title 12 prohibits depository institutions from offering interest-bearing NOW accounts to businesses. Section 19(i) of the FRA (12 U.S.C. § 371a), section

5(b)(1)(B) of the Home Owners' Loan Act (HOLA) (12 U.S.C. § 1464(b)(1)(B)) and section 18 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. § 1828) prohibit member banks, thrifts, and nonmember banks, respectively, from paying interest on demand deposits. Section 102 authorizes depository institutions, as of enactment, to permit the owner of any interest-bearing deposit or account to make up to 24 transfers per month to another account of the owner in the same institution. Effective October 1, 2004, section 102 permits depository institutions to offer interest-bearing NOW accounts to businesses and to pay interest on demand deposits (thereby providing a 5 year transition period).

OCC Comment: The OCC supports this amendment. In a joint report submitted to the Congress in September 1996, the OCC, along with the other Federal banking agencies, concluded that the statutory prohibition against the payment of interest on demand deposits no longer serves a useful public purpose. See Joint Report: Streamlining of Regulatory Requirements (September 23, 1996). The OCC believes that the prohibition on paying interest on business checking accounts is outdated in the modern financial services environment. While banks may incur a cost from paying interest on demand accounts, the long-term effects of removing this regulatory distortion and encouraging increased competition and efficiency in the banking industry are likely to be beneficial. Further, we do not believe that the repeal of this prohibition would result in any long-term supervisory concerns. The amendments also provide a period during which financial institutions could make necessary changes in their funding sources and pricing to accommodate the repeal of the prohibition. Providing for an adequate transition period is particularly important as institutions face unique challenges readying themselves for the year 2000. The proposed effective date of October 2004 provides an ample transition period for this purpose.

Sec. 103. Study of Reserve Ratios for Deposit Insurance Funds.

Summary: This section requires the FDIC, in consultation with the Fed and Treasury, to conduct a study of the adequacy of the deposit insurance funds and to recommend to Congress, before June 30, 2000, an appropriate range of reserve ratios of the Bank Insurance Fund (BIF) and the Savings Insurance Fund (SAIF) to the aggregate amount of insured deposits, and an appropriate mechanism for rebating or providing credit from BIF or SAIF when the balance of either fund exceeds the applicable reserve ratio. This study must take into account expected operating expenses, case resolution expenditures and income, and the effect of assessments on members's earnings and capital; historical failure rates and loss experiences; recent changes in law; the investment income of each fund; the potential implications of the Year 2000 computer problem and industry consolidation; and the historical experiences of the FDIC in providing rebates or credits.

Comment: The OCC defers to the comments of the Treasury and FDIC on this provision.

TITLE II - IMPROVING DEPOSITORY INSTITUTIONS MANAGEMENT PRACTICES

Subtitle A -- National Banks

Sec. 201. Authority to Allow More than 25 Directors

Summary: Section 31 of the Banking Act of 1933 (12 U.S.C. § 71a) requires the board of directors of every national bank and State member bank to consist of at least 5 and no more than 25 members. This section permits the OCC, by order or regulation, to allow a national bank to have more than 25 directors.

OCC Comment: The OCC supports this change. Permitting a national bank to have more than 25 directors, with the approval of the OCC, would provide the bank with flexibility to determine the composition of its board of directors in a manner that best suits its particular needs. For example, a larger board of directors may be more appropriate for banks resulting from a merger or consolidation, and would permit greater geographic representation on the board of directors of interstate banks.

Sec. 202. Loans On Or Purchases by Bank of Its Own Stock

Summary: Section 5201 of the Revised Statutes (12 U.S.C. § 83) prohibits a national bank from making any loan or discount on, or owning or holding, its own stock unless the stock is acquired to prevent loss on a debt previously contracted (DPC) and sold or disposed of within six months. The purpose of section 5201 is to prevent the impairment of a bank's capital resources. See Deitrick v. Greaney, 309 U.S. 190 (1940). This amendment would repeal this section's prohibition on a bank owning or holding its own stock but retain the prohibition on making loans or discounts on the security of the bank's own shares. This section also makes a conforming change to section 18 of the FDI Act so that all insured depository institutions may b e permitted to own or hold their own stock.

OCC Comment: The OCC supports this section. While the OCC has interpreted § 83 in light of other provisions in national banking law and has concluded that a national bank may acquire its own stock for certain legitimate corporate purposes (12 C.F.R. 7.2020), deleting the prohibition in § 83 will eliminate any confusion about the authority of a national bank to purchase its own shares for legitimate corporate purposes, e.g., to reduce its capital when market conditions or internal operations indicate that doing so is in the best interest of the bank and is consistent with safety and soundness. Other examples of legitimate corporate purposes for which a bank may wish to acquire or hold its own stock include offering stock in connection with an officer or employee stock option or bonus plan, selling stock to a potential director in circumstances where a director is required to own qualifying shares, or when conducting a reverse stock split to reorganize as a Subchapter S corporation, which may involve decreasing the number of shareholders of the bank.

However, we do note that a technical change needs to be made to this amendment. The word “previously” should be added before the word “contracted” on page 10, line 17, and again on page 11, line 8.

Sec. 203. Expedited Procedures for Certain Reorganizations

Summary: This section amends the National Bank Consolidation and Merger Act (12 U.S.C. § 215 et seq.) to expedite the procedure by which a national bank reorganizes to become a subsidiary of a holding company. Pursuant to regulations issued by the OCC, national banks would be permitted, with the approval of two-thirds of the shareholders of the bank and the approval of the OCC, to reorganize into a subsidiary of a bank holding company directly. Under this section, the shareholder approval requirements and dissenters’ rights that apply under current law to these transaction would not change, and the requirements of the Bank Holding Company Act (BHC Act) would still apply. In addition, this section requires the OCC, in approving these transactions, to continue to apply the Bank Merger Act’s public notice requirements, statutory convenience and needs test, and CRA review as if the transaction were still subject to the Bank Merger Act. This section also states that it is unlawful for a company to become a bank holding company or for a bank to become a subsidiary of a bank holding company without the prior approval of the Fed pursuant to section 3 of the BHC Act.

OCC Comment: The OCC supports this provision because it would make it easier for a bank to reorganize into a subsidiary of a holding company, if it chooses that corporate form of organization, in a manner that reduces unnecessary burdens and costs. Under current law, a national bank that wishes to reorganize into a subsidiary of a bank holding company must go through a cumbersome multi-step process because there are no provisions in current law that permit a national bank reorganization as a subsidiary of a bank holding company in one direct transaction. Under current law, the bank first forms a “phantom bank” that is owned by a bank holding company. The bank then merges into this phantom bank to become the subsidiary of the bank holding company. Upon the consummation of this transaction, shares of the existing bank are converted into shares of the holding company or other compensation is provided to the shareholders, and the holding company owns all of the shares of the resulting bank. The resulting bank typically is indistinguishable in name, location, and balance sheet from the preexisting bank, with the only difference being the ownership of its stock. However, because the “phantom bank” must be chartered as any other bank with its attendant procedures and costs, this procedure can be unnecessarily expensive and time-consuming, and imposes needless burdens.

Subtitle B -- Savings Associations

211. Noncontrolling Investments by Savings and Loan Holding Companies

Summary: This section amends section 10(e)(1)(A)(iii) of HOLA (12 U.S.C. § 1467a(e)(1)(A)(iii)) to give the Director of OTS the discretion to permit a savings and loan holding company to acquire or retain more than 5 percent of the voting shares of a savings association or another savings and loan holding company that is not a subsidiary. However, this section specifically prohibits the OTS from permitting a multiple savings and loan holding company to acquire more than 5 percent of a company not a subsidiary engaged in any activities, other than certain exempt activities. Current law prohibits the acquisition unless the transaction is subject to an exception, e.g., the shares are acquired in a fiduciary capacity or acquired pursuant to a debt previously contracted. While the Director has the discretion to permit a savings and loan holding company to acquire "control" of a savings association or another savings and loan holding company (control is generally triggered if 25 percent of the voting stock is acquired), the Director does not have the discretion under current law to permit noncontrolling ownership of stock of over 5 percent.

OCC Comment: The OCC defers to the comments of the OTS on this provision.

Sec. 212. Streamlining Thrift Service Company Investment Requirements.

Summary: Under current section 5(c)(4)(B) of HOLA (12 U.S.C. § 1464(c)(4)(B)), a Federal savings association may invest in the stock of any corporation organized under the laws of the State in which the association has its home office if the stock of the corporation is owned only by savings associations chartered by that State and Federal savings associations having their home office in that State. Current OTS regulations further provide that Federal savings associations may apply to engage in activities through a service corporation, other than those that are preapproved, that are "reasonably related" to the activities of financial institutions. 12 C.F.R. § 559.3(e)(2). This section repeals the geographic limitations on where a service company must be chartered and where its owners must be located. This section also permits service corporations to be organized as limited liability companies.

OCC Comment: The OCC notes that the authority for subsidiaries of Federal thrifts to engage in activities not permissible for the thrift itself does not include the types of safety and soundness safeguards that pending financial modernization legislation would apply to subsidiaries of banks engaged in activities not permitted for the bank itself.

Sec. 213. Repeal of Dividend Notice Requirement

Summary: Section 10(f) of HOLA (12 U.S.C. § 1467a(f)) requires savings association subsidiaries of savings and loan holding companies to give 30 days advance notice to the OTS before declaring any dividends. Section 213 of this legislation repeals the notice requirement in section 10(f) of HOLA.

OCC Comment: The OCC defers to the comments of the OTS on this provision.

Sec. 214. Updating of Authority for Thrift Community Development Investments

Summary: Currently, section 5(c)(3)(A) of HOLA (12 U.S.C. § 1464(c)(3)(A)) authorizes a Federal savings association to invest in real estate (or loans secured by real estate) located in areas receiving "concentrated development assistance" under the Community Development Block Grant program. The aggregate amount of real estate investments made under this provision may not exceed 2 percent of assets, and the aggregate real estate investments plus loans made under this provision may not exceed 5 percent of assets.

Section 214 of this legislation replaces the outdated language referring to the Community Development Block Grant program with community development authority that is substantially the same as that which is authorized for national banks and State member banks. This section also replaces the current 2 percent/5 percent asset investment limit with the same investment limit that applies to national banks, specifically, the sum of 5 percent of capital and surplus. A higher amount may be permitted up to 10 percent of capital and surplus if the Director of the OTS determines that this higher amount will pose no significant risk to the deposit insurance fund and the savings association is adequately capitalized. The OCC and the Fed have similar authority to permit community development investments up to 10 percent of capital and surplus for national and State member banks, respectively. See 12 U.S.C. §§ 24(Eleventh) and 338a.

OCC Comment: The OCC defers to the comments of the OTS on this provision.

Subtitle C -- Other Institutions

Sec. 221. Prohibition on Accrual to Insiders of Economic Benefits from Credit Union Conversions.

Summary: This section amends section 18 of the FDI Act (12 U.S.C. § 1828) to prohibit an insured credit union from converting to an insured depository institution or to a stock form of ownership unless the appropriate regulator determines that no current or former (within the past 5 years) director, committee member, or senior management official will receive any economic benefit as a result of the conversion with regard to shares or interests in the credit union or resulting insured depository institution.

OCC Comment: The OCC takes no position on this section.

Sec. 222. Amendments Relating to Limited Purpose Banks.

Summary: Section 4(f) of the BHC Act (12 U.S.C. § 1843(f)) grandfathers companies that control so-called nonbank banks (i.e., banks that were not defined as banks under the BHC Act until that definition was amended by the Competitive Equality Banking Act of 1987 (CEBA)). Under section 4(f)(3), certain restrictions are imposed on grandfathered nonbank banks' activities. Crossmarketing of products or services that a bank holding company could not provide under section 4(c)(8) of the BHC Act is prohibited. Overdrafts (including intra day overdrafts) on behalf of an affiliate are also prohibited except for those that are defined as "permissible overdrafts." CEBA also permitted bank holding companies to retain ownership of nonbank banks provided that the nonbank bank did not engage in any activity in which it was not engaged as of March 5, 1987 or that would have caused the institution to be a bank before the enactment of CEBA or increase the number of locations from which the institution transacts business. (The 7% asset growth restriction was repealed by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.) Section 4(f)(4) of the BHC Act requires companies controlling a grandfathered non-bank bank to divest the nonbank bank if the company: (i) acquires control of an additional bank or an insured institution, (ii) acquires more than 5 percent of the shares of an additional bank or a savings association, or (iii) fails to comply with the restrictions described above. Under current law, it must divest control of the nonbank bank within 180 days or conform to the limitations in the BHC Act within that period.

Section 222: (1) permits a company to control another company that engages in activities permissible for credit card banks without losing its nonbank bank exemption; (2) allows overdrafts incurred as a result of an inadvertent computer or accounting error that is beyond the control of the bank or affiliate or is fully secured by direct obligations of or guaranteed by the U.S. or securities and obligations eligible for settlement on the Federal Reserve book entry system; (3) exempts well-capitalized and well-managed nonbank banks from the activities restrictions of section 4(f)(3); (4) repeals the cross-marketing restrictions; and (5) provides that, if a company fails to continue to qualify for the nonbank bank exemption the company does not have to divest the nonbank bank if it corrects the condition or ceases the activity that violated the exemptions or receives approval from the Fed of a plan to correct the condition or cease the activity within 1 year, and the company implements procedures that are reasonably adapted to avoid the reoccurrence of the offending condition or activity, provided the company notifies the Fed immediately upon failing to qualify for the exemption.

OCC Comment: The OCC does not object to this provision.

Sec. 223. Business Purpose Credit Extensions

Summary: This section adds a provision to section 4 of the BHC Act (12 U.S.C. § 1843) to provide that CEBA credit card banks and non-bank banks that provide credit card accounts for qualified business purposes will not be treated as engaging in the business of making commercial loans by reason of such extensions of credit. The Fed is given the authority to define “qualified business purposes,” with specific parameters: expenditures for capital improvements, inventory acquisitions, or other large acquisitions may not be considered a “qualified business purpose,” while expenditures for employee travel, entertainment, and subsistence, and certain small acquisitions and purchases may meet this definition.

OCC Comment: The OCC does not object to this provision.

TITLE III -- STREAMLINING FEDERAL BANKING AGENCY REQUIREMENTS AND ELIMINATION OF UNNECESSARY OR OUTDATED REQUIREMENTS.

Sec. 301. “Plain English: Requirement for Federal Banking Agency Rules

Summary**:** This section requires each Federal banking agency to use plain language in all proposed and final rulemakings published in the Federal Register after January 1, 2000. In addition, each Federal banking agency must submit a report to Congress by June 1, 2001 that describes how the agency has complied with this requirement. This section is similar to a recent Executive Memorandum issued June 1, 1998 by President Clinton.

OCC Comment: The OCC supports the objective of this section. However, we suggest that the term “plain language” be defined as provided in President Clinton’s Executive memorandum. (This Memorandum states that “plain language” documents have logical orientation, easy-toread design features, and use: (1) common everyday words (except for necessary technical terms), (2) "you" and other pronouns, (3) the active voice, and (4) short sentences.)

Sec. 302. Call Report Simplification

Summary**.** This section requires the Federal banking agencies to jointly develop a system under which insured depository institutions and their affiliates may file call reports, savings association financial reports, and bank holding company consolidated and parent-only financial statements electronically, and make these reports and statements available to the public electronically. The agencies must report to Congress no later than July 1, 2001 with legislative recommendations that would enhance efficiency for filers and users of these call reports and statements. In addition, the Federal banking agencies would be required to jointly adopt a single form for the filing of core information that is required to be submitted to all Federal banking agencies in these reports and statements, and to simplify and establish an index for the instructions for these reports and statements. Finally, each Federal banking agency would be required to review the information required by schedules supplementing this core information and eliminate requirements that are not necessary for safety and soundness or other public purposes.

OCC Comment: These requirements have essentially already been enacted by Congress, and the Federal banking agencies are in the process of implementing them. See section 307 of P.L. 103-325, the Riegle Community Development and Regulatory Improvement Act of 1994. Although the OCC supports simplifying the processes through which banks provide supervisory information, given the demands on computer systems associated with Year 2000 compliance, we do not favor a renewed requirement that would place demands on banks to reprogram their computer systems until after the industry has remediated its mission critical systems. Year 2000 compliance currently requires the full attention of information systems experts and contractors at banks and the Federal banking agencies.

Sec. 303. Purchased Mortgage Servicing Rights

Summary: This section amends section 475 of the FDI Act (12 U.S.C. § 1828 note), which provides that purchased mortgage servicing rights (PMSR) may be included in calculating risk-based capital if, among other things, the servicing rights are valued at not more than 90 percent of their fair market value (10 percent haircut). Specifically, this section permits the appropriate Federal banking agencies to adjust or eliminate this haircut by permitting PMSRs to be valued at more than 90 percent of their fair market value, up to 100 percent, if they jointly find, within 180 days of enactment of this legislation, that such valuation would not have an adverse affect on the deposit insurance funds or on the safety and soundness of insured depository institutions.

This section also requires that any regulations issued pursuant to this section be issued jointly by the banking agencies.

OCC Comment**:** The OCC prefers this provision, which we jointly suggested with the other Federal banking agencies, over any proposal that would repeal this "haircut" altogether.

Sec. 304. Judicial Review of Receivership Appointments.

Summary: Pursuant to section 11(c)(7) of the FDI Act (12 U.S.C. § 1821(c)(7)), insured State depository institutions must bring suit against the FDIC for its decision to appoint the FDIC as conservator or receiver of the institution within 30-days of the appointment. Section 5(d)(2)(B) of HOLA (12 U.S.C. § 1464(d)(2)(B)) also provides a 30-day statute of limitations for the challenge of the appointment by the Director of the OTS of a receiver or conservator of a thrift, and section 203(b) of the Bank Conservation Act (BCA) (12 U.S.C. § 203(b)) provides a 20 day statute of limitations for the appointment by the OCC of a conservator for a national bank. However, current law does not expressly provide a statute of limitations for a decision by the OCC to appoint a receiver of an insured or uninsured national bank. As a result, the general six-year statute of limitations for actions against the U.S. applies to these appointments, see James Madison, Limited v. Ludwig, 82 F.3d 1085 (1996).

Section 304 amends section 2 of the National Bank Receivership Act (12 U.S.C. § 191) to make it consistent with the FDI Act, HOLA, and the BCA by imposing a 30-day statute of limitations on a national bank's challenge to the Comptroller's decision to place the bank in receivership. In addition, this section amends section 11(c)(7) of the FDI Act to place a 30-day statute of limitations for challenges to the appointment of the FDIC as receiver or conservator pursuant to other statutory authority.

OCC Comment**:** The OCC supports this section.

Sec. 305. Elimination of Outdated Statutory Minimum Capital Requirements

Summary: This section repeals section 5138 of the Revised Statutes (12 U.S.C. § 51), which imposes minimum capital requirements for national banks ranging from $50,000 to $200,000, depending on where the bank is located. Section 5138 was first enacted in 1864 and last amended in 1935 and does not reflect current minimum capital ratio requirements that have been adopted pursuant to the authority in section 38 of FDI Act (12 U.S.C. § 1831o) and section 908 of the International Lending Supervision Act (ILSA) (12 U.S.C. § 3907). Section 908 of ILSA was enacted by Congress in 1983 and expressly requires the Federal banking agencies to establish adequate minimum capital requirements for banking institutions. Section 38 of FDI Act was enacted in 1991 and establishes a system of prompt corrective action based on capital levels.

OCC Comment: The OCC supports this section. Section 5138 is outdated and unnecessary in light of current law and should be repealed to avoid any confusion.

Sec. 306. Elimination of Individual Branch Capital Requirements

Summary: Section 5155 of the Revised Statutes (12 U.S.C. § 36(c)) requires a national bank, in order to establish an intrastate branch in a State, to meet the capital requirements imposed by the State on State banks seeking to establish intrastate branches. Section 306 of this legislation would repeal this requirement.

OCC Comment: The OCC supports this repeal. The branch-by-branch capital requirement is obsolete and not necessary for safety and soundness. Moreover, under prompt corrective action, troubled banks are already subject to branching limitations. See 12 U.S.C. § 1831o(e).

Sec. 307. Amendment Relating to Shareholder Notice Provisions Relating to Consolidations and Mergers

Summary: This section eliminates the requirement in 12 U.S.C. §§ 214a, 215, and 215a that shareholder notice for meetings involving a consolidation or merger vote must be made by "certified or registered" mail. National banks still would be required to provide notice of the meeting to each shareholder of record by regular mail, and to publish notice in a newspaper of general circulation in the place where the bank is located.

OCC Comment: The OCC supports this section. Requiring the mailed notice to be certified or registered imposes unnecessary costs and burdens on national banks, without any significant offsetting benefit.

Sec. 308. Payment of Interest in Receiverships with Surplus Funds

Summary: This section amends section 11(d)(10) of FDI Act (12 U.S.C. § 1821(d)(10)) to provide the FDIC with express rulemaking authority, with respect to receivership estates of insured depository institutions, to permit post-insolvency interest to be paid to creditors and to establish an interest rate on those payments following satisfaction of the principal amount of all creditor claims.

OCC Comment: The OCC defers to the comments of the FDIC on this provision.

Sec. 309. Repeal of Deposit Broker Notification and Recordkeeping Requirement

Summary: This section repeals section 29A of the FDI Act (12 U.S.C. § 1831f-1), which requires a deposit broker to file a written notice with the FDIC before soliciting or placing any deposits with an insured depository institution. The FDIC has no enforcement power over deposit brokers, who are part of a generally unregulated industry.

OCC Comment: The OCC defers to the comments of the FDIC and Treasury on this provision.

Sec. 310. Allowances for Certain Extensions of Credit to Executive Officers

Summary: This section provides a specific statutory exemption to the insider lending rules by amending section 22(g) of the FRA (12 U.S.C. 375a) to permit executive officers: (1) to obtain home equity lines of credit up to $100,000 secured by a lien on their primary residence, provided that the aggregate amount of the lien and all other extensions of credit secured by such liens do not exceed the appraised value of the residence; and (2) to obtain credit in an amount not to exceed the greater of (a) the amount that is the lessor of 2.5 percent of the aggregate amount of capital and unimpaired surplus of the bank or $100,000, or (b) $25,000, provided that in either case the extension of credit is secured by readily marketable assets with a fair market value that is not less than twice the amount of credit extended.

OCC Comment: The OCC believes that the Subcommittee should proceed cautiously with the relaxation of insider lending limits proposed in section 310. As a whole, these insider lending limits provide important safeguards including protections against valuation issues arising with collateral provided in transactions by bank insiders. Over time there has been a series of reductions in these limits and we urge the Subcommittee to examine the cumulative effect of earlier liberalization in this area.

Sec. 311. Repeal of Federal Reserve Act Lending Limit

Summary: This section repeals section 11(m) of the FRA (12 U.S.C. § 248(m)), which prohibits a member bank from making loans secured by stocks or bonds to one borrower in excess of 15 percent of the bank's unimpaired capital and surplus.

OCC Comment: The OCC supports repealing this obsolete provision. Section 11(m), as enacted, set a limit of 10 percent (raised to 15 percent in 1994), which at the time corresponded to the 10 percent lending limit applicable to national banks under 12 U.S.C. § 84. In 1982, Congress raised the lending limit in section 84 to 25 percent of unimpaired capital and surplus (not more than 15 percent of which may be unsecured), but did not raise the corresponding limit in section 11(m). This produces anomalous results. For example, if a bank has loaned to one borrower an amount equal to 10 percent of its unimpaired capital and surplus, and those loans are secured by stocks or bonds, section 84 allows that bank to lend an additional 15 percent of its unimpaired capital and surplus on an unsecured basis to that borrower. However, if the borrower does not qualify for an unsecured loan under the bank's credit criteria, section 11(m) prohibits that bank from making a loan secured with stocks or bonds in excess of 15 percent, even though the borrower could qualify for the loan using this additional collateral. Section 11(m) thus hinders a bank's ability to make loans collateralizes to the maximum extent possible and, thus, is inconsistent with safety and soundness.

Sec. 312. Repeal of Bank Holding Company Act Provision Limiting Savings Bank Life Insurance

Summary: Section 312 repeals section 3(f) of the BHC Act (12 U.S.C. § 1842(f)). Section 3(f) provides that a qualified savings bank (a savings bank organized prior to March 5, 1987) that is a subsidiary of a bank holding company may engage directly or through a subsidiary in any activity permissible under State law notwithstanding any other provision of the BHC Act (except for the restrictions in section 3(f)). However, section 3(f) also provides that the insurance activities of qualified savings banks are limited to those permissible for nonbank affiliates of bank holding companies under section 4(c)(8) of the BHC Act (i.e., credit-related activities or agency activities conducted in a place with a population of under 5,000) unless the qualified savings bank is located in Connecticut, Massachusetts, or New York and was permitted under State law to engage in the sale or underwriting of savings bank life insurance as of March 5, 1987. In addition, section 3(f) provides that the grandfathered authority to engage in savings bank life insurance will terminate if the savings bank is acquired by a company which is not a savings bank or a savings bank holding company, unless the activity is otherwise authorized under the BHC Act.

OCC Comment: The OCC does not object to the repeal of section 3(f). We recommend that the legislative history for this provision point out that section 3(f) is no longer needed in light of subsequent judicial clarifications of the BHC Act that the BHC Act does not apply to activities conducted directly or through subsidiaries by national or State bank affiliates of BHCs, and legislation subsequently enacted by Congress, notably section 24 of the FDI Act, which governs the permissible insurance activities of State banks (including savings banks) and their subsidiaries

Sec. 313. Amendment to Section 5137 of the Revised Statutes of the United States

Summary: Currently, section 5137 of the revised Statutes (12 U.S.C. § 29) prohibits national banks from holding any real estate acquired in satisfaction of debts previously contracted (real estate acquired "DPC") for more than five years. However, the OCC may approve possession for an additional five years if: (1) the bank has made a good faith attempt to dispose of the real estate within the five-year period, or (2) disposal within the five-year period would be detrimental to the bank. In addition, national banks which on October 15, 1982 held real estate, including any subsurface rights or interests therein, that as of December 31, 1979 had not been valued on the books of the bank for more than a nominal amount may continue to hold such real estate, rights, or interests for such longer period of time as would be permitted a State chartered bank by the law of the State in which the national bank is located if the aggregate amount of earnings from such real estate, rights, or interests is separately disclosed in the annual financial statements of the association. (Texas law characterizes all mineral interests as real property and has a divestiture requirement similar to section 29. Thus, under current State law, Texas banks must follow the same rules for divestiture of these interests as do national banks.)

This amendment would provide an additional 5 year holding period for subsurface rights of real estate, and interests in such rights, held by a national bank DPC with the approval of the OCC pursuant to section 29, notwithstanding their location and state law treatment of subsurface rights and interests as real or personal property. Specifically, this amendment provides that the OCC may approve possession of these rights and interests for an additional 5 years provided: (1) the national bank acquired the property in satisfaction of debts previously contracted; (2) the bank holds the subsurface rights and interests passively and is not engaged in production, extraction, exploration, or other active use of the rights or interests, (3) the bank values the rights and interests for no more than a nominal amount and separately discloses the aggregate amount of earnings from these rights and interests in its annual financial statements, and (4) the Comptroller determines that the possession of the rights and interests is not inconsistent with the bank's safety and soundness. In addition, the amendment would permit the Comptroller to require divestiture if it is later determined that continued possession of the rights and interests would be detrimental to the bank.

OCC Comment: The OCC does not object to this amendment. However, we note that, as drafted, it is unclear whether this amendment would apply to mineral rights and interests acquired before October 15, 1982, and, therefore, whether national banks that acquired such rights and interests on or before this date may continue holding these rights and interests pursuant to State law, which may have a longer holding period than what is provided by this section. We also have technical comments on this amendment.

TITLE IV -- DISCLOSURE SIMPLIFICATION

Sec. 401. Alternative Disclosure for Variable Rate, Open-ended Home Secured Credit

Summary: This section amends section 127A(a)(2) of the Truth in Lending Act (TILA) (15 U.S.C. § 1637(a)(2)) to allow a creditor to provide a statement that "periodic payment may increase or decrease" in lieu of the 15-year historical table currently required for a variable-rate, open-end, consumer credit plan secured by the consumer's principal dwelling. Section 127A(a)(2) continues to require a creditor to provide the maximum APR and the associated minimum payment. (Section 2105 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended TILA to provide a similar change for closed-end, variable-rate loans.)

OCC Comment: The OCC does not object to this section.

TITLE V --BANK EXAMINATION REPORT PRIVILEGE ACT

Sec. 501. Amendment to the Federal Deposit Insurance Act.

Summary: This section adds a new section 45 to the FDI Act to establish a bank supervisory privilege to protect confidential supervisory information, such as depository institution examination reports or supervisory correspondence or other documents relating to an examination. Recent court decisions have created ambiguity about the confidential status of supervisory information, which is the foundation for the supervisory process.[5]

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[5] See, e.g., In re Bankers Trust, 61 F.3d 465, 470 (6th Cir. 1995) (holding that litigants seeking information from the Federal Reserve Board (FRB) need not subpoena the FRB for the information and instead may obtain the FRB's confidential information from a defendant bank); Schreiber v. Society for Savings Bancorp, 11 F.3d 217, 220 (D.C. Cir. 1993) (holding that the

Specifically, new section 45 provides that all confidential supervisory information is the property of the Federal banking agency that created or requested it and is privileged from disclosure to any other person. Persons in possession of this information are prohibited from disclosing it without prior authorization of that Federal banking agency, with certain exceptions. In addition, this section provides that, when a depository institution submits any information to a Federal, State, or foreign bank supervisory authority, the institution has not waived, destroyed or otherwise affected any privilege it may claim with respect to that information under Federal or State law. This section also provides that the same privilege created by this section exists, in any court proceeding to compel production or disclosure, of information or documents prepared by a State bank supervisor or foreign bank regulatory or supervisory authority.

However, the privilege created by section 45 does not prevent duly authorized committees of the United States Congress or the Comptroller General of the United States from obtaining access to this information. In addition, the Federal banking agencies may waive this privilege, in whole or in part, at their discretion, and may authorize access to confidential supervisory information for any appropriate governmental, law enforcement, or public purpose in accordance with agency regulations and orders without waiving any privilege.

This section also establishes specific procedures for obtaining confidential supervisory information from the originating Federal banking agency. It also provides definitions for “confidential supervisory information,” supervisory process,” and “financial institution” Finally, this section authorizes each Federal banking agency, after consultation with the other Federal banking agencies and the National Credit Union Administration (NCUA), to issue regulations that implement this section.

<u>OCC Comment</u>: The OCC supports this section. In a letter to Rep. McCollum dated September 17, 1997, the OCC, along with the other Federal banking agencies and the NCUA, expressed their support for this legislation. Specifically, this section will help preserve the cooperative, non-adversarial exchange of information by supervised institutions with their examiners and the candid internal analysis of examiners, by codifying and strengthening the examination privilege. Second, the proposed legislation will enforce existing, nationwide uniform procedures for handling and accessing supervisory information, requiring third party litigants to seek supervisory information directly from the Federal banking agencies and not indirectly from the

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bank examination privilege protects only agency opinion from disclosure and does not protect factual information about an institution); <u>Frankford Trust Co. v. Advest Inc.</u>, 1995 U.S. Dist. Lexis 11825 (E.D. Penn, Aug. 25, 1995) (not reported) (holding that the work product privilege is waived by disclosure of privileged information to a bank regulatory agency).

supervised institutions. Third, the proposed legislation will resolve the supervised institutions' concerns that their privileges will be waived if they voluntarily permit the agencies to have access to privileged information that is otherwise valuable to an examiner's assessment of safety and soundness. The proposed legislation favorably resolves many of the unsettled issues regarding the handling of and access to supervisory information, while preserving a fair process, including judicial review, by which third parties may seek access to supervisory information in appropriate circumstances. The OCC recommends, however, that the Subcommittee include the technical amendments that have been discussed with the staffs of the other Federal banking agencies, which clarify the scope of the definition of "confidential supervisory information," insure that confidential supervisory information can be used for law enforcement purposes, and make other minor technical corrections. We look forward to working with the Subcommittee to perfect this amendment.

Sec. 502. Amendment to Federal Credit Union Act

Summary: This section adds a new section 215 to Title II of the Federal Credit Union Act (12 U.S.C. § 1781 et seq.) to establish a credit union supervisory privilege and the procedures for obtaining confidential supervisory information from the NCUA in the case of Federal credit unions. This privilege and these procedures are essentially identical to the privileges and procedures established by section 501 that apply to the Federal banking agencies and depository institutions.

OCC Comment: The OCC defers to the comments of the NCUA on this section.

TITLE VI -- TECHNICAL CORRECTIONS

Sec. 601. Technical Correction Relating to Deposit Insurance Funds

Summary: This section amends an incorrect citation in section 2707 of the Deposit Insurance Funds Act of 1996 (P.L. 104-208, 110 Stat. 3009).

OCC Comment: The OCC supports this technical correction.

Sec. 602. Rules for Continuation of Deposit Insurance for Member Banks Converting Charters (Technical Error in Section 8(o) of FDI Act)

Summary: This section amends an incorrect citation in section 8(o) of FDI Act (12 U.S.C. § 1818(o)).

OCC Comment: The OCC supports this technical correction.

Sec. 603. Waiver of Citizenship Requirement for National Bank Directors

Summary: Section 5146 of the Revised Statutes (12 U.S.C. § 72) requires that the directors of a national bank must be citizens of the United States and that a majority of the directors must live in the same State where the bank is located, or within 100 miles of an office of the bank. The Comptroller may waive the State residency requirement, pursuant to section 2241 of P.L. 104-208, the Economic Growth and Regulatory Paperwork Reduction Act of 1996. As drafted, however, section 2241 inadvertently deleted the long-standing authority of the Comptroller to waive the citizenship requirement for up to a minority of directors of national banks that are subsidiaries or affiliates of foreign banks. In a colloquy on the Senate floor at the time P.L. 104-208 was being considered for final passage, Sens. Mack, D'Amato, and Graham stated that deleting the citizenship waiver authority was a technical drafting error and directed the OCC to treat the authority as unchanged until Congress could correct the error. This section corrects this technical error.

OCC Comment: The OCC supports this section. The OCC, however, prefers the provision adopted by the Senate Banking Committee in S. 576 that gives the OCC the flexibility to waive the citizenship requirements for up to a minority of the directors for any national bank.

Sec. 604. Technical Correction to Prohibition on Comptroller Interests in National Banks.

Summary: Section 329 of the Revised Statutes (12 U.S.C. § 11) prohibits the Comptroller and Deputy Comptroller from having an interest in any association issuing national currency. This section amends 12 U.S.C. § 11 to reflect the fact that national banks no longer issue national currency. The section, however, maintains the purpose of the original provision and it prohibits the Comptroller and Deputy Comptroller from owning interests in the national banks they regulate.

OCC Comment: The OCC supports this section.

Sec. 605. Applicability of Limitation to Prior Investments.

Summary: Section 18(s) of the FDI Act (12 U.S.C. § 1828(s)(1)), as added by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, P.L. 104-208, prohibits a bank or savings association from being an affiliate of, being sponsored by, or accepting financial support, directly or indirectly, from any Government-sponsored enterprise (GSE), except for routine business financings. For purposes of this prohibition, a GSE includes Fannie Mae, Freddie Mac, Farmer Mac, Sallie Mae, the Federal Home Loan Bank System, the Farm Credit Banks, the Banks for Cooperatives, the College Construction Loan Insurance Association, and any of their affiliated or member institutions. Section 605 provides that the prohibition on investments does not apply to investments made in any GSE prior to April 11, 1996. This change is made retroactive back to the effective date P.L. 104-208.

Comment: The OCC takes no position on this provision.

TITLE VII - SPECIAL RESERVE FUNDS

Sec. 701. Abolition of Special Reserve Funds.

Summary: The Economic Growth and Regulatory Paperwork Reduction Act, P.L. 104-208, establishes a SAIF Special Reserve as of January 1, 1999 that will consist of the excess in the SAIF over the designated reserve ratio as of that date (1.25 percent). While the amount in the SAIF Special Reserve cannot be used to calculate any future designated reserve ratio and cannot be used for refunds from the SAIF, it would be available for emergency purposes if the reserve ratio of the SAIF is less than 50% of its designated reserve ratio for a sustained period of time. (FDIC staff currently predicts that the SAIF reserve ratio to be within the range of 1.37 to 1.45 percent on December 31, 1998, which would result in a Special Reserve of $883.6 million to $1.35 billion on January 1, 1999.) The FDIC has stated that, by eliminating any cushion in the SAIF above the designated reserve ratio, the Special Reserve increases the likelihood that the SAIF will fall below this ratio. This would require the FDIC to raise SAIF premiums, which would re-open the issues associated with a BIF - SAIF premium differential.

Public Law 104-208 also establishes the Deposit Insurance Fund (DIF) Special Reserve, which would have the same functions and operations as the SAIF Special Reserve once the BIF and SAIF are merged into the new Deposit Insurance Funds.

This section eliminates both the SAIF and DIF Special Reserves.

OCC Comment: The OCC defers to the comments of the FDIC on this provision.

APPENDIX B

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

OCC REGULATORY RELIEF ITEMS
Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives
May 12, 1999

The OCC requests that the following items be considered for inclusion in H.R. 1585:

1. Facilitating Subchapter S Status for National Banks (12 U.S.C. § 72)

   Recent amendments to the Internal Revenue Code permit banks to organize as subchapter S corporations. However, because subchapter S corporations may only have 75 shareholders or less, the requirement in § 72 that directors own qualifying shares may limit the ability of some banks to obtain subchapter S status. This amendment would permit the Comptroller to waive this stock purchase requirement, in whole or in part, in the case of national banks that elect this corporate status.

2. Clarifying Recapitalization Authority for National Banks (12 U.S.C. § (new))

   This section would clarify the authority of a national bank to engage in reverse stock splits with the approval of the Comptroller and pursuant to any regulations issued by the Comptroller. A reverse stock split is a useful method of enabling a bank to recapitalize. In addition, recent amendments to the Federal tax law enable banks to reorganize as Subchapter S corporations. Because a Subchapter S corporation may have no more than 75 shareholders, a reverse stock split can be a useful mechanism for a bank to reduce its number of shareholders to achieve Subchapter S status. In order to protect the rights of dissenting shareholders, this amendment requires that OCC regulations provide a means for dissenting shareholders to obtain payment of the fair value of their shares.

3. Streamlining National Bank Corporate Reorganizations (12 U.S.C. § 215 et seq.)

   The National Bank Consolidation and Merger Act, 12 U.S.C. § 215 et seq., authorizes and establishes the procedures for the merger or consolidation of national banks with other national banks or with State banks. However, there is no express authority under

Federal law for national banks to merge with nonbank subsidiaries or affiliates that are engaged in activities that are permissible for the bank to conduct directly. As a result, in order to accomplish a corporate reorganization involving a combination of an uninsured subsidiary or affiliate with the bank, the bank must use a more burdensome form of corporate transaction -- a purchase of assets and assumption of liabilities of the subsidiary or affiliate. The substance of the transaction is the same as a merger in that the bank acquires the other entity, but the purchase and assumption transaction can require extensive documentation of transfers of individual assets and can entail issues of corporate succession that do not arise in a merger.

This amendment would expressly permit a national bank, upon the approval of the Comptroller and pursuant to regulations issued by the Comptroller, to merge or consolidate with its nonbank subsidiaries or affiliates, without providing for an increase in powers for the national bank. This amendment, which is included in S. 576, as reported by the Senate Banking Committee, would enhance the ability of banks to organize activities and assets within their banking organizations in the way that makes the best business sense and does not impose unnecessary burdens.

4. Permitting Choice of Appraisal Procedures for National Banks
(12 U.S.C. §§ 214a, 215, and 215a)

Under current law, shareholders of the target bank who dissent from the merger or consolidation of the bank are entitled to receive the value of their shares under certain circumstances. The laws also set out procedures for the formation of a three-member appraisal committee to ascertain the stocks' value. If the Committee is not formed or cannot reach agreement as provided by the statute, the Comptroller makes the initial appraisal which is final and binding. In practice, rarely is the full committee of appraisers appointed and, therefore, the Comptroller performs the appraisal. Even if the committee is formed and does reach agreement on an appraised value, under current law, the Comptroller must make the reappraisal if a dissenting shareholder appeals the committee's decision. This amendment provides that the valuation of a dissenting shareholder's stock will be done in accordance with the corporate governance procedures designated in the bylaws of the bank in which the dissenting shareholder owns stock rather than by the Comptroller.

5. Enhancing National Banks' Corporate Flexibility in the Election of Directors
(12 U.S.C. § 61)

Currently, § 61 requires that, in all elections of national bank directors, each shareholder has the right to (1) vote the number of shares owned for as many persons as there are directors to be elected, <u>or</u> (2) cumulate these shares by multiplying the number of directors by the number of his or her shares and giving all votes to one or more candidates. This amendment would permit national banks to choose which method of electing their directors best suits their business goals and needs, thereby making cumulative voting optional. It also would provide the OCC with authority to issue regulations to carry out the purposes of this section. Because the Model Business Corporation Act and most States' corporate codes provide that cumulative voting is optional, this amendment would make national banking law consistent with the majority rule under State corporate law. In so doing, it would reduce unnecessary regulatory burden by providing national banks with the same corporate flexibility available to many State corporations and State banks.

6. <u>Promoting Management Continuity for National Banks</u> (12 U.S.C. § 71)

Currently, §71 provides that directors of a national bank may hold office for only one year and must be elected on an annual basis. This amendment would permit national banks to elect their directors for terms of up to three years in length, and would permit these directors to be elected on a staggered basis in accordance with regulations issued by the OCC, so that only one-third of the board of directors is elected each year. This would provide national banks with flexibility in their corporate election process. Also, a bank that chooses a staggered election process will at all times have experienced members on its board, thereby enhancing the bank's safety and soundness. This change, which is included in S. 576, as reported by the Senate Banking Committee, is consistent with § 8.06 of the Model Business Corporation Act (1984, as amended 1994) and with many State corporate codes, including Delaware's General Corporation Law, Del. Code Ann. Tit. 8, § 141 (1991, as amended 1994).

7. <u>National Bank Participation in Certain Community Activities</u> (12 U.S.C. § 25a)

Section 25a broadly defines prohibited "lottery" activities to preclude banks from engaging in <u>any</u> arrangement in which the participants advance money or credit to another in exchange for the possibility or expectation of winning an amount more than they advanced. This provision could be interpreted to prohibit types of community-related fund-raising events that are not intended to be covered by the statute and for which there is no cash prize. However, the legislative history of this section indicates that Congress clearly intended to prohibit banks from being used for State lottery activities in which tickets are sold for a chance to win a cash jackpot. This amendment would enhance the ability of national banks to support their community by allowing the OCC to authorize the use of national bank premises to be used for charitable fundraising that does not involve cash awards, such as community raffles.

8. <u>Clarifying National Bank Authority to Branch on Indian Reservations</u> (12 U.S.C. § 36)

Section 36 provides that the OCC may authorize intrastate branches "within the city, town or village" or, alternatively, "at any point within the State" in which the bank "is situated" to the same extent permitted to State banks. However, because Indian land is sovereign territory it is unclear whether an Indian reservation is located "within" a State. In addition, the fact that State banking laws generally do not apply on Indian reservations also makes it unclear whether the National Bank Act, which incorporates state branching laws, permits national banks to branch on Indian reservations. Finally, it is also unclear how § 36 applies in situations where an Indian reservation spans more than one State.

This amendment would enhance the ability of national banks to serve the financial needs of Native American communities by clarifying a national bank's authority to establish and operate branches on Indian reservations, notwithstanding the law of the State or States in which the Indian reservation is located, and provided tribal law permits such branching (thereby treating the various Indian reservations and other lands comprising Indian country similarly to States by permitting tribal governments to control branching laws in their local jurisdiction).

9. <u>Providing parity for Federal Agencies of Foreign Banks</u> (12 U.S.C. § 3102)

This amendment would amend the International Banking Act ("IBA") to provide that Federal agencies may accept foreign source deposits. Currently, pursuant to a decision by the D.C. Circuit Court of Appeals, Federal agencies of foreign banks are prohibited from taking any deposits, including the limited foreign-source deposits (i.e., deposits that are not from "citizens or residents of the United States") even though that type of deposit may be accepted by state-licensed agencies of foreign banks. <u>Conference of State Bank Supervisors v. Conover</u>, 604 F.2d 604, 623 (D.C. Cir. 1983). Consequently, foreign banks that operate Federal agencies in the United States are competitively disadvantaged because they cannot offer the same services to foreign customers that may be offered by state agencies. The recommended change to the IBA would provide that Federal agencies have the same right as state agencies to receive limited foreign source deposits. This amendment would not make any other change to current law or in any other way expand or affect the activities that are permissible for Federal agencies operating in the United States.

10. Providing Examination Parity for Branches and Agencies of Foreign Banks (12 U.S.C. § 3102(b))

Section 2214 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, P.L. 104-208, replaced the annual requirement for an on-site examination of a branch or agency of a foreign bank with a requirement that these branches and agencies be examined as frequently as would a national or State bank by the appropriate Federal banking agency. As a result, branches or agencies that satisfy a comparable asset test imposed on domestic banks may be examined on an 18-month cycle rather than a 12-month basis. However, this legislation did not make a conforming change to § 3102. This amendment, which is included in S. 576, as reported by the Senate Banking Committee, would make that conforming change and clarify that the same rules easing examination requirements and costs for domestic banks apply to Federal branches and agencies of foreign banks.

11. Reducing Regulatory Burden for Representative Offices of Foreign Banks (12 U.S.C. § 3102)

Although the International Banking Act (IBA) sought to provide foreign banks with a Federal option for their U.S. offices, it did not provide the OCC with authority to establish Federal representative offices. In this respect, the IBA does not fully implement the dual banking option nor advance the goal of national treatment. In addition, the absence of a Federal representative office option has in some cases resulted in additional regulatory burden for those foreign banks that would prefer to have their entire U.S. operations under a Federal license. This amendment would amend 12 U.S.C. § 3102 to provide foreign banks with the option of establishing Federal representative offices with OCC approval and under the OCC's supervision, provided that this establishment is not prohibited by state law. This amendment would not affect the Federal Reserve's existing authority to also approve or examine representative offices.

12. Reducing Regulatory Burden of the Capital Equivalency Deposit Requirement for Federal Branches and Agencies of Foreign Banks (12 U.S.C. § 3102)

The capital equivalency deposit requirement is intended to ensure that assets will be available in the U.S. for creditors in the event of liquidation of the U.S. branch or agency of a foreign bank. This amendment would reduce regulatory burden by clarifying, streamlining, and deleting obsolete provisions of the capital equivalency deposit requirement, thereby making this requirement more consistent with comparable state law requirements for asset deposits by foreign banks