

NOVEMBER 20, 1996

QUESTIONS AND ANSWERS ON PART 5

Q. Why are you revising part 5?

A. The OCC is revising part 5 to create a more risk-based approach to applications. There will be different application procedures depending on the type of application, the nature of the proposed transaction, and the strength of the bank. Banks will be able to give after-the-fact notice for certain transactions that are routine and that do not raise significant concerns. In addition, banks that qualify as "eligible banks" -- because of their strength -- will receive expedited processing of certain applications. The changes reduce unnecessary burden and provide incentives for banks to be well managed and well capitalized.

Q. How do the expedited procedures work?

A. Depending on the nature of the filing, eligible banks will generally be deemed to have OCC approval 15 days after the close of the comment period, or if no comment period is applicable, 30 days after the OCC receives the filing. The OCC will remove a filing from the expedited processing if it determines that the filing presents a significant supervisory, CRA (if applicable) or compliance concern requiring additional review.

Q. Does expedited review of corporate applications allow for consideration of CRA comments?

A. Expedited review does not affect the length of the public comment period. A public comment period of 30 days is provided under part 5 for applications subject to CRA in order to elicit CRA comments (except for certain very short-distance branch relocations, which have a 15-day comment period). The final rule provides that an application will be removed from expedited review if the OCC concludes, on the basis of public comment or other information, that an application presents significant unresolved CRA concerns requiring additional review.

The final rule also provides that the OCC may extend the expedited review period by an additional 10 days to investigate specific factual allegations which, if true, would indicate a reasonable possibility that the bank's CRA rating is less than satisfactory institution-wide, in a state, or in a multistate MSA, or the bank's CRA performance is less than satisfactory in an MSA or the non-MSA portion of a state for which the bank seeks approval of an application for a deposit facility. If performance is less than satisfactory, the OCC may remove the application from expedited processing.

Q. What changes are made in the operating subsidiary sections?

A. First, under many state laws, there are a variety of forms for business organizations available besides traditional corporations. For that reason, part 5 now permits a national bank to organize an operating subsidiary as a corporation, a limited liability company, or similar entity. Second, instead of requiring a bank to hold 80 percent of the voting interest in an operating subsidiary, part 5 now permits a bank to hold 50 percent, or even less, so long as the bank has control of the sub and no other entity owns more than 50 percent of the voting interest. Third, a well capitalized or adequately capitalized national bank may acquire or establish an op sub to engage in specific non-complex activities, listed in the regulation, simply by providing the OCC a written notice. For more complex activities, as listed in the regulation, expedited decision procedures are available for eligible national banks.

Q. Are you permitting bank op subs to perform activities not permissible for the parent bank?

A. The new part 5 permits national bank operating subsidiaries to engage in activities that are part of the business of banking or incidental to the business of banking. On occasion, some activities that are part of or incidental to the business of banking may not be permissible for the bank itself, but may be appropriate for a bank operating subsidiary. Part 5 recognizes this distinction and permits the OCC to determine, after notice and public comment, whether a particular activity is permissible for an operating subsidiary, even though it is different from what is permissible for its parent bank.

The new part 5 is one element in the Comptroller's regulatory review process to streamline regulations and eliminate unnecessary requirements without hindering the OCC's ability to ensure the safety and soundness of the banking system. If we find areas in our regulations that can be modified to improve banks' ability to meet customer needs, lower bank and consumer costs, and improve bank competitiveness, without hurting bank safety and soundness, we want to make those changes. This approach led us to this op sub provision, as well as the other changes in the regulation. The op sub provision will provide greater flexibility and organizational efficiency for national banks that will promote long-term bank safety and soundness. These changes will also enable banks to better meet customer needs at lower costs to consumers.

Q. How does part 5 fit in with congressional action on financial modernization?

A. Congress has debated financial modernization for a number of years, and we fully expect that debate to continue in the new Congress. Part of that debate will include legislation submitted by the Treasury Department. Treasury has said that part 5 advances its broader efforts to modernize the financial services industry.

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In the meantime, Congress has charged the OCC with the responsibility to interpret and implement the National Bank Act. Four unanimous Supreme Court decisions in the last three years have affirmed that the OCC's ability to interpret the National Bank Act includes the ability to allow evolution of the activities that national banks may engage in.

Q. What would be an example of an activity for an op sub not permissible for the parent bank?

A. One example is general partnerships. A bank is prohibited from being a general partner in a partnership. The reason for the prohibition is that being a general partner presents potential liability to the bank for the obligations of the partnership. However, an op sub can be a general partner in a partnership because the liability lies with the op sub, not the bank.

Q. Will this op sub provision allow banks to underwrite securities or insurance?

A. The op sub provision does not authorize any new activities for banks. What it does do is establish a process under which a national bank can apply for an operating subsidiary to engage in certain activities that may be different than those permitted to the parent bank. It permits us to consider whether an activity different from those permitted to the parent bank could be safely performed in an op sub, provided the op sub activity does not frustrate the purpose of the restrictions that apply to the parent bank.

Q. Do you have certain activities in mind that you would approve for a national bank operating subsidiary?

A. No. We will review applications on a case-by-case basis and have no preconceived notions of what application we will receive or what is possible under the op sub provision. But whatever we consider will be subject to public notice and comment, legal review and safety and soundness limitations, which can be expanded in specific cases.

Q. Does this op sub provision benefit some banks more than others?

A. The op sub provision is available to all banks. The provision will enable both large and small banks to decide for themselves what corporate structure will be most efficient in their particular circumstances. Past experience with other banking activities, such as mortgage banking, has shown that where banks have choice about how to structure their operations, some will establish operating subsidiaries and others will establish holding company affiliates, depending on their individual strategies and their desire to maximize operating efficiencies. Community banks in particular may find an operating subsidiary to be an efficient and relatively low-cost means to diversify their activities.

Q. Does part 5 include any safety and soundness safeguards for op subs?

A. The new part 5 lays out specific safety and soundness safeguards that apply to all op subs engaging in activities not permissible for the bank. These include requirements that the sub be adequately capitalized and have separate accounting and corporate records.

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The sub must also be separate from the bank, with physical facilities distinct from the bank, employees compensated by the sub, and a corporate name that is not the same as the bank's. It must conduct its operations under independent policies and procedures, intended to inform customers that the subsidiary is separate from the bank. It must ensure that any contracts with the bank are on terms and conditions comparable to contracts with independent entities, and must have internal controls to manage its financial and operational risks. One third of the subsidiary's directors must not be directors of the bank and must have relevant expertise that makes them capable of overseeing the subsidiary's activities.

Q. What other kinds of limits does the regulation place on the relationship between the bank and its operating subsidiary?

A. Part 5 imposes specific safety and soundness restrictions on these operating subsidiaries if they conduct activities as principal. The bank's equity investment in the subsidiary must be deducted from the bank's capital and assets, and the assets and liability of the sub may not be consolidated with those of the bank. Further, the rule applies the safeguards of sections 23A and 23 B of the Federal Reserve Act to transactions between the parent bank and such an operating subsidiary. Generally, these sections limit bank loans to operating subsidiaries to 10 percent of bank capital, require extensions of credit to the operating subsidiary to be fully collateralized, and require that transactions between the bank and the subsidiary be conducted at arm's length.

Q. If a bank operating subsidiary fails, will federal deposit insurance funds be used to cover its losses?

A. No. An operating subsidiary cannot accept insured deposits, and FDIC coverage does not extend to operating subsidiary liabilities. Further, part 5's fire walls limit the parent bank's exposure to any losses the subsidiary may incur to the bank's equity investment in the subsidiary. The parent bank may not make any equity investment unless it is well capitalized both before and after the investment is made.

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The OCC charters, regulates and supervises approximately 2,800 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.