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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 5

[Docket No. 00-07]

RIN 1557-AB80

Financial Subsidiaries and Operating Subsidiaries

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is amending its regulations to implement section 121 of the Gramm-Leach-Bliley Act, which authorizes national banks to conduct expanded financial activities through financial subsidiaries. The OCC also is revising its operating subsidiary rule to make conforming changes and streamline procedures for banks that engage in activities through operating subsidiaries. Finally, the OCC is revising its regulation governing other equity investments to make corresponding changes to the procedures for certain types of non-controlling investments.

EFFECTIVE DATE: March 11, 2000.

FOR FURTHER INFORMATION CONTACT: Stuart Feldstein, Assistant Director, Legislative and Regulatory Activities or Karl Betz, Attorney, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC, 20219.

SUPPLEMENTARY INFORMATION:

Background

On January 20, 2000, the OCC published a notice of proposed rulemaking (65 FR 3157) (proposal) to implement section 121 of the Gramm-Leach-Bliley Act, Public Law 106-102

(GLBA), which authorizes national banks to invest in a new type of subsidiary called a "financial subsidiary." As defined in the proposal, a financial subsidiary is a company that is controlled by one or more insured depository institutions, other than a subsidiary that engages solely in activities that national banks may engage in directly (under the same terms and conditions that govern the conduct of these activities by national banks) or a subsidiary that a national bank is specifically authorized to control by the express terms of a Federal statute. Under section 121 of the GLBA, a financial subsidiary may engage in specified activities that are financial in nature and in activities that are incidental to financial activities if the bank and the subsidiary meet certain requirements and comply with stated safeguards. The proposal incorporates these requirements and establishes alternative procedures for banks to obtain OCC approval to acquire control of, or an interest in, a financial subsidiary.

Following the enactment of the GLBA, national banks also may continue to use operating subsidiaries to engage in those activities that are part of, or incidental to, the business of banking. Thus, the proposal also revises the OCC's operating subsidiary regulation (12 CFR 5.34) to make conforming changes and streamline procedures for banks that engage in activities through operating subsidiaries.

Comments Received

The OCC received 30 comments on the proposal. The comments included 8 from banks and bank holding companies, 15 from trade associations, 5 from community groups, and 2 from law firms. Most commenters supported the proposal. These commenters generally commended the OCC for proposing regulatory changes that enhance the operational flexibility of national banks and facilitate the ability of national banks to engage in activities through operating subsidiaries and financial subsidiaries.

Several commenters recommended specific changes to the proposal. We carefully considered each of the comment letters, and the following discussion identifies and discusses comments received and changes and

additions made to certain sections of the proposal.

Discussion

Financial Subsidiaries (new § 5.39)

Definitions (§ 5.39(d))

The proposal defines a number of key terms used in the rule. One commenter recommended that the OCC define the term "debt" for purposes of the regulation's long term debt rating requirement. We believe, however, that in cases where there is a question about whether an obligation qualifies as "debt," the issue is better addressed on a case-by-case basis. Thus, the final rule adopts the definitions contained in the proposal without change.

Permissible Activities for Financial Subsidiaries (§ 5.39(e) and (f))

The proposal describes activities that are permissible and impermissible for a financial subsidiary. Under proposed § 5.39(e), a financial subsidiary may engage only in activities that are financial in nature or incidental to a financial activity that are not permissible for a national bank to conduct directly (expanded financial activities), as well as activities that may be conducted by an operating subsidiary pursuant to § 5.34 (activities that are part of, or incidental to, the business of banking that are permissible for national banks to conduct directly).

Proposed § 5.39(e) lists the activities that are defined in the Act as "financial in nature." Among other things, this list includes activities that the Board of Governors of the Federal Reserve System (Board) has determined under section 4(c)(8) of the Bank Holding Company Act (BHCA) (12 U.S.C. 1843(c)(8)) to be so closely related to banking or controlling or managing banks as to be a proper incident thereto, and activities that the Board has found under section 4(c)(13) of the BHCA (12 U.S.C. 1843(c)(13)) to be usual in connection with the transaction of banking or other financial operations abroad.¹

¹ The final rule also recognizes that the Secretary of the Treasury (in consultation with the Board) may determine that additional activities are financial in nature or incidental to a financial activity and therefore are permissible for a financial subsidiary. The GLBA provides specific procedures, not covered in the final rule, for coordination between the Secretary of the Treasury and the

Continued

Proposed § 5.39(f) also lists activities that the GLBA specifically describes as impermissible for financial subsidiaries. These activities include providing annuities and certain types of insurance as principal, real estate development or real estate investment (unless otherwise expressly authorized by law), and certain activities authorized for financial holding companies by new sections 4(k)(4)(H) and (I) of the BHCA, as added by the GLBA. At the end of the five-year period beginning on November 12, 1999, however, the Board and the Secretary of the Treasury may find by regulation that the activities authorized under section 4(k)(4)(H) of the BHCA are permissible for financial subsidiaries.

The OCC received no comments on the description of authorized and impermissible activities, and the final rule adopts the language in the proposal with only minor technical changes.

Qualifications (§ 5.39(g))

Proposed § 5.39(g) contains three conditions that a national bank must satisfy to acquire control of, or hold an interest in, a financial subsidiary. First, the national bank and each of its depository institution affiliates must be "well capitalized" and "well managed." Proposed § 5.39(d) defines these terms consistent with their definitions in the GLBA. Second, under the GLBA, the aggregate consolidated total assets of all financial subsidiaries of the bank may not exceed the lesser of 45 percent of the consolidated total assets of the parent bank or \$50 billion. The \$50 billion limit is to be adjusted according to an indexing mechanism established jointly by the Secretary of the Treasury and the Board. Third, a national bank that is one of the 100 largest insured banks, as determined by the bank's consolidated total assets at the end of the calendar year, must have outstanding "eligible debt" that is rated in one of the three highest investment grade rating categories by a nationally recognized statistical rating organization (eligible debt requirement). If a national bank is one of the second 50 of the 100 largest insured banks, the proposal permits the bank to satisfy the eligible debt requirement if it meets alternative criteria to be set jointly through regulation by the Secretary of the Treasury and the Board. The eligible debt requirement does not apply, however, if a bank intends to acquire control of, or hold an interest in, a financial subsidiary that engages solely in activities in an agency capacity.

Board in defining additional financial and incidental activities under this provision.

One commenter recommended revising the eligible debt requirement to account for banks that have not issued debt. This commenter suggested permitting a bank to provide a statement from a nationally recognized statistical rating organization regarding the appropriate investment grade rating category that would apply if the bank were to issue *outstanding debt*. The OCC is aware of these concerns but notes that the GLBA requires a bank that is one of the 50 largest insured banks to have appropriately rated outstanding debt to acquire control of, or an interest in, a financial subsidiary. We also note, however, that the Secretary of the Treasury and the Board are authorized to issue regulations for the second 50 of the 100 largest insured banks that are comparable and consistent with the eligible debt rating requirement. Therefore, the final rule adopts these provisions as proposed.

Safeguards (§ 5.39(h))

Under the proposal, a national bank that controls a financial subsidiary must comply with several conditions. First, a national bank must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries from the assets and tangible equity of the bank. Further, the bank may not consolidate the assets and liabilities of its financial subsidiaries with those of the parent bank. Both of these conditions are imposed by the GLBA.

The final rule implements the required deduction from tangible equity and requires the bank to deduct the investment from its total risk-based capital, with the deduction taken equally from Tier 1 and Tier 2 capital. The bank's resulting Tier 1 and Tier 2 capital levels will then be used to determine the bank's capital category for purposes of 12 CFR part 6, including whether the bank qualifies as "well capitalized" as required by the GLBA and § 5.39(g)(1).

Second, any published financial statement of the national bank must, in addition to providing information prepared in accordance with generally accepted accounting principles, separately present financial information for the bank in a manner that reflects these capital adjustments. Under the third and fourth conditions, the bank must establish reasonable policies and procedures to preserve the separate corporate identity and limited liability of the bank and its financial subsidiaries, and must establish procedures to identify and manage financial and operational risks within the bank and the financial subsidiary

that adequately protect the bank from these risks.

The fifth condition provides that a financial subsidiary is deemed a subsidiary of a bank holding company and not a subsidiary of the bank for purposes of the anti-tying prohibitions in 12 U.S.C. 1971 *et seq.*

Finally, the proposal provides that for purposes of sections 23A and 23B of the Federal Reserve Act (FRA) (12 U.S.C. 371c and 371c-1) a financial subsidiary shall be treated as an affiliate of the bank. Sections 23A and 23B therefore apply to certain transactions between a bank and its financial subsidiary, except that the proposal exempts from the 10 percent quantitative limit of FRA section 23A(a)(1)(A) (12 U.S.C. 371c(a)(1)(A)) covered transactions between a bank and any individual financial subsidiary of the bank. Thus, covered transactions between a bank and any one financial subsidiary may exceed 10 percent of the bank's capital and surplus, but are subject to the 20 percent aggregate limit on transactions with all affiliates and financial subsidiaries found in FRA section 23A(a)(1)(B) (12 U.S.C. 371c(A)(1)(B)). The proposal also provides that, for purposes of FRA sections 23A and 23B, the bank's investment in a financial subsidiary does not include retained earnings of the financial subsidiary. However, the investment in the securities of a financial subsidiary of a bank by an affiliate of the bank is considered to be an investment in those securities by the bank. In addition, the Board may determine that any extension of credit by an affiliate of a bank to a financial subsidiary of that bank is an extension of credit by the bank to the financial subsidiary. The Board can only require this treatment if it determines it is necessary or appropriate to prevent evasions of the FRA or the GLBA.

The final rule adopts the language in the proposal relating to the safeguards as proposed, with additional language clarifying the implementation of the capital deduction requirement.

Procedures (§ 5.39(i))

The GLBA specifically states that OCC approval for a national bank to engage in activities through a financial subsidiary shall be based solely upon specific statutory factors. Thus, the proposal establishes alternative streamlined procedures for national banks seeking OCC approval to acquire control of, or hold an interest in, a financial subsidiary, or to commence an expanded financial activity in an existing financial subsidiary.

Under the first alternative, a national bank may file a "Financial Subsidiary

Certification" with the OCC listing the bank's depository institution affiliates and certifying that the bank and each of those affiliates is well capitalized and well managed. Thereafter, at such time as the bank seeks OCC approval to acquire control of, or hold an interest in, a new financial subsidiary, or commence an additional expanded financial activity in an existing financial subsidiary, the bank must file a written notice with the appropriate district office. The written notice must be labeled "Financial Subsidiary Notice," must state that the bank's certification remains valid, and describe the activity or activities to be performed in the financial subsidiary as well as cite to the specific authority permitting the expanded financial activity to be conducted by a financial subsidiary. (Where the authority relied on is an agency order or interpretation under section 4(c)(8) or 4(c)(13), respectively, of the BHCA, a copy of the order or interpretation should be attached.) The written notice also must state that the aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of 45 percent of the bank's consolidated total assets or \$50 billion (or the increased level set by the indexing process), that the bank will remain well capitalized after making the necessary capital adjustments, and, if applicable, that the bank meets the eligible debt requirement.

Alternatively, a bank may choose to seek approval by filing a combined certification and notification with the appropriate OCC district office at least five business days prior to acquiring control of, or an interest in, a financial subsidiary, or commencing a new expanded financial activity in an existing financial subsidiary. This type of notice would combine the information from the certification and notice described above, and should be labeled "Financial Subsidiary Certification and Notice."

The OCC received 11 comments on the proposed procedures. The commenters generally supported the availability of alternative procedures citing the flexibility they will afford national banks that wish to conduct expanded financial activities through financial subsidiaries. Some commenters, however, suggested that the OCC revise the proposed procedures to require a national bank to provide notice to the OCC at least 15 business days prior to acquiring control of, or an interest in, a financial subsidiary to provide time for public input. Other commenters commended the use of an after-the-fact notice procedure to

expedite approvals and to harmonize the OCC's procedures with those recently adopted by the Board in its interim rules implementing Title 1 of GLBA (65 FR 3785, Jan. 25, 2000).

The OCC believes that the factors upon which OCC approval is based support the use of expedited time frames, and the final rule adopts the language in the proposal with minor changes.

One of the changes to the procedures relates to section 307(c) of GLBA (15 U.S.C. 6716), which requires OCC consultation with the appropriate state insurance regulator in connection with initial and continuing affiliations between a depository institution and a company engaged in insurance activities. The OCC and the National Association of Insurance Commissioners have discussed this section and procedures for sharing appropriate information.² Thus, the final rules for both operating subsidiaries and financial subsidiaries require that operating subsidiary and financial subsidiary filings pertaining to a company engaged in insurance activities contain in the notice or application a description of the type of insurance activity that such company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable.³

Consistent with the GLBA, the proposal also provides that the OCC prohibits a national bank from applying to commence any additional expanded financial activity, or to directly or indirectly acquire control of a company engaged in any such activity, if the bank or any of its insured depository institution affiliates received a Community Reinvestment Act (CRA) rating of less than "satisfactory record of meeting community credit needs" on its most recent CRA examination prior to when the bank files a notice under § 5.39.

Several commenters urged the OCC to allow public comment where the bank or its insured depository institution affiliates have "low satisfactory" ratings in an assessment area or in a lending test in an assessment area. These commenters also requested a regulatory

² It should be noted that under section 5136A of the Revised Statutes the discretion of the OCC to deny approval of a proposed affiliation is limited to the statutory factors in that section.

³ The final rule also makes conforming changes to revised § 5.35, "Bank service companies," and revised § 5.36, "Other equity investments."

revision that would permit the OCC to condition approvals in these situations.

The OCC recognizes the concerns raised by these commenters but notes that the GLBA imports the bank's CRA rating as a factor to determine whether that rating prohibits the bank from commencing any expanded financial activity, or directly or indirectly acquiring control of a company engaged in any expanded financial activity. Moreover, section 5136A of the Revised Statutes directs the OCC to approve a national bank's acquiring control of, or an interest in, a financial subsidiary solely upon the factors set forth in section 5136A; the statute does not provide a basis to deny an application or notice or to condition approvals based on public comment.

Some commenters also asked the OCC to clarify the treatment of insured depository institution affiliates that do not have a CRA rating. For example, certain types of special purpose banks are not subject to CRA examination. The OCC believes that the provision in the proposal, which is derived directly from the GLBA provision, is sufficiently clear to conclude that the CRA rating requirement does not apply to *de novo* banks that have not yet received (or are not the successors of banks that have received) CRA ratings and to limited purpose banks that do not receive CRA ratings. Thus, the final rule adopts these provisions as proposed.

The OCC also notes that the prohibition on commencing any *new activity* authorized under section 5136A(a)(2)(A)(i) of the Revised Statutes if the bank or any of its insured depository institution affiliates received a CRA rating of less than "satisfactory record of meeting community credit needs" incorporates the term "new activity" that is used in the GLBA to refer to the expanded financial activities newly authorized by section 5136A(a)(2)(A)(i) of the Revised Statutes. Thus, when a bank operates through a financial subsidiary, and the bank or one of its insured depository institution affiliates subsequently receives a CRA rating of less than "satisfactory record of meeting community credit needs," the bank may not start up an additional financial activity that may only be conducted by a national bank through a financial subsidiary, nor may it acquire control of or establish an additional financial subsidiary or acquire all or substantially all of the assets of an additional company that is or would be a financial subsidiary, even if the financial subsidiary to be established or acquired is engaged in the same activities as the existing financial subsidiary.

Failure To Continue To Meet Certain Requirements (§ 5.39(j))

The proposal states that a national bank and its affiliated depository institutions must continue to satisfy the well managed, well capitalized, and asset size requirements applicable to its financial subsidiaries and the conditions in proposed § 5.39(h)(1), (2), (3), and (4) after the bank acquires control of, or an interest in, a financial subsidiary. A national bank that fails to continue to satisfy these requirements is subject to several procedural requirements and OCC remedies. For example, the OCC must give notice to the bank and, in the case of an affiliated depository institution to that depository institution's appropriate Federal banking agency, promptly upon determining that the bank, or, as applicable, its affiliated depository institution, does not continue to meet these requirements. Under the proposal, the bank is deemed to have received this notice three days after mailing of the letter by the OCC. Not later than 45 days after receipt of this notice, or any additional time as the OCC may permit, the bank must execute an agreement with the OCC to comply with these requirements.

At any time until the conditions described in the notice are corrected, the OCC may impose limitations on the conduct or activities of the national bank or any subsidiary of the national bank that the OCC determines appropriate under the circumstances and consistent with the purposes of section 5136A of the Revised Statutes. The OCC also may require the bank to divest control of a financial subsidiary if the bank does not correct the conditions giving rise to the notice within 180 days after its receipt of the notice.

The GLBA provides that a national bank that does not continue to meet any applicable eligible debt requirement may not purchase, directly or through a subsidiary, any additional equity capital of a financial subsidiary. The term "equity capital" is defined in § 5.39(j)(2), consistent with the GLBA, to include, in addition to any equity investment, any debt instrument issued by a financial subsidiary if the instrument qualifies as capital of the subsidiary under applicable Federal or State law, regulation, or interpretation. In response to a question posed by a commenter, the final rule clarifies that this limitation applies when the bank has a financial subsidiary where the eligible debt requirement is applicable, *i.e.* where the financial subsidiary is engaged in activities other than solely in

an agency capacity, and with respect to additional equity capital of such a subsidiary.

Finally, one commenter recommended adding clarifying language to § 5.39 similar to the provision in § 5.34 that recognizes the GLBA provisions relating to the functional regulation of certain types of bank subsidiaries and affiliates. The OCC agrees with this suggestion and the final rule adds a new § 5.39(k), which provides that a financial subsidiary is subject to examination and supervision by the OCC, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the GLBA (12 U.S.C. 1820a).

Operating Subsidiaries (revised § 5.34)

Proposed § 5.34 authorizes national banks to engage through operating subsidiaries in activities that are part of, or incidental to, the business of banking. The proposal makes several changes to § 5.34 to be more consistent with the procedural requirements of proposed § 5.39, to remove unnecessary regulatory burden, and to make other adjustments that are necessary in light of the GLBA.

First, the proposal consolidates and moves activities formerly subject to an expedited application review into the more streamlined category which requires banks simply to file a notice with the appropriate OCC district office no later than 10 days after establishing or acquiring an operating subsidiary, or commencing a new activity in an existing operating subsidiary. Second, the proposal expands the list of notice activities to include other activities that the OCC has found to be part of, or incidental to, the business of banking⁴ and has approved on a regular basis for national bank operating subsidiaries. Finally, given the expansion of the notice category, a national bank using the notice procedure must be well capitalized and well managed as defined in § 5.34(d).⁵

The final rule makes several changes to the list of activities eligible for a notice filing, and the OCC will periodically review and update this list as necessary. First, the OCC has added two new activities to the list of activities eligible for notice processing: (1) "acting as a digital certification authority" to

⁴ This is not a complete list of activities that are part of, or incidental to, the business of banking. The OCC will review new proposals for activities that may be permissible under this section pursuant to the application procedures contained in § 5.34 and in response to requests for legal opinions.

⁵ A corresponding change is made with respect to the expanded notice process available for bank service companies in § 5.35(f)(2).

the extent that activity is permitted by published OCC precedent and is conducted in accordance with the terms and conditions set forth in that precedent; and (2) "providing or selling public transportation tickets, event and attraction tickets, gift certificates, prepaid phone cards, promotional and advertising material, postage stamps, and Electronic Benefits Transfer (EBT) script, and similar media," to the extent permitted by published OCC precedent, subject to the terms and conditions contained in that precedent. The OCC also has revised the notice provision relating to underwriting credit life insurance to include other types of credit related insurance the OCC has approved. Thus, the final rule refers to underwriting credit related insurance to the extent consistent with section 302 of GLBA. The final rule also clarifies that the notice provision relating to acting as an investment adviser (§ 5.34(e)(5)(v)(I)) includes acting as an investment adviser with discretion and revises the provision on providing check guaranty and verification services to clarify that it includes payment services. Finally, the final rule clarifies that real estate appraisal services for the subsidiary, parent bank, or other financial institutions are moved from the former list of activities eligible for expedited review to the notice list.

One commenter requested that the OCC expand the language in § 5.34(e)(5)(v) regarding finder activities because of the various opportunities created by the proliferation of electronic commerce. The OCC notes that it currently is soliciting comment on a broad range of issues through an advance notice of proposed rulemaking intended to identify changes to existing rules that would facilitate bank use of new technologies.⁶ The OCC will review this request in that context.

One commenter also urged the OCC to amend § 5.34(e)(5)(v)(P), which is the notice activity for acting as an insurance agent or broker, to expressly limit that activity in any manner required by 12 U.S.C. 92 or 12 U.S.C. 24 (Seventh). However, the OCC believes that additional language is unnecessary because the rule clearly states that operating subsidiaries may only engage in activities permissible for the parent bank to engage in directly, either as part of, or incidental to, the business of banking or otherwise under other statutory authority. This language would address any requirements in 12 U.S.C. 92 or 12 U.S.C. 24 (Seventh) that are applicable.

⁶ 65 FR 4895 (Feb. 2, 2000).

The proposal also clarifies that "authorized products" referenced in the GLBA are activities permissible for operating subsidiaries under § 5.34. The final rule adopts the language in the proposal without changes.

The proposal also revises § 5.34 to conform to other changes made by the GLBA. First, the OCC proposed to remove former § 5.34(f) because the GLBA makes clear that an operating subsidiary may engage only in activities that are permissible for the parent bank to engage in directly. The final rule makes clear that an operating subsidiary conducts its activities subject to the same authorization, terms, and conditions that apply to the conduct of those activities by its parent bank. Second, the proposal removes the former statement that "each operating subsidiary is subject to examination and supervision by the OCC" and clarifies that the OCC's authority to examine and take action against certain subsidiaries is subject to the limitations and requirements of new section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the GLBA (12 U.S.C. 1820a). The OCC did not receive any comments on these provisions, and the final rule adopts the language as proposed.

Non-Controlling Investments (revised § 5.36)

Several commenters suggested including non-controlling (or minority) investments on the list in § 5.34(e)(5)(v), or otherwise providing an expedited notice process for non-controlling investments proposed to be made in the same types of companies eligible for an expedited operating subsidiary notice. Commenters recommended that the OCC establish expedited procedures to approve non-controlling investments made either by national banks directly or by their operating subsidiaries. Among other things, the commenters suggested that the availability of definite time frames would promote the rapid consummation of transactions and enhance the ability of national banks to compete effectively in areas such as electronic banking.⁷

The OCC previously has authorized national banks to own, either directly or indirectly through an operating subsidiary, a *non-controlling* interest in an enterprise.⁸ This authorization,

however, is subject to certain conditions that apply in the case of minority investments but do not apply to the other activities on the list in § 5.34(e)(5)(v), and thus the § 5.34(e)(5)(v) list format does not lend itself to a clear description of these conditions. Nevertheless, the OCC believes that prescribing streamlined procedures for national banks seeking to make certain types of minority investments, directly and by operating subsidiaries, is consistent with the new structural flexibility that the GLBA affords to national banks. For these reasons, we have concluded that it is preferable to revise § 5.36, which governs non-controlling investments, rather than to include minority investments on the list of operating subsidiary activities eligible for notice.

Accordingly, the final rule amends current § 5.36 to provide that a qualifying national bank may make certain non-controlling investments, directly or through its operating subsidiary, in an enterprise by filing a written notice with the appropriate OCC district office no later than 10 days after making the investment. The term "enterprise" includes any corporation, limited liability company, partnership, trust, or similar business entity. The notice procedure applies if the activity conducted by the enterprise is on the list in § 5.34(e)(5)(v), or if it is substantively the same as an activity that has been previously approved for a national bank (or its operating subsidiary) in published OCC precedent, and is conducted on the same terms and conditions that apply to the activity approved in that precedent.

This procedure is available for national banks that are well capitalized and well managed (as those terms are defined in § 5.34), that engage in the activities just described, and that submit a notice that contains the following information.

First, the bank must provide a clear description of the activities conducted by the enterprise in which the bank invests. To the extent the notice relates to the affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business

for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable. Second, the bank must state that the enterprise engages in activities described in § 5.34(e)(5)(v) or state, and describe how, the activities are substantively the same as those contained in published OCC precedent approving a non-controlling investment by a national bank or its operating subsidiary, and that those activities will be conducted in accordance with the same terms and conditions applicable to the activity covered by the precedent. The bank also must provide a citation to the applicable precedent. Third, the bank must certify that it is well capitalized and well managed.

Finally, the bank's notice must demonstrate that it satisfies the requirements applicable to non-controlling investments, as described in the OCC's published decisions. These include: (1) describing how the bank has the ability to prevent the enterprise from engaging in activities that are not set forth in § 5.34(e)(5)(v) or not contained in published OCC precedent approving a non-controlling investment by a national bank or its operating subsidiary, or how the bank otherwise has the ability to withdraw its investment; (2) certifying that the bank will account for its investment under the equity or cost method of accounting; (3) describing how the investment is convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to the bank's banking business; and (4) certifying that the enterprise in which the bank is investing agrees to be subject to OCC supervision and examination, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act and section 115 of GLBA.

The OCC will continue to address on a case-by-case basis situations where a national bank is not well managed or well capitalized but seeks to make a non-controlling investment directly or where a national bank wishes to invest in a company that engages in activities that are not eligible for the notice procedure.

Other Matters

Financial Subsidiaries and Operating Subsidiaries of Federal Branches and Agencies

The proposal also invited comment on whether national treatment principles would be furthered if Federal branches and agencies of foreign banks are authorized to invest in financial and

⁷ Currently, national banks making non-controlling investments directly submit requests for an OCC opinion regarding the permissibility of the investment.

⁸ See, e.g., OCC Corporate Decision No. 97-54 (June 26, 1997); OCC Interpretive Letter No. 692, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (Nov. 1, 1995); OCC

Interpretive Letter No. 694, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH)

¶ 81,009 (Dec. 13, 1995); OCC Interpretive Letter No. 705, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,020 (Oct. 25, 1995); OCC Interpretive Letter No. 711, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (Feb. 23, 1996).

operating subsidiaries, and, if so, how the OCC would apply the applicable qualification standards. The OCC received six comments on this issue. The commenters strongly supported permitting Federal branches and agencies to invest in and control financial subsidiaries and operating subsidiaries. The OCC agrees that Federal branches and agencies should be authorized to hold these subsidiaries and expects to issue a separate proposal to address the details of how that authority may be implemented in the near future.

Conforming Technical Changes

Finally, the final rule makes conforming technical changes to §§ 5.24 and 5.33. These changes clarify that separate notices under § 5.39 to acquire control of, or an interest in, a financial subsidiary are not required where that information is supplied in connection with the conversion or merger application. In addition, the final rule revises § 5.35, the OCC rule relating to bank service companies, to remove the provisions in that section relating to expedited application filings. This change was made to conform to similar changes made to § 5.34. Section 5.35 refers to § 5.34 to determine which activities are eligible for notice filing. Thus, the changes to § 5.34 that consolidated and moved the activities formerly listed in the expedited processing list into the notice category will similarly affect § 5.35.

Effective Date

The Administrative Procedure Act provides that, subject to several exceptions, a final rule may not be made effective until 30 days after publication in the **Federal Register**. 5 U.S.C. 553(d). However, an agency may make a final rule immediately effective upon publication if the agency finds good cause for doing so and publishes its findings with the rule. Likewise, section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI), Public Law 103-325, authorizes a banking agency to issue a rule to be effective before the first day of the calendar quarter that begins on or after the date on which the regulations are published in final form if the agency finds good cause for an earlier effective date. 12 U.S.C. 4802(b)(1).

This final rule takes effect on March 11, 2000. The OCC finds good cause to dispense with the 30-day delayed effective date pursuant to 5 U.S.C. 553(d)(3). The OCC also has determined that good cause exists to adopt an effective date that is before the first day

of the calendar quarter that begins on or after the date on which the regulation is published, as would otherwise be required by section 102 of the CDRI (12 U.S.C. 4802(b)(1)). Unless the OCC has a final rule in place by March 11, 2000, national banks will be unable to exercise the GLBA financial subsidiary authority when it becomes available to them under the law. Moreover, as of March 11, 2000, certain portions of the OCC's current operating subsidiary rule will be superseded by the new law. Therefore, the final rule takes effect on March 11, 2000, in order to eliminate potential confusion or disruption for banks seeking to restructure their operations in accordance with the GLBA.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Comptroller of the Currency certifies that this final rule will not have a significant economic impact on a substantial number of small entities. The principal effect of this final rule is to provide procedures for implementing section 121 of the GLBA for national banks that wish to engage in activities through financial subsidiaries. The final rule also would require national banks making non-controlling investments in certain entities to file a notice with the OCC. The final rule also would reduce regulatory burden by increasing the number of activities that are subject to notice requirements rather than application requirements where a national bank intends to engage in activities through an operating subsidiary or to make a non-controlling investment in an enterprise through an operating subsidiary.

Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC has determined that this final rule will not result in expenditures by State, local, or tribal governments or by the private sector of \$100 million or more. Accordingly, the OCC has not

prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

Executive Order 12866 Determination

The Comptroller of the Currency has determined that this final rule does not constitute a "significant regulatory action" for the purposes of Executive Order 12866.

Paperwork Reduction Act

The collection of information requirements in this final rule are found in §§ 5.24(d)(2)(ii)(G), 5.33(e)(3)(i) and (ii), 5.34(b) and (e), 5.35(f), 5.36(e), and 5.39(b) and (i). These collection of information requirements have been reviewed and approved by the Office of Management and Budget in accordance with the emergency review procedures of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(j)) under OMB Control Number 1557-0215.

List of Subjects in 12 CFR Part 5

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements, Securities.

Authority and Issuance

For the reasons set forth in the preamble, the OCC amends chapter I of title 12 of the Code of Federal Regulations as follows:

PART 5—RULES, POLICIES, AND PROCEDURES FOR CORPORATE ACTIVITIES

1. The authority citation for part 5 is revised to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 93a; and section 5136A of the Revised Statutes (12 U.S.C. 24a).

2. In § 5.24, paragraph (d)(2)(ii)(G) is revised to read as follows:

§ 5.24 Conversion.

* * * * *

(d) * * *

(2) * * *

(ii) * * *

(G) Identify all subsidiaries that will be retained following the conversion, and provide the information and analysis of the subsidiaries' activities that would be required if the converting bank or savings association were a national bank establishing each subsidiary pursuant to §§ 5.34 or 5.39; and

* * * * *

3. In § 5.33, paragraphs (e)(3)(i) and (e)(3)(ii) are revised to read as follows:

§ 5.33 Business combinations.

* * * * *

(e) * * *

(3) * * *

(i) An applicant must identify any subsidiary to be acquired in a business combination and state the activities of each subsidiary. The OCC does not require a separate application under § 5.34 or a separate notice under § 5.39.

(ii) An applicant proposing to acquire, through a business combination, a subsidiary of a depository institution other than a national bank must provide the same information and analysis of the subsidiary's activities that would be required if the applicant were establishing the subsidiary pursuant to §§ 5.34 or 5.39.

* * * * *

4. Section 5.34 is revised to read as follows:

§ 5.34 Operating subsidiaries.

(a) *Authority.* 12 U.S.C. 24 (Seventh), 93a, and section 5136A of the Revised Statutes (12 U.S.C. 24a).

(b) *Licensing requirements.* A national bank must file a notice or application as prescribed in this section to acquire or establish an operating subsidiary, or to commence a new activity in an existing operating subsidiary.

(c) *Scope.* This section sets forth authorized activities and application or notice procedures for national banks engaging in activities through an operating subsidiary. The procedures in this section do not apply to financial subsidiaries authorized under § 5.39.

(d) *Definitions.* For purposes of this § 5.34:

(1) *Authorized product* means a product that would be defined as insurance under section 302(c) of the Gramm-Leach-Bliley Act (Public Law 106-102, 113 Stat. 1338, 1407) (GLBA) (15 U.S.C. 6712) that, as of January 1, 1999, the OCC had determined in writing that national banks may provide as principal or national banks were in fact lawfully providing the product as principal, and as of that date no court of relevant jurisdiction had, by final judgment, overturned a determination by the OCC that national banks may provide the product as principal. An authorized product does not include title insurance, or an annuity contract the income of which is subject to treatment under section 72 of the Internal Revenue Code of 1986 (26 U.S.C. 72).

(2) *Well capitalized* means the capital level described in 12 CFR 6.4(b)(1).

(3) *Well managed* means, unless otherwise determined in writing by the OCC:

(i) The national bank has received a composite rating of 1 or 2 under the

Uniform Financial Institutions Rating System in connection with its most recent examination; or

(ii) In the case of any national bank that has not been examined, the existence and use of managerial resources that the OCC determines are satisfactory.

(e) *Standards and requirements—(1) Authorized activities.* A national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority, including:

(i) Providing authorized products as principal; and

(ii) Providing title insurance as principal if the national bank or subsidiary thereof was actively and lawfully underwriting title insurance before November 12, 1999, and no affiliate of the national bank (other than a subsidiary) provides insurance as principal. A subsidiary may not provide title insurance as principal if the state had in effect before November 12, 1999, a law which prohibits any person from underwriting title insurance with respect to real property in that state.

(2) *Qualifying subsidiaries.* An operating subsidiary in which a national bank may invest includes a corporation, limited liability company, or similar entity if the parent bank owns more than 50 percent of the voting (or similar type of controlling) interest of the operating subsidiary; or the parent bank otherwise controls the operating subsidiary and no other party controls more than 50 percent of the voting (or similar type of controlling) interest of the operating subsidiary. However, the following subsidiaries are not operating subsidiaries subject to this section:

(i) A subsidiary in which the bank's investment is made pursuant to specific authorization in a statute or OCC regulation (e.g., a bank service company under 12 U.S.C. 1861 *et seq.* or a financial subsidiary under section 5136A of the Revised Statutes (12 U.S.C. 24a)); and

(ii) A subsidiary in which the bank has acquired, in good faith, shares through foreclosure on collateral, by way of compromise of a doubtful claim, or to avoid a loss in connection with a debt previously contracted.

(3) *Examination and supervision.* An operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank. If, upon examination, the OCC determines that the operating subsidiary

is operating in violation of law, regulation, or written condition, or in an unsafe or unsound manner or otherwise threatens the safety or soundness of the bank, the OCC will direct the bank or operating subsidiary to take appropriate remedial action, which may include requiring the bank to divest or liquidate the operating subsidiary, or discontinue specified activities. OCC authority under this paragraph is subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the Gramm-Leach-Bliley Act (12 U.S.C. 1820a).

(4) *Consolidation of figures.* Pertinent book figures of the parent bank and its operating subsidiary shall be combined for the purpose of applying statutory or regulatory limitations when combination is needed to effect the intent of the statute or regulation, e.g., for purposes of 12 U.S.C. 56, 60, 84, and 371d.

(5) *Procedures—(i) Application required.* (A) Except as provided in paragraph (e)(5)(iv) or (e)(5)(vi) of this section, a national bank that intends to acquire or establish an operating subsidiary, or to perform a new activity in an existing operating subsidiary, must first submit an application to, and receive approval from, the OCC. The application must include a complete description of the bank's investment in the subsidiary, the proposed activities of the subsidiary, the organizational structure and management of the subsidiary, the relations between the bank and the subsidiary, and other information necessary to adequately describe the proposal. To the extent the application relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable. The application must state whether the operating subsidiary will conduct any activity at a location other than the main office or a previously approved branch of the bank. The OCC may require the applicant to submit a legal analysis if the proposal is novel, unusually complex, or raises substantial unresolved legal issues. In these cases, the OCC encourages applicants to have a pre-filing meeting with the OCC.

(B) A national bank must file an application and obtain prior approval before acquiring or establishing an

operating subsidiary, or performing a new activity in an existing operating subsidiary, if the bank controls the subsidiary but owns 50 percent or less of the voting (or similar type of controlling) interest of the subsidiary. These applications are not subject to the filing exemption in paragraph (e)(5)(vi) of this section and are not eligible for the notice procedures in paragraph (e)(5)(iv) of this section.

(ii) *Exceptions to rules of general applicability.* Sections 5.8, 5.10, and 5.11 do not apply to this section. However, if the OCC concludes that an application presents significant and novel policy, supervisory, or legal issues, the OCC may determine that some or all provisions in §§ 5.8, 5.10, and 5.11 apply.

(iii) *OCC review and approval.* The OCC reviews a national bank's application to determine whether the proposed activities are legally permissible and to ensure that the proposal is consistent with safe and sound banking practices and OCC policy and does not endanger the safety or soundness of the parent national bank. As part of this process, the OCC may request additional information and analysis from the applicant.

(iv) *Notice process for certain activities.* A national bank that is "well capitalized" and "well managed" may acquire or establish an operating subsidiary, or perform a new activity in an existing operating subsidiary, by providing the appropriate district office written notice within 10 days after acquiring or establishing the subsidiary, or commencing the activity, if the activity is listed in paragraph (e)(5)(v) of this section. The written notice must include a complete description of the bank's investment in the subsidiary and of the activity conducted and a representation and undertaking that the activity will be conducted in accordance with OCC policies contained in guidance issued by the OCC regarding the activity. To the extent the notice relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable. Any bank receiving approval under this paragraph is deemed to have agreed that the subsidiary will conduct the activity in a manner consistent with published OCC guidance.

(v) *Activities eligible for notice.* The following activities qualify for the notice procedures, provided the activity is conducted pursuant to the same terms and conditions as would be applicable if the activity were conducted directly by a national bank:

(A) Holding and managing assets acquired by the parent bank, including investment assets and property acquired by the bank through foreclosure or otherwise in good faith to compromise a doubtful claim, or in the ordinary course of collecting a debt previously contracted;

(B) Providing services to or for the bank or its affiliates, including accounting, auditing, appraising, advertising and public relations, and financial advice and consulting;

(C) Making loans or other extensions of credit, and selling money orders, savings bonds, and travelers checks;

(D) Purchasing, selling, servicing, or warehousing loans or other extensions of credit, or interests therein;

(E) Providing courier services between financial institutions;

(F) Providing management consulting, operational advice, and services for other financial institutions;

(G) Providing check guaranty, verification and payment services;

(H) Providing data processing, data warehousing and data transmission products, services, and related activities and facilities, including associated equipment and technology, for the bank or its affiliates;

(I) Acting as investment adviser (including an adviser with investment discretion) or financial adviser or counselor to governmental entities or instrumentalities, businesses, or individuals, including advising registered investment companies and mortgage or real estate investment trusts, furnishing economic forecasts or other economic information, providing investment advice related to futures and options on futures, and providing consumer financial counseling;

(J) Providing tax planning and preparation services;

(K) Providing financial and transactional advice and assistance, including advice and assistance for customers in structuring, arranging, and executing mergers and acquisitions, divestitures, joint ventures, leveraged buyouts, swaps, foreign exchange, derivative transactions, coin and bullion, and capital restructurings;

(L) Underwriting credit related insurance to the extent permitted under section 302 of the GLBA (15 U.S.C. 6712);

(M) Leasing of personal property and acting as an agent or adviser in leases for others;

(N) Providing securities brokerage or acting as a futures commission merchant, and providing related credit and other related services;

(O) Underwriting and dealing, including making a market, in bank permissible securities and purchasing and selling as principal, asset backed obligations;

(P) Acting as an insurance agent or broker, including title insurance to the extent permitted under section 303 of the GLBA (15 U.S.C. 6713);

(Q) Reinsuring mortgage insurance on loans originated, purchased, or serviced by the bank, its subsidiaries, or its affiliates, provided that if the subsidiary enters into a quota share agreement, the subsidiary assumes less than 50 percent of the aggregate insured risk covered by the quota share agreement. A "quota share agreement" is an agreement under which the reinsurer is liable to the primary insurance underwriter for an agreed upon percentage of every claim arising out of the covered book of business ceded by the primary insurance underwriter to the reinsurer;

(R) Acting as a finder pursuant to 12 CFR 7.1002 to the extent permitted by published OCC precedent;¹

(S) Offering correspondent services to the extent permitted by published OCC precedent;

(T) Acting as agent or broker in the sale of fixed or variable annuities;

(U) Offering debt cancellation or debt suspension agreements;

(V) Providing real estate settlement, closing, escrow, and related services; and real estate appraisal services for the subsidiary, parent bank, or other financial institutions;

(W) Acting as a transfer or fiscal agent;

(X) Acting as a digital certification authority to the extent permitted by published OCC precedent, subject to the terms and conditions contained in that precedent; and

(Y) Providing or selling public transportation tickets, event and attraction tickets, gift certificates, prepaid phone cards, promotional and advertising material, postage stamps, and Electronic Benefits Transfer (EBT) script, and similar media, to the extent permitted by published OCC precedent, subject to the terms and conditions contained in that precedent.

¹ See, e.g., the OCC's monthly publication "Interpretations and Actions." Beginning with the May 1996 issue, the OCC's Web site provides access to electronic versions of "Interpretations and Actions" (www.occ.treas.gov).

(vi) *No application or notice required.* A national bank may acquire or establish an operating subsidiary without filing an application or providing notice to the OCC, if the bank is adequately capitalized or well capitalized and the:

(A) Activities of the new subsidiary are limited to those activities previously reported by the bank in connection with the establishment or acquisition of a prior operating subsidiary;

(B) Activities in which the new subsidiary will engage continue to be legally permissible for the subsidiary; and

(C) Activities of the new subsidiary will be conducted in accordance with any conditions imposed by the OCC in approving the conduct of these activities for any prior operating subsidiary of the bank.

(vii) *Fiduciary powers.* If an operating subsidiary proposes to exercise investment discretion on behalf of customers or provide investment advice for a fee, the national bank must have prior OCC approval to exercise fiduciary powers pursuant to § 5.26.

5. Section 5.35 is amended by:

A. Revising paragraph (e);

B. Revising paragraphs (f)(1) and (f)(2);

C. Removing paragraph (f)(3);

D. Redesignating paragraphs (f)(4) through (f)(6) as paragraphs (f)(3) through (f)(5); and

E. Revising paragraphs (g)(2), (h), and (i)(2) to read as follows:

§ 5.35 Bank service companies.

* * * * *

(e) *Standards and requirements.* A national bank may invest in a bank service company that conducts activities described in paragraphs (f)(3) and (f)(4) of this section, and activities (other than taking deposits) permissible for the national bank and other state and national bank shareholders or members in the bank service company.

(f) *Procedures—(1) OCC notice and approval required.* Except as provided in paragraphs (f)(2) and (f)(4) of this section, a national bank that intends to make an investment in a bank service company, or to perform new activities in an existing bank service company, must submit a notice to and receive prior approval from the OCC. The OCC approves or denies a proposed investment within 60 days after the filing is received by the OCC, unless the OCC notifies the bank prior to that date that the filing presents a significant supervisory or compliance concern, or raises a significant legal or policy issue. The notice must include the information required by paragraph (g) of this section.

(2) *Notice process only for certain activities.* A national bank that is “well capitalized” and “well managed” as defined in § 5.34(d) may invest in a bank service company, or perform a new activity in an existing bank service company, by providing the appropriate district office written notice within 10 days after the investment, if the bank service company engages only in the activities listed in § 5.34(e)(5)(v). No prior OCC approval is required. The written notice must include a complete description of the bank’s investment in the bank service company and of the activity conducted and a representation and undertaking that the activity will be conducted in accordance with OCC guidance. To the extent the notice relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable. Any bank receiving approval under this paragraph is deemed to have agreed that the bank service company will conduct the activity in a manner consistent with the published OCC guidance.

* * * * *

(g) * * *

(2) A complete description of the activities the bank service company will conduct. To the extent the notice relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable;

* * * * *

(h) *Examination and supervision.*

Each bank service company in which a national bank is the principal investor is subject to examination and supervision by the OCC in the same manner and to the same extent as that national bank. OCC authority under this paragraph is subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the Gramm-Leach-Bliley Act (12 U.S.C. 1820a).

(i) * * *

(2) *Other limitations.* Except as provided in paragraph (f)(4) of this section, a bank service company shall only conduct activities that the national bank could conduct directly. If the bank service company has both national and state bank shareholders or members, the activities conducted must also be permissible for the state bank shareholders or members.

6. Section 5.36 is amended by:

A. Redesignating paragraphs (c) and (d) as paragraphs (d) and (f) respectively, and

B. Adding new paragraphs (c) and (e) to read as follows:

§ 5.36 Other equity investments.

* * * * *

(c) *Definitions.* For purposes of this § 5.36:

(1) *Enterprise* means any corporation, limited liability company, partnership, trust, or similar business entity.

(2) *Well capitalized* means the capital level described in 12 CFR 6.4(b)(1).

(3) *Well managed* has the meaning set forth in § 5.34(d)(3).

* * * * *

(e) *Non-controlling investments.* A national bank may make a non-controlling investment, directly or through its operating subsidiary, in an enterprise that engages in the activities described in paragraph (e)(2) of this section by filing a written notice. The written notice must be filed with the appropriate district office no later than 10 days after making the investment and must:

(1) Describe the structure of the investment and the activity or activities conducted by the enterprise in which the bank is investing. To the extent the notice relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable;

(2) State which paragraphs of § 5.34(e)(5)(v) describe the activity or activities, or state that, and describe how, the activity is substantively the same as that contained in published OCC precedent approving a non-controlling investment by a national bank or its operating subsidiary, state that the activity will be conducted in accordance with the same terms and conditions applicable to the activity covered by the precedent, and provide the citation to the applicable precedent;

(3) Certify that the bank is well managed and well capitalized at the time of the investment;

(4) Describe how the bank has the ability to prevent the enterprise from engaging in activities that are not set forth in § 5.34(e)(5)(v) or not contained in published OCC precedent approving a non-controlling investment by a national bank or its operating subsidiary, or how the bank otherwise has the ability to withdraw its investment;

(5) Certify that the bank will account for its investment under this section under the equity or cost method of accounting;

(6) Describe how the investment is convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to the bank's banking business; and

(7) Certify that the enterprise in which the bank is investing agrees to be subject to OCC supervision and examination, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the Gramm-Leach-Bliley Act (12 U.S.C. 1820a).

* * * * *

7. A new § 5.39 is added to subpart C to read as follows:

§ 5.39 Financial subsidiaries.

(a) *Authority.* 12 U.S.C. 93a and section 121 of Public Law 106–102, 113 Stat. 1338, 1373.

(b) *Approval requirements.* A national bank must file a notice as prescribed in this section prior to acquiring a financial subsidiary or engaging in activities authorized pursuant to section 5136A(a)(2)(A)(i) of the Revised Statutes (12 U.S.C. 24a) through a financial subsidiary. When a financial subsidiary proposes to conduct a new activity permitted under § 5.34, the bank shall follow the procedures in § 5.34(e)(5) instead of paragraph (i) of this section.

(c) *Scope.* This section sets forth authorized activities, approval procedures, and, where applicable, conditions for national banks engaging in activities through a financial subsidiary.

(d) *Definitions.* For purposes of this § 5.39:

(1) *Affiliate* has the meaning set forth in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), except that the term “affiliate” for purposes of paragraph (h)(5) of this section shall have the meaning set forth in sections 23A or 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1), as applicable.

(2) *Appropriate Federal banking agency* has the meaning set forth in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(3) *Company* has the meaning set forth in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), and includes a limited liability company (LLC).

(4) *Control* has the meaning set forth in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(5) *Eligible debt* means unsecured long-term debt that is:

(i) Not supported by any form of credit enhancement, including a guaranty or standby letter of credit; and

(ii) Not held in whole or in any significant part by any affiliate, officer, director, principal shareholder, or employee of the bank or any other person acting on behalf of or with funds from the bank or an affiliate of the bank.

(6) *Financial subsidiary* means any company that is controlled by one or more insured depository institutions, other than a subsidiary that:

(i) Engages solely in activities that national banks may engage in directly and that are conducted subject to the same terms and conditions that govern the conduct of these activities by national banks; or

(ii) A national bank is specifically authorized to control by the express terms of a Federal statute (other than section 5136A of the Revised Statutes), and not by implication or interpretation, such as by section 25 of the Federal Reserve Act (12 U.S.C. 601–604a), section 25A of the Federal Reserve Act (12 U.S.C. 611–631), or the Bank Service Company Act (12 U.S.C. 1861 *et seq.*)

(7) *Insured depository institution* has the meaning set forth in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(8) *Long term debt* means any debt obligation with an initial maturity of 360 days or more.

(9) *Subsidiary* has the meaning set forth in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(10) *Tangible equity* has the meaning set forth in 12 CFR 6.2(g).

(11) *Well capitalized* with respect to a depository institution means the capital level designated as “well capitalized” by the institution's appropriate Federal banking agency pursuant to section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o).

(12) *Well managed* means:

(i) Unless otherwise determined in writing by the appropriate Federal banking agency, the institution has received a composite rating of 1 or 2 under the Uniform Financial

Institutions Rating System (or an equivalent rating under an equivalent rating system) in connection with the most recent examination or subsequent review of the depository institution and, at least a rating of 2 for management, if such a rating is given; or

(ii) In the case of any depository institution that has not been examined by its appropriate Federal banking agency, the existence and use of managerial resources that the appropriate Federal banking agency determines are satisfactory.

(e) *Authorized activities.* A financial subsidiary may engage only in the following activities:

(1) Activities that are financial in nature and activities incidental to a financial activity, authorized pursuant to 5136A(a)(2)(A)(i) of the Revised Statutes (12 U.S.C. 24a) (to the extent not otherwise permitted under paragraph (e)(2) of this section), including:

(i) Lending, exchanging, transferring, investing for others, or safeguarding money or securities;

(ii) Engaging as agent or broker in any state for purposes of insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, death, defects in title, or providing annuities as agent or broker;

(iii) Providing financial, investment, or economic advisory services, including advising an investment company as defined in section 3 of the Investment Company Act (15 U.S.C. 80a–3);

(iv) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;

(v) Underwriting, dealing in, or making a market in securities;

(vi) Engaging in any activity that the Board of Governors of the Federal Reserve System has determined, by order or regulation in effect on November 12, 1999, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto (subject to the same terms and conditions contained in the order or regulation, unless the order or regulation is modified by the Board of Governors of the Federal Reserve System);

(vii) Engaging, in the United States, in any activity that a bank holding company may engage in outside the United States and the Board of Governors of the Federal Reserve System has determined, under regulations prescribed or interpretations issued pursuant to section 4(c)(13) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(13)) as in effect on November 11, 1999, to be usual in

connection with the transaction of banking or other financial operations abroad; and

(viii) Activities that the Secretary of the Treasury in consultation with the Board of Governors of the Federal Reserve System, as provided in section 5136A of the Revised Statutes, determines to be financial in nature or incidental to a financial activity; and

(2) Activities that may be conducted by an operating subsidiary pursuant to § 5.34.

(f) *Impermissible activities.* A financial subsidiary may not engage as principal in the following activities:

(1) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability or death, or defects in title (except to the extent permitted under sections 302 or 303(c) of the Gramm-Leach-Bliley Act (GLBA)), 113 Stat. 1407–1409, (15 U.S.C. 6712 or 15 U.S.C. 6713) or providing or issuing annuities the income of which is subject to tax treatment under section 72 of the Internal Revenue Code (26 U.S.C. 72);

(2) Real estate development or real estate investment, unless otherwise expressly authorized by law; and

(3) Activities authorized for bank holding companies by section 4(k)(4)(H) or (I) (12 U.S.C. 1843) of the Bank Holding Company Act, except activities authorized under section 4(k)(4)(H) that may be permitted in accordance with section 122 of the GLBA, 113 Stat. 1381.

(g) *Qualifications.* A national bank may, directly or indirectly, control a financial subsidiary or hold an interest in a financial subsidiary only if:

(1) The national bank and each depository institution affiliate of the national bank are well capitalized and well managed;

(2) The aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of 45 percent of the consolidated total assets of the parent bank or \$50 billion (or such greater amount as is determined according to an indexing mechanism jointly established by regulation by the Secretary of the Treasury and the Board of Governors of the Federal Reserve System); and

(3) If the national bank is one of the 100 largest insured banks, determined on the basis of the bank's consolidated total assets at the end of the calendar year, the bank has at least one issue of outstanding eligible debt that is currently rated in one of the three highest investment grade rating categories by a nationally recognized statistical rating organization. If the national bank is one of the second 50 largest insured banks, it may either satisfy this requirement or satisfy

alternative criteria the Secretary of the Treasury and the Board of Governors of the Federal Reserve System establish jointly by regulation. This paragraph (g)(3) does not apply if the financial subsidiary is engaged solely in activities in an agency capacity.

(h) *Safeguards.* The following safeguards apply to a national bank that establishes or maintains a financial subsidiary:

(1) For purposes of determining regulatory capital:

(i) The national bank must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries from its total assets and tangible equity and deduct such investment from its total risk-based capital (this deduction shall be made equally from Tier 1 and Tier 2 capital); and

(ii) The national bank may not consolidate the assets and liabilities of a financial subsidiary with those of the bank;

(2) Any published financial statement of the national bank shall, in addition to providing information prepared in accordance with generally accepted accounting principles, separately present financial information for the bank in the manner provided in paragraph (h)(1) of this section;

(3) The national bank must have reasonable policies and procedures to preserve the separate corporate identity and limited liability of the bank and the financial subsidiaries of the bank;

(4) The national bank must have procedures for identifying and managing financial and operational risks within the bank and the financial subsidiary that adequately protect the national bank from such risks;

(5) Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1) apply to transactions involving a financial subsidiary in the following manner:

(i) A financial subsidiary shall be deemed to be an affiliate of the bank and shall not be deemed to be a subsidiary of the bank;

(ii) The restrictions contained in section 23A(a)(1)(A) of the Federal Reserve Act shall not apply with respect to covered transactions between a bank and any individual financial subsidiary of the bank;

(iii) The bank's investment in the financial subsidiary shall not include retained earnings of the financial subsidiary;

(iv) Any purchase of, or investment in, the securities of a financial subsidiary of a bank by an affiliate of the bank will be considered to be a

purchase of or investment in such securities by the bank; and

(v) Any extension of credit by an affiliate of a bank to a financial subsidiary of the bank may be considered an extension of credit by the bank to the financial subsidiary if the Board of Governors of the Federal Reserve System determines that such treatment is necessary or appropriate to prevent evasions of the Federal Reserve Act and the GLBA.

(6) A financial subsidiary shall be deemed a subsidiary of a bank holding company and not a subsidiary of the bank for purposes of the anti-tying prohibitions set forth in 12 U.S.C. 1971 *et seq.*

(i) *Procedures to engage in activities through a financial subsidiary.* A national bank that intends, directly or indirectly, to acquire control of, or hold an interest in, a financial subsidiary, or to commence a new activity in an existing financial subsidiary, must obtain OCC approval through the procedures set forth in paragraph (i)(1) or (i)(2) of this section.

(1) *Certification with subsequent notice.* (i) At any time, a national bank may file a "Financial Subsidiary Certification" with the appropriate district office listing the bank's depository institution affiliates and certifying that the bank and each of those affiliates is well capitalized and well managed.

(ii) Thereafter, at such time as the bank seeks OCC approval to acquire control of, or hold an interest in, a new financial subsidiary, or commence a new activity authorized under section 5136A(a)(2)(A)(i) of the Revised Statutes (12 U.S.C. 24a) in an existing subsidiary, the bank may file a written notice with the appropriate district office at the time of acquiring control of, or holding an interest in, a financial subsidiary, or commencing such activity in an existing subsidiary. The written notice must be labeled "Financial Subsidiary Notice" and must:

(A) State that the bank's Certification remains valid;

(B) Describe the activity or activities conducted by the financial subsidiary. To the extent the notice relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable;

(C) Cite the specific authority permitting the activity to be conducted by the financial subsidiary. (Where the authority relied on is an agency order or interpretation under section 4(c)(8) or 4(c)(13), respectively, of the Bank Holding Company Act of 1956, a copy of the order or interpretation should be attached);

(D) Certify that the bank will be well capitalized after making adjustments required by paragraph (h)(1) of this section;

(E) Demonstrate the aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of 45 percent of the bank's consolidated total assets or \$50 billion (or the increased level established by the indexing mechanism); and

(F) If applicable, certify that the bank meets the eligible debt requirement in paragraph (g)(3) of this section.

(2) *Combined certification and notice.* A national bank may file a combined certification and notice with the appropriate district office at least five business days prior to acquiring control of, or holding an interest in, a financial subsidiary, or commencing a new activity authorized pursuant to section 5136A(a)(2)(A)(i) of the Revised Statutes in an existing subsidiary. The written notice must be labeled "Financial Subsidiary Certification and Notice" and must:

(i) List the bank's depository institution affiliates and certify that the bank and each depository institution affiliate of the bank is well capitalized and well managed;

(ii) Describe the activity or activities to be conducted in the financial subsidiary. To the extent the notice relates to the initial affiliation of the bank with a company engaged in insurance activities, the bank should describe the type of insurance activity that the company is engaged in and has present plans to conduct. The bank must also list for each state the lines of business for which the company holds, or will hold, an insurance license, indicating the state where the company holds a resident license or charter, as applicable;

(iii) Cite the specific authority permitting the activity to be conducted by the financial subsidiary. (Where the authority relied on is an agency order or interpretation under section 4(c)(8) or 4(c)(13), respectively, of the Bank Holding Company Act of 1956, a copy of the order or interpretation should be attached);

(iv) Certify that the bank will remain well capitalized after making the

adjustments required by paragraph (h)(1) of this section;

(v) Demonstrate the aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of 45% of the bank's consolidated total assets or \$50 billion (or the increased level established by the indexing mechanism); and

(vi) If applicable, certify that the bank meets the eligible debt requirement in paragraph (g)(3) of this section.

(3) *Exceptions to rules of general applicability.* Sections 5.8, 5.10, 5.11, and 5.13 do not apply to activities authorized under this section.

(4) *Community Reinvestment Act (CRA).* A national bank may not apply under this paragraph (i) to commence a new activity authorized under section 5136A(a)(2)(A)(i) of the Revised Statutes (12 U.S.C. 24a), or directly or indirectly acquire control of a company engaged in any such activity, if the bank or any of its insured depository institution affiliates received a CRA rating of less than "satisfactory record of meeting community credit needs" on its most recent CRA examination prior to when the bank would file a notice under this section.

(j) *Failure to continue to meet certain qualification requirements—(1) Qualifications and safeguards.* A national bank, or, as applicable, its affiliated depository institutions, must continue to satisfy the qualification requirements set forth in paragraphs (g)(1) and (2) of this section and the safeguards in paragraphs (h)(1), (2), (3) and (4) of this section following its acquisition of control of, or an interest in, a financial subsidiary. A national bank that fails to continue to satisfy these requirements will be subject to the following procedures and requirements:

(i) The OCC shall give notice to the national bank and, in the case of an affiliated depository institution to that depository institution's appropriate Federal banking agency, promptly upon determining that the national bank, or, as applicable, its affiliated depository institution, does not continue to meet the requirements in paragraph (g)(1) or (2) of this section or the safeguards in paragraph (h)(1), (2), (3), or (4) of this section. The bank shall be deemed to have received such notice three business days after mailing of the letter by the OCC;

(ii) Not later than 45 days after receipt of the notice under paragraph (j)(1)(i) of this section, or any additional time as the OCC may permit, the national bank shall execute an agreement with the OCC to comply with the requirements in paragraphs (g)(1) and (2) and (h)(1), (2), (3), and (4) of this section;

(iii) The OCC may impose limitations on the conduct or activities of the national bank or any subsidiary of the national bank as the OCC determines appropriate under the circumstances and consistent with the purposes of section 5136A of the Revised Statutes; and

(iv) The OCC may require a national bank to divest control of a financial subsidiary if the national bank does not correct the conditions giving rise to the notice within 180 days after receipt of the notice provided under paragraph (j)(1)(i) of this section.

(2) *Eligible debt rating requirement.* A national bank that does not continue to meet the qualification requirement set forth in paragraph (g)(3) of this section, applicable where the bank's financial subsidiary is engaged in activities other than solely in an agency capacity, may not directly or through a subsidiary, purchase or acquire any additional equity capital of any such financial subsidiary until the bank meets the requirement in paragraph (g)(3) of this section. For purposes of this paragraph (j)(2), the term "equity capital" includes, in addition to any equity investment, any debt instrument issued by the financial subsidiary if the instrument qualifies as capital of the subsidiary under federal or state law, regulation, or interpretation applicable to the subsidiary.

(k) *Examination and supervision.* A financial subsidiary is subject to examination and supervision by the OCC, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the GLBA (12 U.S.C. 1820a).

Dated: March 3, 2000

John D. Hawke, Jr.,

Comptroller of the Currency.

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